



PROJECT ON DEVELOPING INTERVENTIONS TO ADDRESS REGULATORY AND COMPETITION BOTTLENECKS IN GROWTH OF PAYMENTS BANKS

LITERATURE REVIEW NOTE

BACKGROUND

CUTS International has initiated a research project to identify issues which might hamper growth of payments banks in India. Such impediments may arise on account of regulatory complexity or uncertainty, differential treatment of similarly placed entities or anti-competitive practices by stakeholders. The objective is to identify such issues and develop necessary interventions to address them.¹

The guidelines on payments banks were issued in November 2014.² Subsequently, a set of clarifications were issued in January 2015³. 11 payments banks have since been granted in-principal approval to launch payments banks, within 18 months of grant of approval, subject to compliance with mentioned conditionalities and RBI satisfaction.⁴

This note takes stock of available literature on payments bank, including regulatory scenario, research reports, opinion pieces, practices in other jurisdictions, and highlights some areas of concern. It also sets out questions for stakeholder consultation to plug the information gaps identified and obtain in-depth understanding on the issues, necessary to design corrective interventions.

The issues identified in this note are segregated under following broad heads:

- A. Customer on-boarding
- B. Operational issues
- C. Additional approval requirements
- D. Business Correspondent related issues
- E. Structural issues
- F. Competition with other banks
- G. Competition with pre-paid instrument issuers
- H. Multiple regulations

¹ <http://www.cuts-ccier.org/PaymentsBanks/>

² RBI guidelines for licenses of payments banks dated 27 November 2014. Available at: https://rbi.org.in/scripts/bs_viewcontent.aspx?Id=2900.

³ RBI press release dated 01 January 2015

⁴ RBI press release dated 19 August 2015

As indicated, the note tracks the life cycle of payments banks operation, by beginning with customer acquisition related issues. It then deals with other operational and structural issues which the payments banks might have to face, including obtaining other approvals and the managing business correspondents. The notes then deals with competition related concerns which payments banks might have to face, and concludes with highlighting the multiple regulations which payments banks might have to comply with.

A. CUSTOMER ON-BOARDING

1. The payments bank will have to undertake its own KYC/AML/CFT exercise as any other bank.

While this measure is targeted to enable level playing field amongst payment banks, some players (especially telecom operators) would already have existing customers who would have been acquired through basic KYC. In case such KYC is not accepted, then automatic transfer of such customers (say, from a PPI wallet account to a payment bank account) might not be possible. This could result in imposition of additional costs on payments banks and customers.

Also, it might be inefficient if a payment bank will have to do its own KYC if the customer already has a bank account (which might not be impossible because of PMJDY initiative, which has resulted in explosion of bank accounts), meaning basic KYC has been conducted. Repetition of KYC process will make customer onboarding process inconvenient and expensive to all stakeholders, including customers.

Also, the easiest way to onboard customers will be through use of Aadhar information. However, confusion persists about its use. While it seems that Supreme Court has disallowed its use for KYC purposes⁵, but RBI has recently issued a circular saying that use of Aadhar for opening of bank accounts was voluntary.⁶ Interestingly, SEBI also recently issued similar notification, but made usage of Aadhar voluntary and optional, subject to final judgment of Supreme Court.⁷

In addition, currently the RBI guidelines on KYC applicable to commercial banks provide that the information collected from customers for the purpose of opening of account is to be treated as confidential and details thereof should not be divulged for the purpose of cross selling, etc. Information sought from the customer should be relevant to the perceived risk and be non-intrusive. Any other information that is sought from the customer should be called for separately only after the account has been opened, with his/her express consent and in a different form,

⁵ Supreme Court order dated 11 August 2015 in *Justice K.S. Puttaswamy v. Union of India* notes, “*The Unique Identification Number or the Aadhaar card will not be used by the respondents for any purpose other than the PDS Scheme...The information about an individual obtained by the Unique Identification Authority of India while issuing an Aadhaar card shall not be used for any other purpose, save as above, except as may be directed by a Court for the purpose of criminal investigation.*” This order was modified on 15 October 2015 to add 4 government schemes, MNREGA, all pension schemes, EPF and Jan Dhan Yojana, to allow usage of Aadhaar card for the purpose of verification. It has been reported that on a request of the Attorney General Mr. Mukul Rohatgi to add opening of bank accounts to the list of services which could use it for the purpose of verification, the Hon’ble bench refused to add the same to the list. See, Joydeep Ghosh, It’s time to get an Aadhaar card, *The Business Standard*, Oct 18, 2015, at http://www.business-standard.com/article/pf/it-s-time-to-get-an-aadhaar-card-115101800779_1.html

⁶<https://rbi.org.in/Scripts/NotificationUser.aspx?Id=10225&Mode=0>

⁷ http://www.sebi.gov.in/cms/sebi_data/attachdocs/1453470677181.pdf

distinctly separate from the application form. It should be indicated clearly to the customer that providing such information is optional.⁸

Inability to use KYC information for commercial purposes might limit the revenue generating potential for payments bank, and requirement of additional procedures for obtaining other information could increase cost of operations for payments banks, and inconvenience for customers.

