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POLICY PAPER

Payments Banks: Support Policy Framework for Enhancing Viability and Inclusion

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CONTENTS

EXECUTIVE SUMMARY

For the past several years, there have been a series of policy responses to the changing landscape of Financial Inclusion and Payments globally. The proliferation of non-bank participants in facilitating payment services, such as business correspondents, third-party service providers (who have created distribution networks to service diverse end user needs) and Mobile Network Operators has generated different approaches to delivering financial services access to hitherto unserved and under-served populations. In particular, there have been a host of different innovations in Mobile Money in sub-Saharan Africa, in South East Asia as well as in the South Asian neighbourhood.

In India, the Reserve Bank of India (RBI) has espoused a "Bank-led" approach to payments and inclusive financial services. The Business Correspondent[1] (BC) model introduced in 2006 has thus far been the chief instrument of outreach. It is estimated that currently there are over 200,000 BC agents[2] across India. In addition, Prepaid Payment Issuers (PPI) licenses were issued to cater to a host of different transaction use cases. BCs being bank backed are allowed to offer cash withdrawals. PPIs on the other hand are allowed to offer closed loop instruments such as vouchers that have limitations on transferability, duration and convertibility or semi-closed wallets where the cash out needs funds to be transferred into a regular bank account.

While progress has certainly been made, few BC entities claim to operate sustainable business models. PPIs have been clamouring for being allowed to become open loop providers – that is to say, allow cash outs from non-bank issued wallets, as is the case in several markets globally.

The guidelines[3] on Payment Banks issued by the RBI is a policy step towards creating differentiated banking structures to respond to the difficulties faced by certain under-served segments of the population in accessing formal financial services as well as to promote a "less-cash" economy through digital payments. It is also a response to address long-standing concerns of BCs as well as PPIs. Owing to the high cost of cash transactions, the RBI has been advocating a movement towards a "less-cash" economy through institutions that can facilitate the adoption of digital money that can manifest itself through smart cards, mobile phones or other technologies that offer a secure access to a stored value account.

Over the last five years, the single largest contributor to transaction volumes and revenues for BCs has predominantly been fees from domestic remittances. These are predominantly cash to account. Core Banking Systems (CBS), the National Electronic Fund Transfer System (NEFT) and lately the Immediate Payment System (IMPS) coupled with

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[1] Business Correspondent guidelines: http://www.rbi.org.in/Scripts/BS_CircularIndexDisplay.aspx?Id=2718

[2] According to the CPMI non-banks in retail payments report dated September 2014: Between March 2010 and March 2013, policy measures have helped to increase banking outlets (including branches, business correspondents and other modes) in rural India fourfold to cover more than 268,000 villages. More than 109 million Basic Savings Bank Deposit Accounts (BSBDAs) have been opened during this period and more than 490 million ICT-based transactions have been carried out through BCs.

[3] Payment Bank Guidelines: http://www.rbi.org.in/scripts/BS_PressReleaseDisplay.aspx?prid=32615

widespread rural to urban migration have resulted in successful adoption of over the counter remittance services. Migrant workers willingly pay for the speed, convenience and safety of domestic remittance services. A vast majority of the agent network also provides a combination of various payment services. These are typically travel ticketing and utility bill payments (mobile, electricity, water, gas).

The RBI states the objective behind the plan to issue Payment Bank licences as follows:

> *To further financial inclusion by providing (i) small savings accounts and (ii) payments / remittance services to migrant labour workforce, low income households, small businesses, other unorganised sector entities and other users, by enabling high volume-low value transactions in deposits and payments / remittance services in a secured technology-driven environment*

Following the issuance of the draft[4] Payment Bank licencing guidelines, there was considerable dialogue and discussion on the place this new type of Banks will be able to carve out for themselves to achieve policy objectives as financially viable, self-sustaining entities. The final guidelines have incorporated and addressed a wide range of concerns voiced by potential applicants through the consultative process through which the RBI invited comments.

ACCESS-ASSIST, the microfinance programme portfolio of ACCESS is a Public Charitable Trust with a mandate to work at all levels of the financial value chain and make efforts, to engage both the demand as well as supply side actors and catalyze greater access to financial services to the poor. This paper has been commissioned by ACCESS-ASSIST with a specific objective to explore:

- The question of viability of business model for Payments Banks
- Policy measures that may support Payments Banks in achieving stated goals
- The role of Payments Banks in National Financial Inclusion Plans

In order to address the above, this paper is structured as follows:

1. The first section sets the Indian context in the light of the Payment Bank guidelines issued by the Reserve Bank of India.
2. The second section examines global experiences for non-banks in payments and the lessons therefrom.
3. The third section delves into the state of payments in India and discusses viewpoints from potential market participants regarding the payment bank guidelines.[5]
4. The fourth section outlines the recent developments in financial inclusion driven by the government of India and their possible impact on potential payment banks.
5. The final section explores some potential ideas that could further improve the enabling environment towards achieving financial inclusion.

Global Experiences and Recommendations

Financial Inclusion has gained tremendous momentum in the last decade. There are a vast number of project deployments of varying hues. Bank-led models, MNO led models, technology provider led models as well as hybrids.

Non-banks are now participating in nearly every stage of payments transaction flows. Based on the prevailing regulatory framework, country context as well as business models, different types of services have been offered. There is sufficient

[4] Draft PB guidelines issued July '14: http://rbi.org.in/scripts/bs_viewcontent.aspx?Id=2857
[5] The discussions were held before the final guidelines were out and hence the views were against the draft guidelines. This paper only discusses issues that remain relevant following the issuance of final guidelines.

evidence to suggest that these efforts are positively impacting financial inclusion. This paper discusses these in some detail.

The key recommendations from global experiences are summarized below:

- *International experience has shown thatlight-touch regulation - allowing the market to develop first, before defining statutory regulations to limit unintended consequences - is an approach that has repeatedly worked.*

- *Regulators need to work with all system participants to manage risks. While non-banks provide front-end services, Regulated banks can support back-end risk and compliance functions to the payments business, giving comfort to the regulator.*

- *Collaboration between multiple regulatory / supervisory entities to create an institutional framework to address regulatory boundaries is recommended to achieve meaningful outcomes. This is becoming increasingly critical with the onset of convergence and the arrival of the "internet of things".*

- *There may not be much that regulators can do to facilitate market linkages between providers. While market making is often slow and difficult, results can be achieved so long as regulation is not overly prescriptive.*

- *In growth phase markets, regulators need to show great restraint towards tariffs as well as in technology choices as business models need time to evolve.*

Concerns & Views from Stakeholders in the Payment Banks Ecosystem

In order to obtain a wide range of views on the draft guidelines, a few anticipated concerns were spelled out to various stakeholders for views and suggestions. The summary of views from the discussions is as under:

- *There are no major concerns around the limitations on credit products for most players. There was a suggestion that it could be allowed with certain restrictions, given that deposit risks have been mitigated significantly through the CRR/SLR restrictions specified as well as the requirement to invest 75% of deposits in government securities and treasury bills. However, as the final guidelines have introduced distribution of mutual fund units, insurance products and pension products, these will certainly strengthen the revenue opportunity.*

- *Participants expressed they would want the regulator to allow unfettered market pricing as this is critical to discovering appropriate pricing, business models and viability.It is welcome that there is nothing in the final guidelines to indicate that there are any restrictions on tariffs.*

- *With regard to ring-fencing existing non-bank businesses from the business of payment banks, the consensus view is that resource sharing is needed to bring about cost efficiencies at scale. There needs to be leeway to share human resource, distribution and technology so long as the separation of funds is clearly established and adhered to.*

- *The promoter shareholding guidelines as well as dilution timetables were an area of significant concern across the board.These have been addressed in the final guidelines.*

- *Know Your Customer norm is a specific area where avoiding duplication is expected to bring about enormous cost efficiencies as well as remove friction in customer adoption. The final guidelines state that the payments bank will have to undertake its own KYC/AML/CFT exercise as any other bank. This will present some escalation in acquisition costs as well as speed of adoption; however, there may be room for technology-led innovation to address that, provided there is regulatory leeway to do so.*

- *Participants had felt that full Foreign Direct Investments should be allowed in payment banks as the return gestations are expected to be long with high investments in infrastructure build-out. The final guidelines have addressed this by* *allowing upto 49% through the automatic route and 74% through approval route.*

- *Participants had felt that the proposed promoter dilution timetable was penal to the promoter. The final guidelines have completely reversed the draft guidelines by removing dilution requirements altogether and making it conditional upon reaching a net worth of Rs 500 crore, at which point the Payments Bank is considered systemically important by the RBI and similar requirements as those for scheduled commercial banks (SCB) will then apply.*

- *There were no major concerns on the requirement to serve underserved markets. However, the participants are not clear whether the government will co-opt them into their financial inclusion schemes. They are also apprehensive about mandated targets for inclusion as well as mandated tariff subsidies.*

Financial Inclusion – PMJDY and its Possible Impact on Payment Banks

The government of India launched the ambitious Pradhan Mantri Jan Dhan Yojana (PMJDY) to provide every citizen with a bank account. Beyond the basic purpose of being able to facilitate leakage free cash transfers, the government has also expressed an intention to provide insurance as well as credit at a later point in time from these accounts.

