CUTS International

Submission of Comments to the Reserve Bank of India on
Policy Paper on Authorisation of New Retail Payments Systems

1. Background

1.1. In January 2019, the Reserve Bank of India (RBI) issued a policy paper on authorisation of new retail payments systems (policy paper) inviting public comments. The policy paper was issued with a view of minimizing the concentration risk in retail payment systems, from a financial stability perspective and to foster innovation and competition, and encourage more players to participate in and promote pan-India payment platforms, as stated in the Statement on Development and Regulatory Policies issued by the RBI in June 2018.[1]

1.2. In anticipation of the policy paper, in October 2018, CUTS International had submitted its suggestions to the RBI for managing concentration risk and promoting competition and innovation in retail payments.[2] This submission complements previous submission made by CUTS International on the subject.

2. Possible impact of concentrated payments systems

2.1. The policy paper postulates possible advantages and disadvantages of concentrated payment systems, and notes that some possible disadvantages include negative impact on consumers with respect to charges, quality of service and access, and lack of innovation and upgradation. However, these assumptions were not verified with on-ground data.

2.2. We recently concluded a user perspective study to understand perception and experience of consumers and merchants with respect to availability, access, usage, experience, benefits, and challenges faced by users in digital payments and reforms required to deepen digital payments. The study was conducted in ten districts of five states (Karnataka, Haryana, Madhya Pradesh, Bihar and Assam) with 2,020 respondents, comprising 1,200 consumers, 800 merchants and 20 business correspondents. The sample was distributed between urban and rural areas, with adequate representation of respondents with different education levels, occupations, incomes and age groups (CUTS digital payments study).[3]

2.3. Findings from CUTS digital payments study appear consistent with the assumptions made in relation to disadvantages of concentrated payments systems in the policy paper. For instance, it was found that infrastructure necessary for digital payments is not consistently available in the country, and awareness of digital payments is significantly low.

2.4. In addition, high charges, transaction failures and lack of interoperability were highlighted among key challenges faced by consumers in digital payments (see figures 1 and 2 below).

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[1] The policy paper is available at https://rbidocs.rbi.org.in/rdocs/PublicationReport/Pdfs/ANRPS21012019A8F5D4891BF84849837D7D611B7FFC58.PDF

[2] CUTS submission is available at http://www.cuts-ccier.org/pdf/CUTS_Submission_to_RBI_on_Innovation_and_Competition_in_Retail_Payments.pdf

[3] Findings of the CUTS digital payment study are available at http://www.cuts-ccier.org/Payments-Infrastructure/pdf/Presentation_for_RBI_Committee_on_Deepening_Digital_Payments.pdf

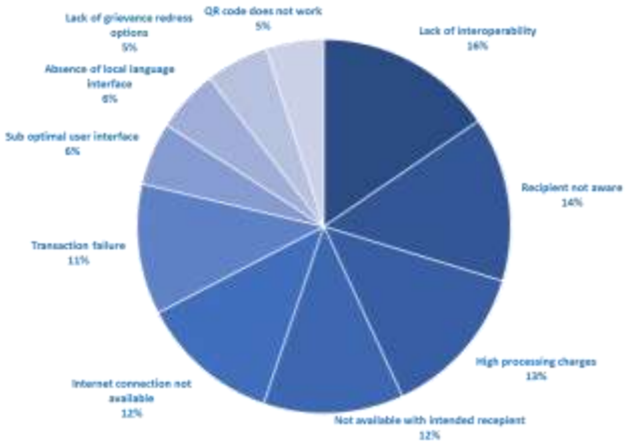

Fig 1: Key challenges in wallet payments (consumer responses)