In addition, payments banks are expected to rely on technology and mobile network for verifying customer details and acquiring customers. Some of the selected applicants are established players in mobile network market. Consequently, possibility of differential treatment of competitors for customer data verification might be possible.

Question for stakeholders: What is the strategy for customer acquisition? What customer identification procedures are they planning to adopt? Will the information collected be used for any other purpose? Is it possible to differentiate between non-group and group customers for data verification purposes?

2. In the case of walk-in customers, the payments banks are required to follow extant KYC guidelines issued by the RBI.

According to RBI Master Circular on KYC/ AML etc, in case of transactions carried out by a non-account based customer, that is a walk-in customer, where the amount of transaction is equal to or exceeds Rs. 50,000/-, whether conducted as a single transaction or several transactions that appear to be connected, the customer's identity and address should be verified. In addition, with respect to accounts of non-face-to-face customers, the circular provides, “*With the introduction of phone and electronic banking, increasingly accounts are being opened by banks for customers without the need for the customer to visit the bank branch. In the case of non-face-to-face customers, apart from applying the usual customer identification procedures, there must be specific and adequate procedures to mitigate the higher risk involved. Certification of all the documents presented should be insisted upon and, if necessary, additional documents may be called for. In such cases, banks may also require the first payment to be effected through the customer's account with another bank which, in turn, adheres to similar KYC standards. In the case of cross-border customers, there is the additional difficulty of matching the customer with the documentation and the bank may have to rely on third party certification/introduction. In such cases, it must be ensured that the third party is a regulated and supervised entity and has adequate KYC systems in place.*”⁹

Most customers in case of payments banks are expected to be non-face to face. Consequently, payments banks might be required to put in place additional customer identification procedures, which could increase the cost, time and skill requirements for customer acquisition.

⁸ RBI Master Circular on KYC/AML, 01 July 2015, at https://rbi.org.in/Scripts/BS_ViewMasCirculardetails.aspx?id=9848

⁹ RBI Master Circular on KYC/AML, 01 July 2015, at https://rbi.org.in/Scripts/BS_ViewMasCirculardetails.aspx?id=9848

Question for stakeholders: Are additional customer identification measures being planned for walk-in and non face to face customers?

B. OPERATIONAL ISSUES

1. Payments bank will initially be restricted to holding a maximum balance of Rs. 100,000 per individual customer. However, payments bank can accept a large pool of money to be remitted to a number of accounts provided at the end of the day the balance does not exceed Rs. 100,000.

Payments banks might need to devise mechanisms to prevent deposit of more than Rs. 1 lakh in customers' account, or facilitate mechanisms to ensure that customer is aware of such increase, and is in position to withdraw excess amount before end of the day. For instance, on the day of receipt of salary, if a salary is more than 1 lakh, while it will be allowed to be deposited, the excess amount will have to be withdrawn during the day. So payments banks will have to devise a mechanism to generate an alert within the system and a SMS to the account holder, as soon as the balance exceeds 1 lakh to request the account holder to withdraw excess amount before end of day, else such excess will be transferred to a separate account and kept in trust for the customer. If the customer does not withdraw the excess amount, the payment bank might have to park it in another account. It is not clear if payments bank will have to provide interest on such other account.

Payments banks are expected to facilitate i) incoming payments from non-payment bank sources, ii) outgoing payments to non-payment banks, iii) payments within a payment bank (amongst different account), and iv) payments between different payment banks. The level of control in these payments transactions is expected to differ, with payments banks having more control on outgoing transfer and transfer intra and inter-se payments banks. Payments banks might need to ensure that when destination of funds is a payment bank account, the amount transferred is not more than Rs. 1 lakh. If it allows to transfer funds exceeding Rs. 1 lakh to other payments bank, there might be a situation that other payment bank refuse to authorise transfer. If such situation arises, it is not clear which bank will be liable for payment of interest on amount exceeding 1 lakh.

In addition, the RBI clarifications mention that the individual customer limit will apply to PPIs outstanding balances as well. Consequently, the payments banks which operate PPIs will have to comply with these restrictions. As a result, the PPIs operated by entities other than payments banks will have to comply with different regulations with respect to customer limit, when compared with payments banks operated PPIs. This could result in differential treatment of similarly placed entities.