Discussions with potential participants during the course of this paper do not suggest any dampening of appetite as a consequence of this development. Participants felt that the infrastructure that PBs will build will definitely further the cause of financial inclusion. However, they are wary of mandated participation with imposed subsidies or other requirements that would impact sustained viability.

Acknowledgements

This paper is the outcome of independent research as well as inputs from discussions held with various potential system participants to understand their perspectives, challenges, strengths and weaknesses such that policy makers may adopt approaches that provide a convergence of goals between policy and market action that ultimately benefits the citizen.

The participants interviewed as part of the discussions desired to remain anonymous. However, the author would like to express his sincerest debt of gratitude to all those people who gave their time for the interviews and shared their diverse points of view.

INTRODUCTION

In July 2014, the Reserve Bank of India (RBI) released the draft guidelines[6] for licensing of Payment Banks and Small Banks. The RBI immediately opened invitations to inputs on the draft guidelines. The final guidelines[7] were issued four months later on November 27th, 2014. The Payment Bank licensing, as per the RBI is a move towards differentiated Banks. Thus far, all banking and financial inclusion outreach measures have required to be "Bank-led" as Banks are the sole institutions authorized to offer "deposit taking" services to the public.

This is the first time that the RBI has initiated a move to directly regulate Non-Bank corporate entities, such as mobile phone companies, supermarket chains, existing Non-Banking Finance Companies (NBFCs), online e-commerce providers, Business Correspondents and distributed agency organizations that provide customer facing banking and payment services. The guidelines have drawn significantly from the recommendations[8] of the Nachiket Mor Committee report released[9] earlier this year. The final guidelines have been considerably improved to address concerns based on inputs received from various stakeholders.

The table below provides a brief summary of the scope of service of a Payments Bank (PB).

S.No	Service	Restrictions	Description/implication
1	Accept demand deposits	Maximum balance of rupees 100,000	A licensed PB can accept deposits for current as well as savings account. Significantly unlike Prepaid Payment Instrument (PPI) issuers, PBs can cash out their customers.
2	Provide Payments & remittances services & accepting utility bill payments	Total of Credits into the account not > rupees 100,000 based on reduced KYC for small accounts.	This may suffice the needs of migrant workers, given that the average ticket size of a remittance is around Rs 4,000. The question of what to do, once the balance or transaction limits are breached will need guidance to prevent genuine savers from having accounts frozen for good behavior. If customers pay bill amounts to a merchant or utility, it would help to exclude credits to the extent of bills paid from the annual transaction limit. While, this constrains the target segment for PBs to customers with low incomes, access to the financial market infrastructures such as NEFT, RTGS and IMPS implies that PBs will now look to address bill payments to utilities, and merchants. This represents a significant opportunity even for addressing e-commerce payments offline.

[6] Draft guidelines for payment banks: http://rbi.org.in/scripts/bs_viewcontent.aspx?Id=2857
[7] Payment Bank Guidelines: http://www.rbi.org.in/scripts/BS_PressReleaseDisplay.aspx?prid=32615
[8] See Annexure 1
[9] Mor Committee Report: http://rbidocs.rbi.org.in/rdocs/PublicationReport/Pdfs/CFS070114RFL.pdf

S.No	Service	Restrictions	Description/implication
3	Issuance of ATM/ Debit Cards	None. PBs can partner with existing card networks. This is good news for customers, PBs, card networks, banks as well as merchants.	This is a very positive move so long as the choice of criteria for issuance as well as applicable fees remains with the provider. PBs are allowed to install ATMs if they should so choose. Cash-out is also permitted at POS machines, which will allow prospective PBs to better leverage their non-Branch agent networks.
4	PPI Issuance	Existing restrictions	PPI issuance was already available to licensed PPIs. Now they can offer cash out from PPIs. Combined with the previous point, PBs may consider issuing branded prepaid cards linked to existing card networks.
5	Internet / Mobile payments	None mentioned. Compliance with information security risk management will be expected.	Adoption could be challenging for the target segment as every layer of security multiplies transaction drop-off risk significantly. For small value transactions, friction drives people to cash. Based on examples in the South Asian neighbourhood such as bKash in Bangladesh and Easypaisa in Pakistan, there is definite room to expect that initial services will be over the counter with limited self-serve models.
6	Cross-border remittance transactions	Based on RBI approval of the application by the PB to process transactions in foreign exchange.	This is a definite boost to the product side given that India is the world's largest recipient of foreign inward remittances. It is likely to excite existing specialist players in the foreign inward remittance market to think about becoming a PB. It is not clear if outward remittances as well as Money Changer services themselves will also be allowed under this product.
7	Distribution: Mutual fund units, insurance products, pension products	Based on prior approval of RBI as well as the relevant sectoral regulator for the product.	This is an excellent bouquet of additions to the product basket. However, efforts may be needed to simplify the process of cross-regulatory approvals in order for such products to genuinely take off. Perhaps a single cross-regulatory authority should examine such approvals.
8	Sourcing Credit	PB must be a BC of a licensed commercial bank	Offer last mile services of marketing loans for banks. This may increase the scope of PB offerings and may provide a revenue stream depending on how customer friendly the process of appraisal, disbursal, role of PB in loan repayment or collections and nature of remuneration by partner bank is, for the PB.

The guidelines allow PBs to accept deposits and offer remittances but not offer loan products. This is with the intent of entirely removing credit risk and thereby ushering in lower norms for capital adequacy. The absence of a principal income stream available to commercial banks, in the form of marginal interest from lending (Net Interest Margin {NIM} after paying interest rates on savings deposits) is not available to PBs.However, the final guidelines have introduced a host of product options that PBs can creatively deploy. Since commercial banks are only allowed to take a minority stake in PBs, this now presents a real opportunity to applicants to address the underserved segment with razor sharp focus.

As part of the guidelines, PBs will need to maintain CRR & SLR and invest 75 percent of deposits collected in government securities or treasury bills (G-Secs, T-Bills)[10]. They can invest the remaining 25 percent in current and time / fixed deposits with other scheduled commercial banks for operational purposes and liquidity management. This is a major relaxation over the earlier stipulations in the draft guidelines where 100 percent of the deposits had to be invested in G-Secs and T-Bills.

Still, in the absence of credit as a source of business as well as money markets as an option for improving the rate of return, in India, PB business models will need to be based upon strong transaction fee revenues. Transactions that fall into "deposit" taking, such as utility bills and other payments, money remittances and international inward remittances are expected to be pivotal to the business case. The final layer will be the distribution of products like mutual funds, insurance and pension products.

The following were perceived as important viability questions for potential payment bank applicants:

1. *Absence of credit products limiting income streams*
2. *Requirements to keep the other financial and non-financial services activities of the promoters distinctly ring-fenced from the banking and financial services business of the Payments Bank*
3. *Preference for applicants who propose to set up Payments Banks with access points primarily in the under- banked States / districts in the North-East, East and Central regions of the country*

Ultimately, a thriving digital payments system is expected to provide a significant push to the economy and lift hundreds of millions of Indians out of poverty. Digitizing payments invariably brings in dramatic speed and cost efficiencies at scale, from the elimination of the risks as well as costs associated with paper money. However, electronic money comes with its own set of challenges including operational, fraud and legal risks. As such it is in the interest of all stakeholders to create a vibrant digital financial ecosystem that provides the rails for inclusive growth while minimizing attendant risks.

This paper is an attempt to understand and detail the issues above and explore possible solutions that may require policy support.

[10] Government Securities: http://www.rbi.org.in/scripts/FAQView.aspx?Id=48

GLOBAL EXPERIENCES

Over the last decade, the rapid development and proliferation of Internet and mobile technologies has had a profound impact on payment systems. The ability to connect different system participants securely, switch transactions online and settle funds accurately, combined with delivering a more convenient, cashless and superior customer experience have resulted in several innovations in retail payments.