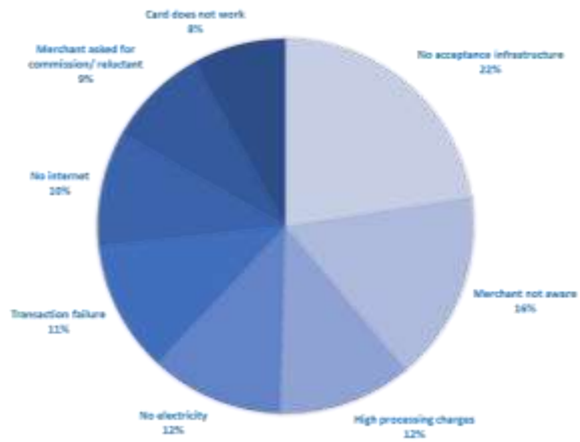

Fig 2: Key challenges in card payments (consumer responses)

2.5. Similarly, lack of interoperability, transaction failure and high processing charges were highlighted among key challenges faced by merchants in digital payments (see figure 3 below).

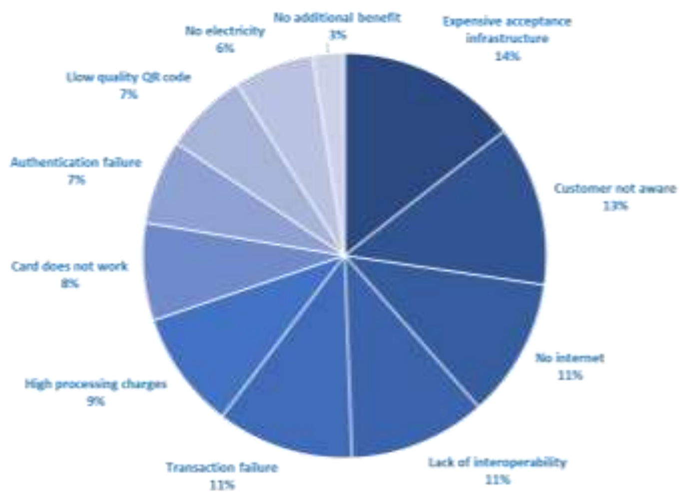

Fig 3: Key challenges in digital payments (merchant responses)

3. Issues to address

3.1. In light of above findings, there seems to be a valid case for addressing concentration in payments systems in India. However, while concentration might be a key feature of payment system, it might not be the only one. An optimal regulatory approach must consider all developments in the sector as a whole, without focusing exclusively on a single component.

3.2. As recently noted by Abdul Rasheed Ghaffour, Deputy Governor of Central Bank of Malaysia, there are three key challenges for regulatory agenda for payments going forward:[4]

- Evolving landscape characterised by fast change, cyber security and concentration risks

[4] Abdul Rasheed Ghaffour, Reimagining the regulatory landscape for payment systems, Global Payments Week 2018, 04 December 2018, at https://www.bis.org/review/r181206h.pdf

- Market fragmentation
- Shifting market expectations

3.3. Ghaffour suggests four focus areas for the payments regulatory agenda moving forward: [5]

- Preserving trust to safeguard the resilience and integrity of payment systems;
- Apply proportionate regulation to effectively manage risk, whilst not stifling innovation;
- Enabling connectivity through collaboration towards greater standardisation and interoperability; and
- Promoting efficiency and innovation through greater competition.

3.4. It appears that several countries are congnisant of emerging challenges in the payments systems and are keen to revisit their incumbent regulatory framework. For instance, in October 2018, the Federal Reserve of the United States of America sought public comments on possible actions to facilitate real-time interbank settlement for faster payments.[6] Hong Kong[7] and Australia[8] are also revisiting their architecture of payments and are designing new faster payments systems. In Hong Kong, the Faster Payments System (FPS) was launched in September 2018 with a total of 21 banks and 10 non-bank e-money issuers participating in the scheme. The UK went even further in April 2018, with the Bank of England allowing a non-bank to access both clearing and settlement facilities in the RTGS system.[9]

3.4. Consequently, any proposed regulatory framework to address concentration risk and promote innovation in payments must be informed by ground realities and undertake a comprehensive approach to address existing and emerging risks in the sector. It is clear that providing level playing field among banks and non-banks in payments sector is one of the key measures utilised globally to address emerging risks in the sector.

