26 September 2016

SUBMISSION TO THE COMMITTEE TO REVIEW THE FRAMEWORK RELATED TO DIGITAL PAYMENTS

REFORMS REQUIRED IN REGULATORY ARCHITECTURE OF DIGITAL PAYMENTS

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1. Background

The transition from cash heavy to less cash society will be difficult to achieve without ensuring adequate consumer convenience and protection. The target consumers for digital payments are low and middle income individuals and merchants (small vendors). The regulatory architecture of digital payments needs keep these consumer groups at its core.

CUTS International[1], a 33 year young economic policy research and outreach organisation, has contributed to several pro-consumer reforms during last several years. We have also been closely reviewing the regulatory architecture of digital payments from consumers' perspective.[2]

This note summarises our suggestions on key reforms required in regulatory architecture of digital payments. It focuses on following three areas, wherein interactions between customers and digital payments service providers take place:

- customer acquisition
- service delivery
- consumer protection grievance redress

These suggestions are focused on promoting consumer convenience and protection, to facilitate adoption of digital payments.

[1] www.cuts-international.org
[2] For instance, CUTS research project on payments banks, see http://www.cuts-ccier.org/PaymentsBanks/

2. Customer acquisition

Opening of account/ registration with digital payment service providers (such as banks, prepaid payment instrument (PPI)/ wallet issuers) is the first step to bring customers within the digital payments fold. This is known as customer acquisition, in relation to which several regulations have been issued.

2.1. The Central KYC Registry

Regulations require digital payments service providers to verify identity and address of the customer for customer acquisition. This is known as Know Your Customer (KYC) exercise. Several documents have been prescribed to act as proof of identity and address, such as passport, voter identification, driving license, aadhar card etc.

Service providers are required to record the customer details in template prescribed by the Central KYC Registry (CKYCR)[3], a central repository of customer records.[4] The template requires submission of unverified details like names of both spouses and occupation of the customer. These details are not required to establish identity and residence of customer and the service providers might require customers to furnish additional documents to establish the veracity of these details. This might increase inconvenience and cost for consumers.

Suggestion: Limit the information in CKYCR template to customer identity and address. This will require amendment to CKYCR template.

The service providers are required to scan and submit relevant proofs, photographs and signature specimen of customers with the CKYCR. The guidelines prescribe the specification and formats in which documents are required to be uploaded.[5] This imposes avoidable costs on service providers which will eventually be passed on to consumers.

Suggestion: Amend Clause IV(B) of CKYCR Operating Guidelines, 2016, and allow submission of documents by service providers to CKYCR in the format most feasible to service providers.

As a result, the service providers tend to insist on submission of physical documents and two photographs by the customers. The lack of regulatory clarity on possibility of submission of documents and photographs digitally also inhibits the seamless customer acquisition.

Suggestion: Allow submission of KYC documents by customers to service providers through digital modes. This will require amendment to Clause 16 of the RBI Master Directions on KYC, 2016 and Clause 5.3 of the RBI Master Circular on Customer Service in Banks, 2015

2.2. Electronic KYC

In addition to paper-based KYC, the RBI has allowed electronic KYC for consumers willing to use Aadhar for KYC purposes. In this regard, the customer is required to provide consent to Unique Identification Authority of India (UIDAI) to share relevant details with service providers. The RBI has insisted that such consent be provided only biometrically to UIDAI[6]. This is contingent on availability of internet and high quality machine capable of capturing biometric details of customers.

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[3] The template is available at https://rbidocs.rbi.org.in/rdocs/content/pdfs/KYCIND261115_A1.pdf. For details, see clause 57 of RBI Master Direction on KYC Direction, 2016 at https://www.rbi.org.in/Scripts/BS_ViewMasDirections.aspx?id=10292

[4] RBI Master Direction on KYC Direction, 2016 at https://www.rbi.org.in/Scripts/BS_ViewMasDirections.aspx?id=10292

[5] For details, see Clause IV(B) of CKYCR Operating Guidelines, 2016, Version 1.1 available at https://www.ckycindia.in/ckyc/guidelines.html https://www.rbi.org.in/Scripts/BS_ViewMasDirections.aspx?id=10292.