Retail payments, for the purpose of this paper, refer to transfer of monetary value between:

a) Person to business – payments for purchase of goods and services

b) Person to person – electronic remittance as a cash substitute

Unlike business-to-business, business-to-bank or bank-to-bank transactions, where most of these payments are likely to be large-value transactions, retail payments are far higher in terms of numbers of transactions but far lower in terms of value. Retail payment mechanisms typically also tend to use a variety of instruments including cash, cheque, debit and credit cards, online payment from bank accounts, and payments from wallets issued by different entities. Historically, interbank payment systems have been operated or managed by central banks while there is significant involvement of private sector providers for transaction processing as well as settlement of retail payments.

Owing to the use of innovative technology, the role of non-banks in retail payments has increased significantly, allowing non-banks to compete in what were previously near-oligopolistic areas for banks.

Regulating Payment Systems with non-Bank participants

The development of retail payments depends on:

- A supportive regulatory framework
- Availability of existing national payment infrastructure with open access to a wide variety of payment system participants
- Socio-economic factors, such as a monetized economy, urbanization, migration, literacy
- Availability and penetration of enabling devices, as well as communications and connectivity infrastructure

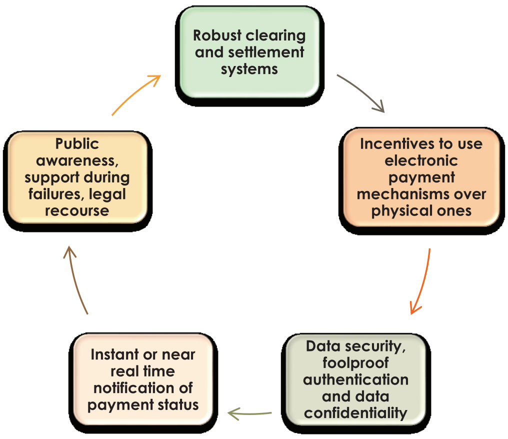
The proverbial silver lining for developing countries with under-penetrated electronic payments ecosystems is that innovative payment solutions can allow the market to leapfrog traditional or existing payment mechanisms, regardless of how entrenched and successful they may have been in the past or elsewhere.

Specifically in telecommunications, India provides an outstanding example[11], having completely leapfrogged fixed line telephony in favor of mobile communications. This extends to the adoption of the Internet too. It is now widely acknowledged that most Indians will access the Internet for the first time on a mobile device.

[11] Annexure 2 – India telecom subscription data

Globally, successful models for retail payments have witnessed infrastructure improvements across a host of different parameters as shown in Figure 1 below.

Figure 1. Areas requiring improvements in infrastructure



Retail payments particularly of the electronic variety invariably involve several different system participants. This often leads to some degree of conflict, between competing players, chiefly on the issue of customer ownership. Cooperation between different players to achieve interoperability is critical to scale and success. However, this has been somewhat challenged where participating entities within the country have multiple supervisory authorities.

The Bank for International Settlements (BIS) Committee on Payments and Market Infrastructures (CPMI) in it's report on innovations in retail payments[12] encourages regulators to constitute altogether new institutions with relevant expertise for smoothing the road to interoperability. As an example, the European Payments Council (EPC) and the GSM Association (GSMA) have collectively defined and published requirements and specifications for the different roles among various players in the mobile payments market for the position of a "Trusted Service Manager".

The Nachiket Mor committee report also recommends[13]formation of a Working Group comprising TRAI, CERC, and Credit Information Companies to develop a framework for sharing of data between telecom companies, electrical utilities, and credit bureaus. This framework must define creation of regulations on the collection, storage, modification and protection of personal information by financial services providers; and establishment of mechanisms to ensure that consumers have access to, and are given an effective opportunity to seek modifications to their personal information. In light of the guidelines on PB licensing, wherein the RBI has allowed PBs to distribute non-risk third-party products such as mutual funds, insurance products and pension products, it may be worth examining the creation of an authority that is constituted by drawing experts from relevant sector regulators. This authority may perhaps be tasked with drafting frameworks for product as well as consumer protection guidelines that are binding on PBs. This is important simply to allow speed of experimentation. To succeed, these experiments must *fail* or *succeed* quickly. Financial Inclusion will require innovations not only in product, but also in process, distribution, business models and customer care. Mobile and Internet technologies will also need to play an important role if disruptive ways of addressing the problem of exclusion are to be found. It is perhaps even unfair to expect a single regulator to possess such a diversity of skill sets.

Non-banks in retail payments

In September 2014, the Bank for International Settlements (BIS) Committee on Payments and Market Infrastructures released a report[14] on non-banks in retail payments. The

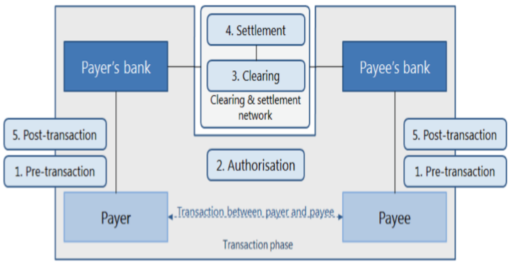
[12] CPMI: Innovations in retail payments. http://www.bis.org/cpmi/publ/d102.pdf
[13] See Annexure 1, recommendation (4.8) from the Nachiket Mor Committee report
[14] CPMI Report on non-banks in retail payments: http://www.bis.org/cpmi/publ/d118.htm

report encourages central banks to consider the implications of the issues that are analyzed in the report, including risk, ensuring a level playing field, and act as appropriate in their jurisdictions[15].

The CPMI report defines non-banks as entities "***involved in the provision of retail payment services whose main business is not related to taking deposits from the public and using these deposits to make loans***".

Traditionally, retail payments were primarily the domain of banks. The diagram below reproduced from the CPMI report on non-banks in retail payments is a schematic and simplified representation of a payments system marketplace without non-bank players.

Figure 2. Retail payments with banks as sole participants



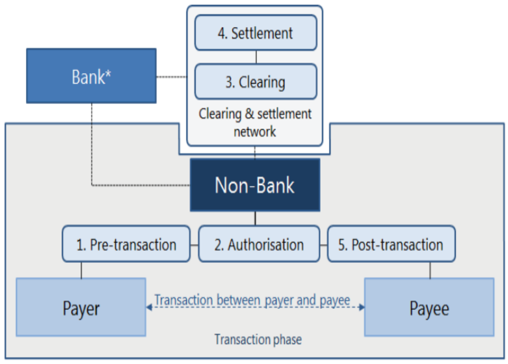
Note: For simplicity, large-value payment systems used for settlements are not shown in the figure above.

Banks use market infrastructures to clear and settle the transactions. For example in India, the RBI operates the Real Time Gross Settlement (RTGS)[16] system and the National Electronic Funds Transfer (NEFT) system. The National Payments Corporation of India (NPCI)[17] has been authorized by the RBI to operate the National Financial Switch (NFS), Immediate Payment System (IMPS), Cheque Truncation System (CTS), National Automatic Clearing House (ACH) and Aadhaar Enabled Payments System (AEPS) for interbank settlements. Various card networks including American Express, Diners, MasterCard, RuPay and Visa have been authorized for debit and credit card issuance.

Finally, prior to the issuance of the PB guidelines, the RBI had issued a large number of licenses to Prepaid Payment Issuers (PPI) all of whom were non-Banks.

The issuance of PPI licenses to non-banks had amended the Indian payments landscape from a banks only domain to the following one shown in Figure 3, again reproduced from the CPMI report on non-banks in retail payments.

Figure 3. Retail payments with non-banks participants



The RBI is seeking to directly regulate non-Bank participants in Payment Systems by issuing Payment Bank licenses. This move will mean that India will once again go back to a regime where entities solely regulated by the central bank are the only payment systems players – as shown in Figure 2 previously, rather than allow non-Banks to continue with their primary purpose of business while additionally

[15] The RBI had very senior level representation including the Chairman-ship of the committee
[16] RTGS / NEFT: http://www.rbi.org.in/scripts/FAQView.aspx?Id=65
[17] NPCI: http://www.npci.org.in/#

being legitimate payment system participants with a limited function.

Globally there are many successful examples of payment systems in the form of branchless banking or mobile money deployments that have scaled successfully in terms of customers and transactions and achieved significant domestic volumes. These are in geographies as varied as bKash[18] in Bangladesh, Easypaisa[19] in Pakistan, EcoCash[20] in Zimbabwe, Gcash[21] in the Philippines, M-Pesa[22] in Kenya andWing[23] in Cambodia to name a few in developing economies.

In the case of Easypaisa and EcoCash, the non-Bank entities acquired a commercially licensed bank while continuing to operate its non-Bank payments business. In the case of bKash, an entirely new entity led by a technology player partnered with a commercially licensed bank, but only to securely manage depositor funds. Wing on the other hand started out as an ancillary unit of a bank that later sold the business to a technology provider, who continues to run a very successful service.

