

Developing regulatory interventions to address regulatory and competition bottlenecks in growth of payments banks

Background and Rationale

In late August 2015, the Reserve Bank of India (RBI) granted in-principle approval to 11 applicants, chosen from a list of 41 diverse applicants to set up payments banks in India. Payments banks are the RBI's first set of differentiated banks, aimed at providing deposit, payments and remittance services to low income groups, and other non-risk sharing simple financial services. However, they are not allowed to undertake lending activities. The principle behind payments banks is accelerating the penetration of financial services among low-income consumers by leveraging technology and the large, non-banking retail network without compromising the security of the financial sector.

The RBI had issued operational guidelines for payment banks in November 2014 and provided clarifications thereon in January 2015. The successful applicants are required to comply with relevant conditions under RBI guidelines and respective in-principle approval within 18 months. This triggered the need to undertake analysis of RBI guidelines and clarifications in greater detail, amongst relevant stakeholders. A preliminary review of existing literature, RBI guidelines and clarifications, and similar practices in other markets reveals existence of several regulatory and competition concerns, which have the potential to impose avoidable burden and restrict the growth of payment banks. Further, none of these institutions have prior banking experience (though some have prepaid instruments experience), due to which the RBI will be forced to grapple with an entirely new class of institutions.

CUTS International with support from Bill & Melinda Gates Foundation, New Delhi is undertaking an evidence based research project to identify key competition and regulatory bottlenecks in establishment and growth of payments banks in India. The objective is to develop necessary policy interventions to address the bottlenecks for enhancing access to banking to the unserved and underserved sections of the society.

Brief Methodology

A bottom up approach pioneered by CUTS in implementation of its evidence based research interventions will be utilised to undertake the project. This involves detailed interactions with diverse stakeholder classes, including regulators, industry, and consumers, understanding the ground scenario, and adopting a balanced approach to formulate practical and implementable recommendations.

In addition, the project implementation will be guided and reviewed by a group of experts (Expert Committee) in digital finance sector. The project activities carried out in the following phases will set the ground to achieve the desired outcomes:

- Secondary research: This will involve literature review and desk research on possible ambiguities in regulatory and practical landscape in efficient operation of payment banks. Also, literature available in public domain, in form of articles, research papers, policy guidelines, websites of regulators in different jurisdictions, think tanks, payment bank-like entities in other jurisdictions etc. will be analysed. The information gaps in secondary research will be identified, and stakeholder interaction tools will be designed.

- **Primary research and stakeholder interaction:** The secondary research will be followed by stakeholder interaction (one to one interviews) to address the data/ information gaps, validate the findings of the secondary research and understand any other potential/ existing challenges in the regulatory framework. In addition, the stakeholder interaction will reveal possible measures to address key competition and regulatory bottlenecks in growth of payment banks. This stage will include interaction with representatives from government, regulators, payment bank licensees, experts, media, academia, think tanks etc.
- **Analysis and designing of recommendations:** The information collected through stakeholder interaction will be recorded, tabulated and analysed. Review of measures utilised by other sector regulators and financial sector regulators in other countries will take place to develop practical measures to address identified competition and regulatory concerns. The findings, analysis and recommendations will be recorded in a draft research report.
- **Policy dialogues:** Three separate policy dialogues will be organised to discuss the findings and recommendations with specific

stakeholder groups, viz. representatives from regulators and government; payments banks; and civil society and academia. Organising of separate discussion platform is expected to enable exchange of frank views, which is aid in fine-tuning of recommendations. A report summarising discussion at each policy dialogue will be prepared.

- **Finalising of recommendations:** The draft research report will be finalised on the basis of discussions at the policy dialogues. It will summarise the findings and recommendations of the research and external dialogues.

Outputs

- Reports of policy dialogues
- Draft and final research report

Outcomes

This project will identify potential competition and regulatory barriers to growth of payments banks in India and develop necessary regulatory interventions to address the same.

Duration

The project will run up to May 2016.