[6] For details, see proviso to clause 17 of RBI Master Direction on KYC Direction, 2016 at https://www.rbi.org.in/Scripts/BS_ViewMasDirections.aspx?id=10292

The UIDAI has in-built processes to take express customer consent through one time password (OTP) sent on registered mobile number of Aadhar card holder.[7] This facility is allowed by other financial regulators (Securities and Exchange Board of India[8], Pension Fund Regulatory and Development Authority[9]) and they do not necessarily require in person verification for small value transactions. Similar relaxations can be provided for opening of small value accounts by RBI, such as accounts with payments banks, which have end of day limit of Rs. 100,000.

Suggestion: Allow customer consent through OTP route in electronic KYC for payments banks accounts. This will require amendment to proviso to clause 17 of RBI Master Direction on KYC Direction, 2016 and RBI guidelines on payments banks.

2.3. Requirement to quote Permanent Account Number (PAN)/ Submit Form 60

The Income Tax (22nd Amendment) Rules, 2015 require customers to quote PAN for opening of bank account (other than basic saving bank deposit account), obtaining a debit card, and making payments (including digital payments) beyond a specific amount. In case PAN is not available, customers are required to make a declaration in Form 60. [10] An officer/ manager of the relevant entity (bank/ entity receiving payment) is required to ensure compliance with this requirement, and furnish a statement in Form 61 to government authorities. Such entity is required to retain Form 60 for a period of six years from the end of financial year in which the transaction was undertaken.[11]

The objective of quoting PAN/ submission of Form 60 appears to be related to verification of tax related documents submitted by individuals and prevention of tax evasion. However, such requirement has the potential to impose avoidable cost and inconvenience on consumers. There could be better alternatives to verify tax related documents and prevent tax evasion.

Suggestion: Discontinue the requirement to quote PAN/ submit form 60 for specific financial transactions. This would require amendment to the Income Tax (22nd Amendment) Rules, 2015.

2.4. Avoid repetition in KYC exercise

The scope of entities eligible to offer digital payments services is gradually increasing. These entities include mobile network operators, prepaid payment instrument (PPIs) providers, universal banks, soon to be launched payments banks and small finance banks.

It is likely that many of these entities will have common customers. While all of these entities are required to undertaken KYC check (of different standards, depending on services offered), it needs to be ensured that customers are not required to provide same information more than once.

For instance, like KYC requirements of RBI, the regulations issued by Department of Telecommunications (DoT) prescribe that individuals are required to provide a self-attested photograph, proof of identification and proof of address for getting a mobile connection, among other details.[12] These requirements are substantially similar and should a telecom customer desires to open a bank account, she must not be required to furnish already submitted documents to regulatory agencies. A mechanism needs to be developed to allow transfer/ sharing of customer information between mobile network operator and bank, subject to customer consent. It must be possible to use such documents to access other financial services as well, such as opening of a mutual fund account.

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[7] UIDAI, *Policy note on Aadhar E-KYC service,* November 2012

[8] Frequently Asked Questions issued by SEBI on circular dated 22 January 2016 on KYC Requirements – Clarification on voluntary adaptation of *Aadhar* based e-KYC process

[9] PFDRA circular dated February 05, 2015 on acceptance of e-KYC as valid process of KYC verification

[10] For details see http://gjf.in/pdf/circulars/Notification_of_PAN_card.pdf

[11] Ibid

[12] Department of Telecommunications, *Instructions on verification of new mobile subscribers*, August 09, 2012, available at http://saveaamadmi.com/DOTVERIFICATIONPOLICY090812.pdf

Suggestion: Develop inter-regulatory coordination for KYC related issues. In the long term, this should aim at harmonisation of KYC standards (for same level of risks) across different services and creation of sector neutral Central KYC Repository. In the interim, the regulations should allow customer acquisition through sharing of customer KYC documents/information across service providers subject to customer consent and obtaining of additional documents from customers, in case of high risk. This would require amendment to DoT instructions on verification of new mobile subscribes and RBI Directions on KYC.