The benefits of converting non-bank players as per the CPMI definition earlier in this report, into differentiated banks through licensing PBs remains unknown, particularly with regard to encouraging innovation and proliferation of the use of electronic forms of money in the hitherto unbanked populations. The success of several of these deployments is widely attributed to the very fact that these institutions were not constrained by the traditional organizational structures, business models, distribution channels and operational priorities of traditional banks.

Further, market making and innovation in each of these markets has *preceded* regulation allowing new practices and technology to be adopted successfully by customers, channels, and providers while the systemic risks posed by transaction volumes remained small. Regulatory monitoring and oversight increased as the levels of transaction and risk increased. This may be a good example to follow in India. The PB guidelines certainly show that the regulatory dispensation may be starting to lean in this direction.

The PB guidelines go a long way in sharpening the focus of PBs into offering payment services by:

- Excluding credit (product focus)
- Limiting size of account balances (customer segment focus)
- Reducing competition from scheduled commercial banks in doing the above

Given the size of India's economy and the income disparities, there is reason to believe that diverse players providing different products and market segments could co-exist sustainably. Perhaps in future the RBI may consider a less stringent licensing regime where payment providers can exist without licensing through self-declaration and stipulated periodic reporting, up until they hit one or more of a defined set of parameters or circuit breakers identifying systemic risk thresholds.

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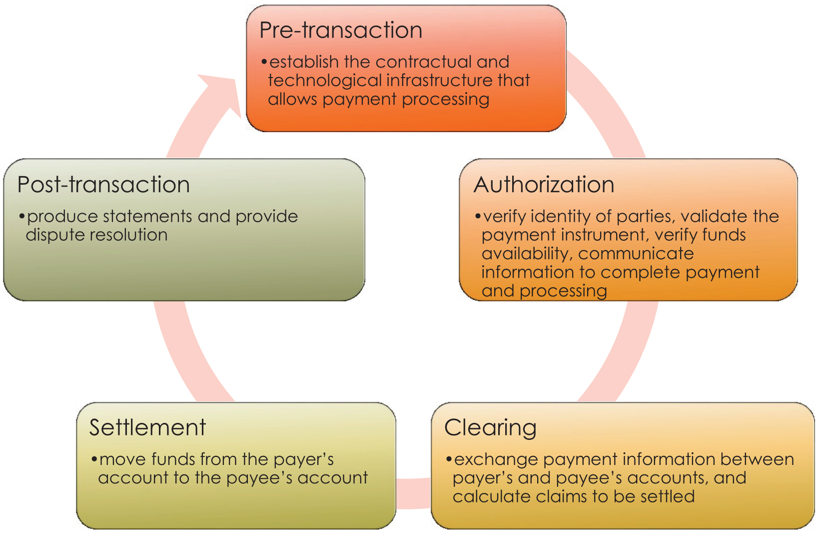
[18] bKash, Bangladesh: http://www.bkash.com
[19] Easypaisa, Pakistan: http://www.easypaisa.com.pk
[20] EcoCash, Zimbabwe: https://www.econet.co.zw/ecocash/
[21] Gcash, Philippines: http://www.globe.com.ph/gcash
[22] M-Pesa, Kenya: http://www.safaricom.co.ke/personal/m-pesa

Non-bank participation in payment transactions

The CPMI report on non-banks in payments defines five broad stages for payment transactions. This has been diagrammatically summarized in Figure 4. The report details the various sub-activities that constitute each of the broad stages of payment transactions and compares the level of participation of non-banks in each. The committee has found that non-banks are already participating directly or providing services to banks for every stage of the payments process.

Figure 4. Stages of payment transactions



Amongst players that the guidelines identify as potential applicants, the closest fits to the definition of non-banks (traditional banking not being their primary purpose of business) are:

- Corporate BCs
- Mobile telephone companies
- Super-market chains
- Companies
- Real sector cooperatives

In order to better understand what activities non-banks are capable of, or currently providing to their customers, for their ***existing businesses***, the detailed set of activities within the five broad payment transaction stages have been mapped for three non-bank entity types (Indian)in Table 1.

In light of the guidelines for payment banks, in particular with regard to ring-fenced operations, the CPMI definition of non-banks bears careful consideration.

Table 1. Mapping non-bank participation in Payment Transaction activities

Stage	Activities	BC[24]	MNO[25]	SMC[26]
Pre-Transaction	Customer acquisition including KYC	Yes	Yes	No
	Provision of payment instruments/devices to front-end customers	No	Yes*[27]	No
	Provision of hardware to accept payment instruments/devices	Yes**[28]	Yes*	Yes**
	Provision of software to accept payment instruments/devices	Yes	Yes	Yes
	Provision of internet security-related technology/support	Yes	Yes	Yes
	Payment card industry compliance services to merchants and/or payers	No	No	No
	Provision of data centre services to back-end customers	Yes***[29]	Yes***	Yes***
	e-invoicing: Creation and delivery of electronic invoices to front-end customers	No	No	No
	Communication connection for merchants: Provision of gateway to acquirer/payment processors/Networks	Yes	Yes	Yes
Authorization	Transaction authorization: process to verify and confirm if payer has sufficient funds (or credit lines) available to cover the transaction amount	Yes[30]#	Yes#	No
	Fraud and risk management services to front-end customers	No	Yes[31]##	No
	Fraud and risk management services to card issuers	No	No	No
Authorization	Debiting the front-end customer's (payer's) account/e-money purse	Yes	Yes	Yes
	Ex ante compliance services: anti-money laundering, countering financing of terrorists, suspicious transaction reporting	No	No	No
Clearing	Preparation: Sorting merchant's sales information by payment instrument/network for clearing, submission of sales information to each payment instrument network, calculation of each network member's net position and transmission of net position information to each member, etc.	No	No	No
	Clearing: Transmission of clearing orders to a financial institution / ACH and clearing	No	No	No
Settlement	Posting credit and debit at various financial institutions	No	No	No
Post-transaction	Statement: provide statement preparation/delivery services for payers – account statements	Yes	Yes	Yes
	Reconciliation: Matching invoices and payments	No	No	No
	Retrieval: Provision of chargeback and dispute processing services	No	No	No
	Reporting and data analysis: to merchants, customers, financial institutions	Yes	Yes	Yes
	Ex post compliance services: Compliance with anti-money laundering and terrorist financing regulation	No	No	No

23 Wing, Cambodia: http://www.wingmoney.com
24 Business Correspondent
25 Mobile Network Operator
26 Supermarket Chain
27 SIM card
28 POS terminal / Mobile with dongle
29 Through bilateral arrangements with data center providers
30 For prepaid instruments or wallets by PPIs, bank accounts, agent wallets by BC
31 MNOs have highly evolved processes for fraud management for their mobility business

The mapping shown above may be an over simplification of the capabilities of the providers chosen. However, there are capabilities for activities above, such as ex ante and ex post compliance services that will be very easy for non-banks to develop or acquire through partnerships. Not possessing those at this point need not be deemed a disqualification for being able to offer and operate a payment system successfully.

Critically, as the analysis shows, most players possess the bulk of the "front-end" capabilities namely for Pre-transaction and Authorization stages. There is reason to believe that the remaining stages can be accomplished through partnerships or regulated access to financial market infrastructures. The PB guidelines have highlighted this by allowing scheduled commercial banks (SCBs) to acquire a stake in PBs as permitted by the banking regulations act.

Similarly, reporting for Fraud and risk management can be strengthened over time as the transaction volumes and concomitant systemic risk increases. It may be worth examining reporting exemptions for new entrants with regard to requirements that are applicable to commercial banks involved in large volume payments. At the market making stage, these can perhaps be too onerous and distract the PBs from focusing on addressing the principal challenge of reaching underserved market segments. In the initial few years, margins may not be sufficient to support such overheads. The RBI has already relaxed norms for promoter stake dilution for PBs and linked it to systemic risk. There may be room to extend this line of thinking to reporting and compliance requirements too. This will be particularly handy even in reducing the audit & compliance burden of the RBI as and when it moves to an on-tap licensing regime.

On the other hand, there may be services such as clearing, settlement and reconciliation that these institutions never need to provide and can partner with banks or clearing houses[32] to do so. The regulator has already announced that PBs will gain access on equal terms as SCBs various financial market infrastructure systems. Similar to the option available to PBs to partner with an SCB as it's BC, in case they wish to offer credit, it may be worth considering ways in which a PB or even a non-Bank Payment player outsources clearing and settlement functions to a partner bank.