4. Suggestions on regulatory approach to payments

4.1. In light discussion, following suggestions are made to address existing and emerging risks.

4.2. **Create threat of competition** – The National Payments Corporation of India (NPCI), a banks' owned non-profit company, is recognised as the sole retail payments organisation in the country. It operates the critical infrastructure (such as IMPS and UPI) to support retail payments. While NPCI's performance has been spectacular, regulatory vacuum exists in relation to eligibility criteria and operating conditions for another interested organisation to offer services similar to the NPCI. Evidence suggests that threat of competition is an enabler for competition and innovation.

4.3. **Avoid conflict of interest** – Indian retail payments sector has several instances of conflict of interest which may have impeded competition and innovation. For instance, the NPCI operates

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[5] Abdul Rasheed Ghaffour, Reimagining the regulatory landscape for payment systems, Global Payments Week 2018, 04 December 2018, at https://www.bis.org/review/r181206h.pdf
[6] https://www.federalreserve.gov/newsevents/pressreleases/other20181003a.htm
[7] https://www.pymnts.com/news/faster-payments/2018/hong-kong-faster-payment-system-international-retail/
[8] https://www.pymnts.com/news/faster-payments/2018/australia-npp-new-payments-platform-swift/
[9] https://www.bis.org/review/r181206h.pdf

critical infrastructure as well as payments instruments (such as BHIM and RuPay) etc. It also operates as Bharat Bill Payment Central Unit for the Bharat Bill Payment System. Given its role, it also acts as quasi-regulator in the retail payments sector. It is essential that different roles played by NPCI do not adversely impact growth of the sector. Consequently, NPCI's role as an infrastructure provider needs to be separated from its role as instrument operator, by situating its payment instruments related functions in a separate profit making entity.

4.4. **Encourage level playing field** – The RBI has taken laudable steps to enable competition in the retail payments sector. Most recently, it has allowed phased interoperability between banks and non-bank PPIs. However, in order to facilitate effective competition, there is a need to encourage level playing field by treating similarly placed entities similarly, and dissimilarly placed entities dissimilarly. For instance, despite the move towards interoperability, only banks are allowed to issue open PPIs. Also, non-bank PPIs are required to maintain their outstanding balance in an escrow account with any bank, i.e. their potential competitors. Similarly, under the peer to peer lending platform regulations, platforms are required to maintain two escrow accounts, mandatorily promoted by banks, and all fund transfers are required to be routed only through banks, excluding non-banks. Also, cross-border outward transactions can be conducted only through PPIs issued by banks. The objective of safekeeping depositors' money can be achieved without compromising competition. There is a need to review the rationale for such regulatory differentiation and ascertain if it restricts competition and innovation in the sector.

4.5. **Ensure proportionate risk based regulation** – Disproportionate regulation has the potential to impose unreasonable costs on market participants thereby impeding competition and innovation in retail payments. A summary review of regulation in retail payments reveals several instances of such unreasonable regulation that needs to be reformed. For instance, requirement to undertake full KYC even for small amount PPIs, capital adequacy ratio of payments banks higher than universal banks; requirement to quote PAN/ submission of Form 60 for account opening; submission of documents to Central KYC Registry in physical format; requirement of significantly high minimum positive net worth for PPIs; restrictive eligibility criteria for non-banks to operate peer to peer lending platforms; restriction on innovative ways of customer authentication; prohibition on virtual currencies; among others. It is possible to meet objectives of these regulations through economical and more efficient means. There is a need to reform such disproportionate entity based regulation and move towards proportionate risk based regulation to promote competition and innovation.

4.6. **Adopt Regulatory Impact Assessment and structured stakeholder consultation –** The RBI has remained cognisant of market developments and innovations and has also been prompt in considering innovative regulatory mechanisms. It has been reported that it is considering formation of regulatory sandbox and data science lab. In addition, it should consider institutionalising regulatory impact assessment framework in regulation making. These can introduce clarity in regulatory objectives, and promote use of tools like cost-benefit analysis for selection of regulation. In this regard, it should also consider constituting a Payment Systems Advisory Council to regularly consult with stakeholders in the sector.

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