2.5. Acquisition of small merchants

As indicated earlier, bringing small and informal merchants into digital fold will be essential to ensure success of digital payments initiatives. At present, opening of current accounts by such small merchants requires furnishing of proof of identity and address of an individual representative of the business along with relevant registration/ tax related documents with respect to such business. Owing to their informal nature, most small merchants do not possess business related documents.

Unavailability of such business documents impedes ability of small merchants to benefit from formal financial system, despite service providers having the capability to monitor account activity and track transactions, thus reducing the potential risks involved. Consequently, small merchants must be allowed to open small value current accounts, such as current accounts offered by payments banks, on basis of individual KYC.

Suggestion: Allow small merchants to open current accounts with payments banks on the basis of individual KYC. This will require amendment to RBI Master Direction on KYC and RBI guidelines on payments banks.

S. no.	Table 1: Summary of reforms required in customer acquisition
1.	Delete requirement to insert 'occupation type' in personal details (point 1), details of related person (point 6) individual CKYCR application form
2.	Amend Clause IV(B) of CKYCR Operating Guidelines, 2016, and allow submission of documents by service providers to CKYCR in the format most feasible to service providers.
3.	Allow submission of KYC documents by customers to service providers through digital modes. This will require amendment to Clause 16 of the RBI Master Directions on KYC, 2016 and Clause 5.3 of the RBI Master Circular on Customer Service in Banks, 2015
4.	Allow customer consent through OTP route in electronic KYC for payments banks accounts. This will require amendment to proviso to clause 17 of RBI Master Direction on KYC Direction, 2016 and RBI guidelines on payments banks.
5.	Discontinue the requirement to quote PAN/ submit Form 60 for digital payments related transactions. This would require amendment to the Income Tax (22nd Amendment) Rules, 2015.
6.	Allow customer acquisition through sharing of customer KYC documents/information across service providers subject to customer consent and obtaining of additional documents from customers, in case of high risk. This would require amendment to DoT instructions on verification of new mobile subscribes and RBI Directions on KYC.
7.	Allow small merchants to open current accounts with payments banks on the basis of individual KYC. This will require amendment to RBI Master Direction on KYC and RBI guidelines on payments banks.

3. Service delivery

Having acquired customers, digital payment service providers offer different avenues to customers to undertake digital financial services. Several regulations have been put in place to regulate the manner and scope of service delivery and related activities.

3.1. Interoperability of customer facing business correspondents

The digital payments service providers offer services to their customers through different modes, including business correspondents.[13] A retail outlet or a sub-agent of a BC is required to represent only the bank which has appointed the BC. Interoperability[14] is permitted at the retail outlets or sub-agents of BCs (i.e. at the point of customer interface), provided the technology available with the bank, which has appointed the BC, supports interoperability, subject to certain conditions prescribed by RBI.[15]

Experience suggests that interoperability among BCs at the point of customer interface has not yet taken off, thus customers are required to approach the BCs of banks in which they have an account. This increase inconvenience and cost to consumers.

While interoperability among ATM has been achieved and while label ATM regime has been operationalised, such push has been missing in the BC ecosystem.

Suggestion: Promote interoperability among BCs at the point of customer interface and operationalise white label BC regime. This will require amendment to Clause 12(B) of RBI Master Circular on Branch Licensing, 2015.

3.2. Cross-selling of financial products and services

The number of products and services capable of being offered digitally is increasing at an astonishing speed. These include digital access to credit, insurance, mutual funds, pensions etc. Offering such products involve collaboration between digital payment service providers and financial service providers. This results in multiple regulators coming into picture, and the requirement to obtain multiple approvals and undertake multiple reporting.[16]

Such multiple and repetitive requirements impose costs on market players, which are eventually passed on to the customers.

Suggestion: Develop single window clearance and reporting mechanism when activities of payments service providers fall under the regulatory purview of more than one financial regulator.

3.3. Digital payments acceptance infrastructure

Digital payments can be facilitated through digital payments acceptance infrastructure like ATMs, point of sale (PoS) machines, mobile payments applications (apps) etc. ATMs and PoS machines traditionally enabled payments through cards.