In light of the PB guidelines allowing for distribution of products such as mutual funds, insurance and pensions, the products are subject to supervision by completely different sector regulators. In the three examples above,the RBI only indirectly regulates Business Correspondents for banking business where they partner with Bank sponsors. However BCs operate without any regulatory oversight with respect to their other payments businesses such as travel ticketing, utility bill payments, mobile recharge and hotel bookings. MNOs are regulated by the Telecom Regulatory Authority of India (TRAI) for their principal business, but subject to RBI regulations as PPIs. Physical supermarket retail chains are unregulated for their retail business. The RBI did issue guidelines to allow them to offer cash-out at POS, however, this has not seen any significant uptake perhaps owing to the absence of a viable business model being forged with partner banks that are the card issuers. (Supermarket retail chains have thus far only issued so-called closed loop physical instruments such as gift vouchers or loyalty reward cards.) Online retailers have experimented with digital wallets, however the penetration of e-commerce in retail in India is currently miniscule in the context of providing meaningful financial inclusion.

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[32] Clearing house for GSM: http://www.syniverse.com/products-services/product/Data-Clearing-House-for-GSM; MNOs worldwide already partner clearing houses to settle roaming revenue

Beyond PBs, a partial supervision approach may also be considered to allow non-banks to participate as payment system providers while they continue their existing businesses. A possible scenario could be one where an MNO chooses to remain a PPI issuing electronic money in stored value accounts or wallets, partners with a supermarket chain who is a PB.

- Cash-in by customer at an agent of the MNO into her wallet issued by the MNO
- Customer can transfer funds electronically from one wallet to another in a different city
- The recipient could then approach an outlet of the supermarket chain partnered with the MNO and seek cash-out
- A traditional bank can facilitate the large value clearing and settlement transactions between the MNO and the Supermarket chain

Major concerns that need to be addressed would be with respect to a) the proper KYC of the wallet account holders to address anti-money laundering and countering of terror financing and b) cash availability at agent locations for providing cash outs on demand.

Two of the above entities, namely Business Correspondents (owing to their supervision by Banks) and MNOs (owing to strong KYC norms specified by TRAI already) are fully equipped to handle KYC. Additionally, with the continued penetration of Aadhaar, the national unique identity system, other participating players will increasingly find it easier to comply with strong KYC process norms.

In any event, transaction sizes limits, velocity limits and additional authentication requirements such an added authentication factor can be *chosen by customers* based on the type of account or transaction to limit fraud risk. Regulators can stipulate all of these requirements without non-banks having to change their original purpose of business, while still accepting payments.

As for the requirement to cash out, so long as the non-banks designated as payment system providers have adequate access to the financial market infrastructure with appropriately designed safeguards,licensed banks can continue to be the primarycustodians of physical currency while being supplemented by PB agent network outlets or supermarket retailers for low value cash outs.

Key Lessons:

- *In most cases where mobile or branchless banking has reached scale, central banks have taken a 'follow the market' approach to regulating mobile money services or the provision of payments by non-banks. International experience has shown that allowing the market to develop first, and then based on monitoring business progress and risk, defining appropriate regulations to limit unintended consequences is an approach that has repeatedly worked.*

- *Regulators need to work with non-banks and trust them to manage operational risks. Regulated banks can continue to provide support to and oversight of the risk and compliance function to the payments business, giving comfort to the regulator.*

- *In several cases, the non-bank entities entering into payments or financial inclusion services are already businesses that are regulated by a different supervisory entity. Collaboration between such entities to create an institutional framework to address regulatory boundaries is recommended to achieve meaningful outcomes.This is becoming increasingly critical with the onset of convergence and the arrival of the "internet of things".*

- *In the case of PBs, such a cross-regulatory collaboration could be applied to KYC with dramatic impact. One way to do this would be for the RBI, TRAI, SEBI and the Pension Fund Regulatory and Development Authority (PFRDA) to constitute a working group to* *define different levels of risk and a set of common KYC standard for each risk level. This would allow providers to collect the minimum information from customers needed for each product. Additionally, they could reduce the data collection and verification overheads as well as improve customer convenience by only sourcing incremental data beyond what they have already captured for another product. Lastly, with the momentum gained by Aadhaar as well as the proposal[33] to provide a cloud based digital locker[34], a common set of KYC standards across supply-side institutions will significantly reduce front-end customer acquisition costs as well as citizen convenience.*

- *For a regulatory framework that allows banks to 'outsource' functions to be effective,such as the case for Business Correspondents, issues relating to access, interoperability, branding and customer service / grievance handling need tobe resolved successfully by the providers. There may not be much that the regulator can do to facilitate these kinds of market linkages. While market making is often slow and difficult, results can be achieved so long as regulation is not overly prescriptive.*

- *Finally, in order for innovation to succeed as well as for markets to grow organically, regulators need to desist from suggesting technology choices (even with respect to security measures since technology is continuously evolving) as well as adopt considerable restraint towards tariffs, as business models need time to evolve. Ultimately, customers will determine fairness of pricing while competitive pressures force innovators including those who have attained supernormalmarket shares to price competitively, as examples in domestic remittances amongst BCs in India, telecom tariffs as well as several global mobile money examples bear testimony.*

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[33] News report: http://www.bgr.in/news/maharashtra-government-develops-aadhar-linked-e-locker-for-crucial-documents/

[34] Maharashtra Government's Aadhaar linked elocker: https://elocker.maharashtra.gov.in/Account/Login/CitizenLogin.aspx

INDIA CONTEXT

The report of the committee on financial sector reforms [Rajan Committee (2009)] states that:

In an efficient financial system, the playing field is level so that different institutions compete to provide a function, no institution dominates others because of the privileges it enjoys, competition results in resources being allocated efficiently, and society gets the maximum out of its productive resources. This is also equitable for only thus will the interests of consuming masses be emphasized, instead of the more usual trend of privileged producers being protected.

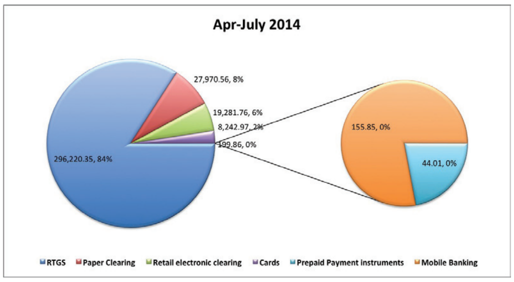
The RBI in its PB guidelines identifies its licensing objectives as:

To further financial inclusion by providing (i) small savings accounts and (ii) payments / remittance services to migrant labour workforce, low income households, small businesses, other unorganised sector entities and other users, by enabling high volume-low value transactions in deposits and payments / remittance services in a secured technology-driven environment

Present Status of Retail Payments in India

Figure 5 is a graphical representation of the value of retail payments in India based on RBI data.

Figure 5. Value of payments in rupees billion, April-July 2014 – RBI statistics[35]



As is clearly evident from the data, the aggregated value of all retail payments including Retail electronic clearing, Cards, Prepaid Payment Instruments (PPI) and Mobile Banking is at 8% of the total formal, non-cash payments aggregated for April to July 2014. Of this, PPI and Mobile Banking account for less than 1% of the value. This level of volumeperhaps cannot be considered as posing a systemic risk. Also, according to the RBI[36] the number of non-cash transactions per citizen is very low in India (6 transactions per inhabitant) when compared to other emerging markets.

In complete contrast, the sum of volume of payments (number of transactions) through prepaid payment instruments and mobile banking is equal to that for RTGS. Of course, this is not unusual. Interbank payments are bound to be large value, low volume payments. In other words, the objective of licensing payment banks may also be to encourage PPI and Mobile Payments that are low value, high volume.

[35] RBI Statistics: http://www.rbi.org.in/scripts/NEFTView.aspx

[36] RBI payment systems vision 2012-2015: http://rbi.org.in/scripts/PublicationVisionDocuments.aspx?ID=678

Figure 6. Volume of payments in millions, April-July 2014 – RBI statistics

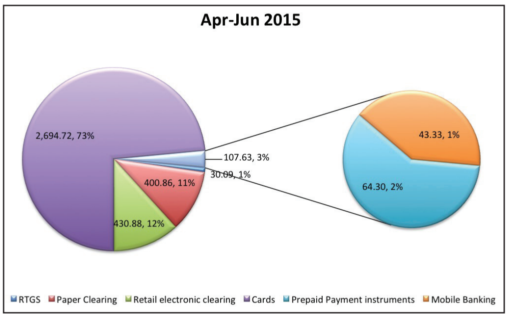
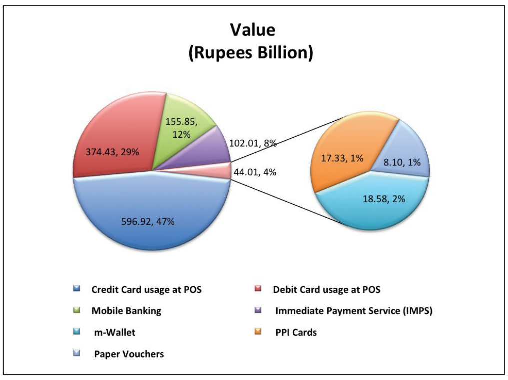
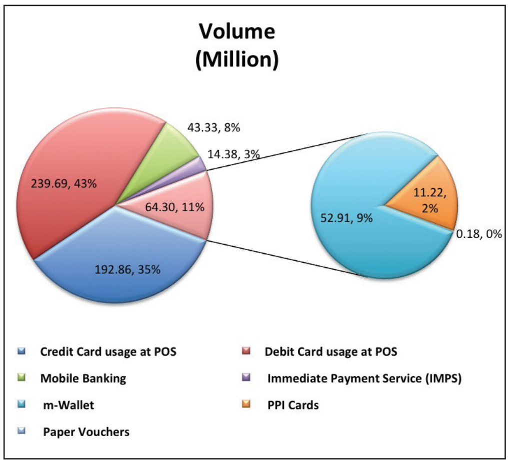


Figure 7. Value of retail payments in rupees billion, April-July 2014, RBI statistics



As the charts in Figures 7 & 8 show, cards dominate retail payments landscape. Credit and debit card transactions at POS account for 76% of the value of retail payments. Transactions for Mobile Banking (12%) and Immediate Payment System[37] (IMPS8%) from NPCI account for another 20% of the value of retail payments leaving less than 4% of value through m-Wallet, PPIs and paper vouchers. Paper voucher volumes are insignificant in volume terms as the next figure shows.

Figure 8. Volume of retail payments in millions, April-June 2014 – RBI statistics



Note: There is no separate category for Internet banking shown in the report by RBI. It has been assumed that transactions initiated from tablets and mobile phones by customers logging into the Internet banking login of banks are also being reported under mobile banking.

Card payment accounts for roughly 78% of the volume of retail payments. Mobile Banking accounts for 8% and IMPS transactions for 3% of the volume of retail payments. While m-Wallet payments and PPIs account only for 11% of the total volume of transactions, m-Wallets are already showing much promise, accounting for over 80% of the volume.

If the intention is to drive low value high volume payments, then there is a need to clearly understand and *define low value*. This is important not only to create appropriate infrastructure, mechanisms and processes to enable uptake of low value transactions. This could include, for example security, fraud prevention measures as well as reporting requirements for providers that are appropriate to the level of risk being represented.

Amongst the most commonly known reasons for the very heavy use of cash are:

- Ubiquitous acceptance
- Speed of payment (particularly for low value transactions) – this translates to convenience

[37] http://www.npci.org.in/aboutimps.aspx

- Control, resulting from physical possession

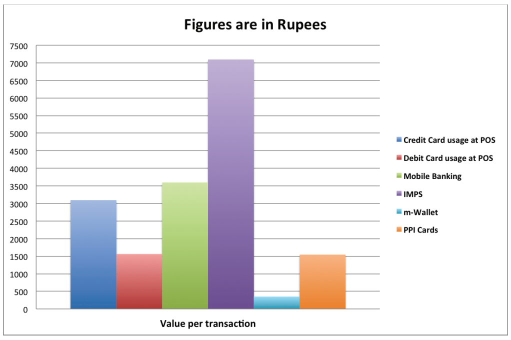
For electronic or digital payment systems to succeed, it is imperative not only to meet the above benefits of cash, but also to provide additional incentives in the form of:

- Safety (non-physical nature)
- Mobility (for remote payments)
- Denominational convenience (tackling the problem of loose change)

Based on RBI data, the figure below graphically depicts the value of transactions in retail payments aggregatedfor April-July 2014 as:

Rupee value per transaction = [Sum of Volume of transactions]/[Sum of Value of transactions]

Figure 9. Value per transaction across retail payments



Credit card transactions are at Rs 3095 and Debit card at Rs 1562. IMPS transactions at Rs 7095 are the highest value per transaction. Based on the value of Rs 3597 per transaction for mobile banking, it does seem to suggest that these include Internet banking transactions. PPI transactions are at Rs 1545 per transaction.

m-Wallet transactions at Rs 351 per transaction are the lowest.

Despite the relatively recent introduction of m-Wallets, they have clearly found a transaction size that can safely be termed low value. Globally, mobile money programs have witnessed very healthy uptake and scale. India is a laggard in comparison to both our South Asian neighbours.

In July 2014, bKash[38] in Bangladesh reported over 30 million mobile money transactions including deposits withdrawals and remittance per month for US$ 680 Million (Rs 40 Billion – three times the monthly m-Wallet transactions in India). bKash is categorized in Bangladesh as a Mobile Financial Services provider rather than a payments bank and offers deposits, withdrawals, remittances and payment services. Recognizing that international inward remittances account for over 10% of Bangladesh's GDP, Bangladesh Bank has allowed[39] bKash wallets to receive international inward remittances.

All of this suggests that regulators can often take an approach to allow non-banks to keep their primary purpose that is not banking and yet grow to provide a very useful alternative means to payments and financial inclusion. Now that we will soon have non-banks as licensed Payments Banks, perhaps the day is not far, when we will have pure play non-bank payments providers.

Business Model Viability

This section is based on interviews with potential bidders and stakeholders in the financial services ecosystem in India. The objective of the exercise was to solicit feedback on:

- The suitability of the proposed regulatory framework as encapsulated in the draft PB guidelines in order to the achieve the stated objectives
- Understand concerns that may be significant and propose solutions such that potentially licensed PBs believewill enhance the probability of viability, scale and success

[38] http://www.bkash.com/products-services/cash-in
[39] See Annexure 3

Three main areas were examined during the course of the interviews:

1. **Absence of credit products limiting income streams:** The interviews solicited views on the restriction on not being able to offer credit products[40] it's impact as perceived by the respondents.

Feedback & Suggestions

- Participants across the board were mostly neutral on the exclusion of credit products for now. They are content not to offer credit. They believe they can compete basis payment transaction revenues although their view is that the restrictions on float means long gestation periods for business model break-even. They desired that RBI may consider a small percentage of deposits[41] being freed-up for low-risk investments outside of G-Secs and T-Bills. This has now been addressed with a reduced 75 percent SLR in G-Secs and T-Bills.
- One participant opined that since there is no deposit risk, why should there be a blanket ban even on credit products? There may be concerns around institutional lending, but for retail lending, it could be allowed with a ceiling on the loan amount or tenure or a combination. If the PB is able to find a viable model of lending, then it is entirely their risk and they should be allowed to take it. The example case in point was postpaid as a proxy credit offering from MNOs. It is noteworthy that it was a Banker who pointed this out. There are already examples[42] of very short term, small value and collateral free lending taking place in sub-Saharan Africa.
- Premium collection for Insurance is one payment category that was recommended for inclusion amongst payment services and has now been included in the guidelines. Global examples suggest that Microinsurance penetration can grow significantly from partnerships between insurers and mobile money or payment bank like entities; although Insurance is regulated by the Insurance Regulatory Development Authority (IRDA) in India, it may be worth considering a collaborative cross-regulatory framework that allows for insurance premium to be payable through such accounts, regardless of product distribution; Microinsurance is allowed to be sourced by entities similar to payment banks in Pakistan – the regulator, the Securities and Exchange Commission of Pakistan has establishedfairly progressive guidelines. Easypaisa[43] for example offers life insurance against savings balances.
- Participants expressed that given the low margin on products, they would expect the regulator to allow market pricing to prevail, specifically by abstaining from guidance/mandates on providing services free of charge or specify charges (such as the limit of 1% of fee as Merchant Discount Rates for debit card transactions[44]). Participants felt that even with pricing freedom, the break-even periods for PBs would be a minimum of seven to ten years as they would be competing with banks who are established players in this segment and tend to offer payment services free of cost.

2. **Requirements to keep the other financial and non-financial services activities of the promoters, distinctly ring-fenced from the banking and financial services business of the Payments Bank:** The interviews solicited views on the interpretation of "ring-fencing" as well as the impact of this guideline on the shared use of existing resources – human, capital, process (e.g. KYC) and technical.

[40] The interviews were held basis draft guidelines. Several of the concerns related to product limitation have already been addressed in the final guidelines
[41] The RBI has allowed PBs to invest upto 25% outside of G-Secs and T-Bills in the final guidelines
[42] m-Pawa in Tanzania, EcoCash Save in Zimbabwe
[43] Easypaisa's Khushaal Beema: http://www.easypaisa.com.pk/en/services/khushaalbeema
[44] RBI circular on MDR for debit cards http://rbi.org.in/scripts/NotificationUser.aspx?Id=7304&Mode=0

Feedback & Suggestions

- On this count there were somewhat differing viewpoints between third-party non-bank players, Banks and MNOs. The third-party view is to completely merge existing operations into those of the PB. In other words the existing business would be subsumed into the entity obtaining the PB license thereby making the PB the sole business and obviating the problem. However, they also believe that significant additional costs would need to be incurred in order to staff the PB entity as well as towards regulatory reporting and compliance.