[13] For details, see, RBI Master Circular on Branch Licensing, 01 July 2015, at https://www.rbi.org.in/Scripts/BS_ViewMasCirculardetails.aspx?id=9817

[14] Ability of BC to represent multiple service providers

[15] Clause 12(B) of RBI Master Circular on Branch Licensing, 2015, at https://www.rbi.org.in/Scripts/BS_ViewMasCirculardetails.aspx?id=9817

[16] For instance, in order to cross-sell insurance products, payments banks are required to obtain approval from Insurance Regulatory and Development Authority for which no-objection certificate from RBI is required. After obtaining approval from IRDA, payments banks might be required to approach RBI again for final approval. In addition, there is requirement to submit periodic reports to IRDA, in addition to RBI.

The Government has promoted card based digital payments through mandating issuance of RuPay cards through Jan Dhan Yojana.[17] It has also issued a concept paper on improving card acceptance infrastructure in India.[18]

Increasingly, cardless payments through mechanisms like mobile apps are witnessing a boost. The market players are also realising this and are increasingly providing cardless options. One such option is Unified Payments Interface (UPI), offered by National Payments Corporation of India (NPCI). It has been reported that UPI has been offered to banks to the exclusion non-bank PPI/ wallet operators.[19]

Such regulatory preference to select modes of digital payments is uncalled for, as they distort markets and impose costs on market players and consumer.

Suggestion: The regulations should not push for a particular mechanism for digital payments. Level playing field between card and cardless digital payments will need to be promoted and complete transparency and disclosure about charges, security, privacy and convenience needs to be ensured. This will require RBI to cease regulatory push to increase card acceptance infrastructure and enable PPI operators to use UPI. It will need to work with competition regulator, Competition Commission of India in this regard.

S. no.	**Table 2: Summary of reforms required in service delivery**
1.	Promote interoperability among BCs at the point of customer interface and operationalise white label BC regime. This will require amendment to Clause 12(B) of RBI Master Circular on Branch Licensing, 2015.
2.	Develop single window clearance and reporting mechanism when activities of payments service providers fall under the regulatory purview of more than one financial regulator.
3.	Drop regulatory push to increase card acceptance infrastructure. Enable PPI operators to use UPI. Work with Competition Commission of India to improve level playing field in digital payments sector.

[17] RuPay gains market share with the help of Jan Dhan Yojana, 14 March 2016, at http://timesofindia.indiatimes.com/business/india-business/RuPay-gains-market-share-with-help-of-Jan-Dhan-Yojana/articleshow/51398719.cms

[18] RBI Concept paper on card acceptance infrastructure, March 2016, at https://rbi.org.in/scripts/PublicationReportDetails.aspx?ID=840

[19] Wallets aren't allowed on UPI because banks needed time to catch up, 31 May 2016, at http://www.medianama.com/2016/05/223-india-wallets-upi-banks-ncpi-hota/

4. Consumer protection and grievance redress

High standards of consumer protection without diluting consumer redress, and user friendly modes of grievance redress will be keys to increase trust and confidence in digital payments. Several regulations are in place with respect to consumer protection and grievance redress.

4.1. Transparency in charges for digital payments

Multiple entities are involved in facilitating digital payments. These include banks, merchants (like restaurants, shops etc)/ while label ATMs providers, digital payments infrastructure providers (like National Payments Corporation of India etc). To set up digital payments acceptance infrastructure (ATMs/ point of sale machines), the service providers have to incur costs, which are eventually borne by merchants and consumers, in form of charges to make digital payments. While several regulations have been issued with respect such charges, there is a lack of transparency and disclosure to customer at the time of making transaction.

In addition, there regulations which promote cross-subsidizing of digital payments.[20] These include regulations which mandate minimum number of transactions at ATMs of banks other than bank in which customers have an account to be free.[21] There is also a cap on merchant discount rate[22] which could be charged, and the requirement to unbundle the same[23].

Suggestion: Increase disclosure and awareness of charges involved in digital payments, and avoid cross-subsidization. Before final authorisation of any digital payment, customer should be made aware of the charges involved in the transaction (through mechanisms like a message box on ATM screen/ PoS machine, SMS to customer, etc). Such mechanisms are expected to increase confidence in digital payments ecosystem. This will require amendment to RBI Master Circular on Customer Service.

4.2. Convenience and security in digital payments

Different security measures are in force in at present to undertake digital payments. Typically, transactions are subject to two factors of authentication.[24] A relaxation is given in case of card present transactions using near field/ contactless technology wherein the value of transaction is not more than Rs. 2,000.[25]

Transition to digital payments requires building of customer trust without doing away with customer convenience. While low income first time consumers could require highest level of security standards in all transactions, irrespective of the amount, high income habitual consumers might be comfortable with lower levels of security standards in low value regular transactions.

Suggestion: Undertake a comprehensive cost-benefit analysis to establish minimum security standards for low income vulnerable consumers and beyond that enable the consumers to choose, compare and select security standards offered by different service providers. This will require changes to the RBI circular on additional factor of authentication.

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[20] *No free lunch: Rajan on ATM transactions,* Business Standard, 16 September 2014, available at http://www.business-standard.com/article/finance/no-free-lunch-rajan-on-atm-transactions-114091501134_1.html, quoting Dr. Raghuram Rajan, notes "*There is no such thing as a free lunch; we tend to forget this sometimes. If your bank has to pay some other bank for those transactions, it has to collect it from somewhere. It does this by increasing some other fee on customers. It passes the cost back to customers," he said, adding five such transactions cost a bank Rs 75-100.*"

[21] RBI circular on rationalisation of number of free transactions on usage of ATMs dated 14 August 2014, at https://www.rbi.org.in/scripts/NotificationUser.aspx?Id=9170&Mode=0

[22] RBI circular on MDR for debit structure for debit card transactions, 04 July 2012, at https://rbi.org.in/scripts/NotificationUser.aspx?Mode=0&Id=7422

[23] RBI circular on MDR structure - unbundling of charges dated 01 September 2016, at https://rbi.org.in/scripts/NotificationUser.aspx?Mode=0&Id=10591

[24] What you have (card/ card details) + What you are (PIN/ OTP)

[25] RBI Circular on card payments and relaxation of additional factor of authentication for small value card present transactions, 14 May 2015, at https://rbi.org.in/scripts/NotificationUser.aspx?Mode=0&Id=9718

4.3. Improve grievance redress standards

The RBI Master Circular on Customer Service in Banks requires banks to set up an institutional framework in form of customer service committee of the Board. A customer grievance redressal policy is required to be put in place, complaints handling mechanism is required to be set up at branch level, and disclosure on consumer protection and grievance redress steps is required to be clearly provided.[26]

With reduction in human interaction and increase in digitisation of services, consumer protection and grievance redress services should be no exception. Real-time response, feedback and refund mechanisms, periodic public disclosure and reporting of qualitative customer grievance redress information will be keys to improve grievance redress in digital payment transactions.

Suggestion: Facilitate use of technology to improve standards of customer grievance redress, reporting and disclosure of grievance related data. This would require amendment to RBI Mater Circular on Customer Service in Banks.

S. no.	**Table 3: Summary of reforms required in customer protection and grievance redress**
1.	Amend RBI Master Circular on Customer Service to increase disclosure about charges involved in digital payments. Before final authorisation of any digital payment, customer should be made aware of the charges involved in the transaction (through mechanisms like a message box on ATM screen/ PoS machine, SMS to customer, etc).
2.	Undertake a comprehensive cost-benefit analysis to establish minimum security standards for low income vulnerable consumers and beyond that enable the consumers to choose, compare and select security standards offered by different service providers. This will require changes to the RBI circular on additional factor of authentication.
3.	Facilitate use of technology to improve standards of customer grievance redress, reporting and disclosure of grievance related data. This would require amendment to RBI Mater Circular on Customer Service in Banks.

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[26] RBI Master Circular on Customer Service in Banks dated July 01, 2015, available at https://rbi.org.in/Scripts/BS_ViewMasCirculardetails.aspx?id=9862