- The Bank view is that it is in the interest of efficiencies of cost to allow sharing of resources where it is possible. What is critical is to ensure the separation of funds. Here too, since the deployment of depositor funds is defined to government securities, treasury bills, and other banks, there is no apparent cause for concern on the count of "comingling of funds" with those of the parent non-bank institutions.

- MNOs on the other hand clearly will continue to have their communications business as the primary business. They will leverage distribution and agent networks they currently manage but sign fresh contracts with agents, specific to PB operations.

- MNOs also said that significant technology investments have already been made in order to separate the technology infrastructure of the PB from that for their telecommunications business, even for systems such as mobile recharge (their cash-deposit equivalent). Hence ring-fencing is already in place.

- MNOs view is that allowing them to re-use completed customer KYC with some guidance on customer consent and recency, (e.g. KYC with the MNO must be less than one year old in order to be re-used) would be a tremendous boost to reducing KYC costs and adoption. This is certainly in the interest of quickening financial inclusion. MNOs also think that allowing KYC done for MNO services to automatically qualify for PB services would bring great benefits and allow scale quickly. Such KYC sharing would in fact be a very good practice for other non-Bank entities that obtain KYC for the purpose of some other business, allowing costs as well as friction to be reduced for customer onboarding.

3. **Preference for applicants who propose to set up Payments Banks with access points primarily in the under- banked States / districts in the North-East, East and Central regions of the country:** The interviews solicited views on participation in financial inclusion and its impact.

- The statement of preferences based on geography did not deter the participants given that most of them already have presence in such geographies. However, the received view is that even Public Sector banks are reluctant participants in mandated financial inclusion initiatives. One participant suggested that the cost of enrolment for a zero balance account that carries full-fledged banking services including a RuPay debit card could be upwardsof five dollars (three hundred rupees). Hence the PB licensees are likely to be neutral to participation in a Financial Inclusion drive.

- They do affirm that the accounts they provide will be able to receive direct benefit transfers (DBT). To that extent, if the government includes their customers as part of the DBT program, their expectation is that the government

[45] DoT circular to MNOs: http://www.dot.gov.in/sites/default/files/doc.pdf
[46] http://pmindia.gov.in/en/news_updates/pm-launches-pradhan-mantri-jan-dhan-yojana/

will also compensate them for such services on par with any prevailing remuneration structure for participating banks.

- Allowing existing KYC to be re-used to attach a DBT linked savings account to a PB is certainly a prospect that was exciting to the participants. Given the recent order[24] from the Department of Telecommunications asking MNOs to collect Aadhaar number when issuing new SIM cards, re-use of KYC seems a logical step towards enabling such reuse without losing KYC fidelity.

- Hence, should there be mandates for inclusion, there may be a need to allow the potential licensees leeway towards meeting financial inclusion obligations through tariff tolerance.

FINANCIAL INCLUSION

At the end of August 2014, the government of India launched Pradhan Mantri Jan Dhan Yojana[25] (PMJDY). PMJDY the is National Mission for Financial Inclusion to ensure access to financial services, namely, Banking/ Savings & Deposit Accounts, Remittance, **Credit, Insurance, Pension** in an affordable manner.

As of November 28, 2014, more than 8 Crore accounts had been opened under PMJDY. The Finance Minister said in Lok Sabha[47] that the beneficiaries would get a RuPay Debit card having inbuilt accident insurance cover of Rs one lakh. According to reports, by September 30, RuPay Cards had been issued to 1.78 Crore account holders.[48]

The PB guidelines state that an objective of this licensing is:

> ***To further financial inclusion by providing (i) small savings accounts and (ii) payments / remittance services to migrant labour workforce, low income households, small businesses, other unorganised sector entities and other users...***

While all of the above will certainly be possible through Payment Banks, their product proposition may not compare favorablywith those that the government has directed commercial banks[49] to offer citizens under the PMJDY. Unlike the Government, PBs may not be in a position to announce Accident Insurance or overdrafts without divining a viable business case. In fact, while they are allowed to issue ATM and debit cards, it is unlikely that these will be issued free if PBs are to find viability.

Role of PBs

Regardless of the differences in product offerings, PBs will be able to provide a bank account that will allow the customer the following:

a) A bank account that is connected to the existing financial institutional and market infrastructure

b) A widespread network of locations where funds in such accounts can be conveniently accessed

Hence by enrolling savings account customers, PBs automatically further the cause of financial inclusion. By offering savings accounts, PBs are promising the customer cash withdrawals based on the pricing model that they adopt. As discussed previously, the business model will need to be transaction based. As has been observed in mobile money deployments in other parts of the world, players often charge fees for withdrawals. Debit cards are offered in some cases[50] but charges apply.

At scale, the reach of PBs and their appetite to serve low-income customers are both expected to be superior to that of existing banks.

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[47] http://economictimes.indiatimes.com/news/economy/policy/eight-crore-people-opened-bank-accounts-under-pradhan-mantri-jan-dhan-yojana-finance-minister-arun-jaitley/articleshow/45306811.cms
[48] http://www.financialexpress.com/news/5.29-cr-accounts-opened-under-pmjdy/1295160
[49] SBI information on PMJDY accounts https://www.sbi.co.in/portal/web/customer-care/-faq-pradhan-mantri-jan-dhan-yojana-pmjdy
[50] EcoCash Zimbabwe: https://www.econet.co.zw/save/debit_card.html

Potential PB applicants already have cumulative points of presence (agent network points) that are several times the number of bank branches. Domestic remittance players and MNOs already handle hundreds of millions of small value transactions profitably every day.

The recent directive to link Aadhaar number with SIM card issuance strengthens the beneficiary identification mechanism. Hence it is recommended that PB customers are encouraged to link their PB savings accounts with government benefit schemes in case that is their only formal institutional account. This would benefit the government, citizens, as well as invite transactions, benefiting the service provider.

Presently it is not clear if there are incentives or fees that the government will provide participating banks for direct benefit transfers. The bulk of the cost incurred by banks and business correspondents in servicing benefit transfers is in cash management costs. In cases where an incentive is provided by the government agency disbursing the funds, it is usually linked to the cash withdrawal of the funds by the beneficiary. However, for transacting accounts, it is not feasible to distinguish credits or debits in an account that are a result of customer activity from those that are government payments. As such, most providers encourage the beneficiaries to use the accounts exclusively as a benefit transfers account to avoid reconciliation complexities that would deny provider commission receipts linked to such cash outs. This in turn results in low transaction activity as well as dormancy in such accounts.

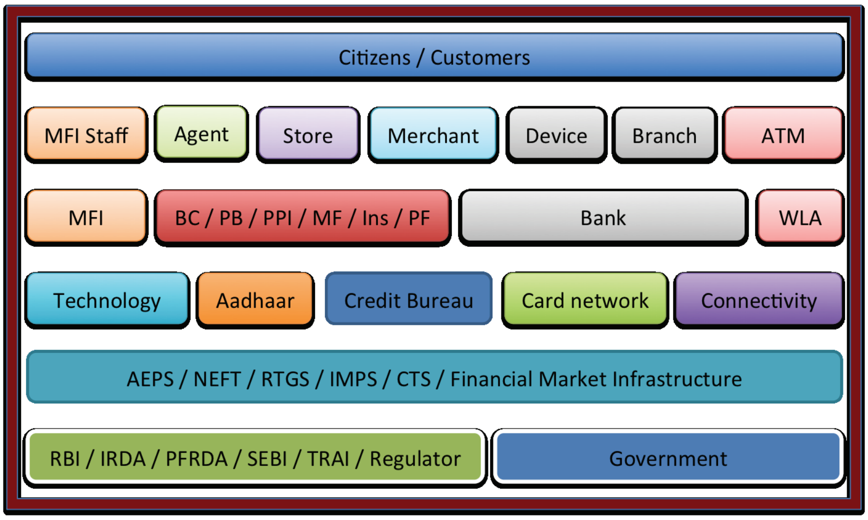
Regardless of any incentive payouts for servicing benefit payments,mandates requiring PBs to subsidize their pricing mechanism specifically to service benefit payment withdrawalsor issue debit cards free of charge are likely to negatively impact the viability of PB business models or result in some other distortion.

Finally, given the recent positive momentum of the PMJDY program coupled with the fact that the licensing process for PBs has still not been finalized, there are concerns around what directed financial inclusion role the PBs will be able to play in the short-term, as the rollout of PBs is now expected to be in the later part of 2015.

STRENGTHENING THE FRAMEWORK

The licensing of PBs, small banks, the launch of the PMJDY are all welcome initiatives to solve the large and important issue of financial exclusion. This section explores some possible means of further strengthening the framework of financial inclusion over the medium to long term.

Figure 10. India's Financial Services Ecosystem



As shown in the figure above, India already has a very sophisticated and well-developed financial services ecosystem. The move towards licensing PBs / Small Banks is only expected to add layers to deepen this. In order to further oil the wheels and extend access to excluded populations, the following other areas could benefit from attention.

- ***Unification of KYC standards and data:***
  - o *With the proliferation of Aadhaar as well as the impending rollout of citizen digital lockers, there is a real opportunity to adopt cross-regulatory industry standards for KYC. There is perhaps an opportunity to create a unified KYC repository on the lines of CDSL[51] and NSDL[52].*
  - o *The use of NADRA[53] and CNIC[54] has allowed Pakistan to provide cash-to-cash remittance services as well as improve KYC convenience to citizens. There is every reason to believe that along with Aadhaar and a standardized KYC definition, as well as AEPS, access to citizens seeking formal financial services can be made much more hassle free.*

[51] Central Depository Services Limited: https://www.cdslindia.com/index.html
[52] National Securities Depository Limited: https://nsdl.co.in
[53] Pakistan's National Database Registration Authority: http://www.nadra.gov.pk
[54] Computerized National Identity Card: http://www.nadra.gov.pk/index.php/products/cards/cnic

- ***ATMs/ White Label ATMs / POS terminals /Agent cash***:

  - *Cash is expensive and cash handling is a significant cause of increased expenditure for all financial service providers. Further, the absence of any disincentive to use cash over digital money is one of the primary reasons for the poor uptake of non-cash transactions in India. Shared ownership of infrastructure created for cash such as ATMs (as opposed to mere interoperability) must be considered to bring about order of magnitude reduction in costs. Telecommunications providers in India have created joint venture institutions to create and manage expensive tower infrastructure as a shared service. This is an excellent example to emulate for ATMs.*

  - *White Label ATM providers are the closest example of the creation of such shared infrastructure. However, they are left to compete with SCBs, escalating costs for both. This means that PBs will need to either create their own ATMs and load those costs to customers or create partnerships with Banks and White Label ATM providers and pass on the cost of interchange fees to customers. Mechanisms of shared ownership of critical infrastructure like ATMs will significantly bring down cash handling costs, improving access significantly.*

  - *Additionally, there is a massive amount of cash being handled by supermarket chains today. This infrastructure is currently not being leveraged at all as a mechanism of cash out. The entry of retailers as PBs may partially alter that equation, however, there is room to consider the benefits of integrating retail infrastructure to bring down cash management costs.*

  - *Finally, the big promise of PBs is the explosion of end-user access points in the form of the agent network. Every one of these agents already handles varying amounts of cash every day based on the nature of outlet, location and security available. Integrating these by creating interoperability and settlement mechanisms will multiply the number of access points, not only for PB customers, but also for existing Banked customers, benefiting the ecosystem as a whole.*

  - *In addressing these challenges, the foundation for moving towards a less cash architecture will be laid. That can then be leveraged in the future in the journey towards a less-cash economy.*

ANNEXURE 1

The following are the specific recommendations on Payments Banks extracted and reproduced from the Mor Committee report.

These (3.9, 3.10, 3.11) Recommendations Relate to the Conditions for Licensing Payment Banks.

3.9 Given the difficulties being faced by PPIs and the underlying prudential concerns associated with this model, the existing and new PPI applicants should instead be required to apply for a Payments Bank licence or become Business Correspondents. No additional PPI licences should be granted.

3.10 Under the Banking Regulation Act, a set of banks may be licensed which may be referred to as Payments Banks with the following characteristics:

a. Given that their primary role is to provide payment services and deposit products to small businesses and low-income households, they will be restricted to holding a maximum balance of Rs. 50,000 per customer.

b. They will be required to meet the CRR requirements applicable to all the Scheduled Commercial Banks.

c. They will be required to deposit the balance proceeds in approved SLR securities with duration of no more than three months and will not be permitted to assume any kind of credit risks.

d. In view of the fact that they will therefore have a near-zero risk of default, the minimum entry capital requirement for them will be Rs. 50 crore compared to the Rs. 500 crore required for full-service SCBs.

e. They will be required to comply with all other RBI guidelines relevant for SCBs and will be granted all the other rights and privileges that come with that licence.

f. Existing SCBs should be permitted to create a Payments Bank as a subsidiary.

3.11 RBI to work with TRAI to ensure that all mobile phone companies, including those with Payments Bank subsidiaries, be mandated to provide USSD connectivity as per recent TRAI regulations with the price cap of Rs. 1.5 per 5 interactive sessions and to categorize all SMSs related to banking and financial transactions as Priority SMS services with reasonable rates and to be made available to the banking system.

This recommendation (4.8) recognizes the cross-regulatory challenges in facilitating payments and suggests a mechanism to resolve them.

4.8 There is a need to develop a robust legal and regulatory framework around customer data generated in various transactions (credit and payments, digital and off-line), with the objective of customer ownership of their own transactions data and its use, among others, for signaling credit-worthiness. RBI should constitute a Working Group comprising TRAI, CERC, and Credit Information Companies to develop a framework for sharing of data between telecom companies, electrical utilities, and credit bureaus. This framework should be in keeping with the FSLRC's draft Indian Financial Code which recommends the creation of regulations on the collection, storage, modification and protection of personal information by financial services providers; and establishment of mechanisms to ensure that consumers have access to, and are given an effective opportunity to seek modifications to, their personal information. [Identical to Recommendation 4.42]

ANNEXURE 2

Shown below is a snapshot of data from TRAI on Telecom Subscription. India has completely leapfrogged fixed line telephony in favour of mobile telecommunications.

Source[55]: TRAI

TELECOM REGULATORY AUTHORITY OF INDIA
New Delhi, 7th July, 2014
(www.trai.gov.in)

Highlights on Telecom Subscription Data as on 31st May, 2014

Particulars	Wireless	Wireline	Total Wireless + Wireline
Total Subscribers (Million)	**910.16**	**28.18**	**938.34**
Total Monthly Net Addition (Million)	2.71	-0.18	2.54
Monthly Growth	0.30%	-0.62%	0.27%
Urban Subscribers (Million)	**533.94**	**22.31**	**556.25**
Urban Subscribers Monthly Net Addition (Million)	0.07	-0.11	-0.04
Monthly Growth	0.01%	-0.49%	-0.01%
Rural Subscribers (Million)	**376.22**	**5.87**	**382.10**
Rural Subscribers Monthly Net Addition (Million)	2.64	-0.07	2.58
Monthly Growth	0.71%	-1.14%	0.68%
Overall Teledensity*	**73.24**	**2.27**	**75.51**
Urban Teledensity*	139.72	5.84	145.56
Rural Teledensity*	43.72	0.68	44.40
Share of Urban Subscribers	58.66%	79.16%	59.28%
Share of Rural Subscribers	41.34%	20.84%	40.72%
No. of Broadband Subscribers (Million)	**50.38**	**14.95**	**65.33**

55 http://trai.gov.in/WriteReadData/WhatsNew/Documents/PR-TSD-May,%2014.pdf

ANNEXURE 3

Some key requirements in the Bangladesh Bank (central bank) guidelines for Mobile Financial Services are listed below:

- *At any point of time, the relevant balance in bank book shall be equal to the virtual balance of all registered mobile accounts shown in the system. Banks will be the custodian of individual customers' deposits.*
- *The inward foreign remittance (credited to Nostro* ***Accounts*** *of Banks) transfer arrangement through designated Cash Points/ Agents will be used only for delivery in local currency.*
- *The platform should not be used for cross border* ***outward remittance*** *of funds without prior approval from Bangladesh Bank.*
- *Banks and its partners shall have to comply with the prevailing Anti Money Laundering (AML)/ Combating the Financing of Terrorism (CFT) related laws, regulations and guidelines issued by Bangladesh Bank from time to time.*
- *Banks shall have to use a new 'Know Your Customer (KYC)' format as given in Annex I (see MFSguideline). The Bank will be responsible for authenticity of the KYC of all the customers.*[56]
- *Banks shall have to follow full KYC format issued by Anti Money Laundering Department (AMLD) of Bangladesh Bank for the cash points/agents/partners.*

[56] http://www.b angladesh-bank.org/aboutus/regulationguideline/mfsguideline.pdf

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