Question for stakeholders: How do payments banks plan to comply with the individual customer limit?

2. Payments banks cannot issue credit cards

Currently, PPIs provide cash backs. Cash backs are simply refunds of a particular proportion of amount actually paid. The payment bank clarifications provide that payment for third party

products/services on a post-paid basis will be treated as credit and not allowed. RBI might effectively construe cash backs as offering of credit for customer retention.

Payment banks might also be planning to provide cash backs for attracting customers. A payment bank might come up with a scheme which allows customer to pay up to 90 percent of bill amount and rest will be paid by the payment bank, or payment of utility bill after the due date without any late fee. It is not clear if these cash backs or similar facilities would be allowed.

Questions for stakeholders: Is there clarity on what constitutes credit/ credit card in case of payments banks? What kind of facilities are payments banks planning to offer its customers?

3. Payments banks can allow payments and remittance services through various channels including branches, Automated Teller Machines (ATMs), Business Correspondents (BCs) and mobile banking.

The key for payments banks to keep the costs low would be low investments in channels of service delivery i.e. branches, ATMS and BCs, and banking on the available interoperability. Success of interoperability would depend on charges levied, procedure for fixing accountability, and disclosure requirements. Currently, there are charges to use other bank ATM after more than five transactions. The clarifications provide that norms for free initial ATM transactions will apply to payments banks as well.

Questions for stakeholders: What is the strategy for facilitating services through different channels, i.e. managing interoperability and levying charges thereof?

4. The payments bank will participate in the payment and settlement system and will have access to the inter-bank uncollateralised call money market and the collateralized repo and CBLO market for purposes of temporary liquidity management.

CBLO market includes intra bank borrowing and lending. Consequently, payments bank might be allowed to undertake short term lending to other banks for the purpose of temporary liquidity management. The clarifications provide that payments banks will be allowed to enter into repurchase agreements on their government securities holdings. This is despite payments bank not being allowed to undertake lending to other customers.

Questions for stakeholders: Will payments banks allowed to undertake inter-bank lending temporary liquidity management?

5. Payments bank will be required to have at least 25 per cent of physical access points including BCs in rural centres (population up to 9,999 as per the latest census). Further, a controlling office for a cluster of access points should also be established for control over various outlets and customer grievance redressal.

According to RBI clarifications, controlling offices should be manned by employees of the payments bank. Business correspondents are agents and therefore BC outlets cannot be

designated as controlling offices. Consequently, corporate BCs cannot act as controlling office. This might increase cost of operations.

Also, there is no requirement to have controlling office in rural centres. While customer access points will be there in rural areas, as control over a cluster of physical access points could happen through online channel, thus it might be possible that COs are not in rural areas but only in urban settings. This will have problems with respect to customer grievance redressal.

Questions for stakeholders: What strategy payments banks are adopting to establish controlling office? How will the controlling office redress grievance of customers?

6. The payments banks are required to have a high powered Customer Grievances Cell to handle customer complaints. The payments banks will come under the purview of RBI's Banking Ombudsman Scheme, 2006.

Under the Banking Ombudsman Scheme, banks are required to display salient features of scheme for common knowledge of public in all offices and branches of bank. It is not clear if this would be applicable to physical access points as well, as customers would mostly come to these, in case of payments banks.¹⁰

The banks are required to appoint nodal officers at their regional/ zonal offices, responsible for representing the bank and furnishing information to the Banking Ombudsman in respect of complaints filed against the bank. It is not clear if BCs could be authorised to conduct this task.

Questions for stakeholders: What is strategy to comply with Banking Ombudsman Scheme?

7. Deployment of funds by payments banks is required to happen in following manner:

- 1. Amounts maintained as CRR with RBI on its outside demand and time liabilities**
- 2. Invest 75 percent of demand deposit balances in short term G-sec/ T-bills, which are eligible for SLR**
- 3. Invest 25 percent of demand deposit balances in current and time/ fixed deposits with other SCBs**

Balances outstanding under PPIs issued should be flexibly invested/ deployed to between SLR eligible Government securities/Treasury Bills and bank deposits (both demand and time) in such a manner that it is able to comply with the requirements of CRR and SLR on its "overall outside demand and time liabilities" including its deposit balances and outstanding balances in PPIs issued.

According to the RBI guidelines, the CRR requirement is applicable on outside demand and time liabilities. Commercial banks are required to maintain CRR on total DTL adjusted for certain exemptions. This could result in differential treatment. Further, it is not clear if CRR required to

¹⁰BO Scheme available at <http://www.axisbank.com/download/revised-bankingombudsmanscheme.pdf>

be maintained on outside demand and time liabilities of payments bank business only or any other business (including PPI) which payments banks might be conducting.

Also, it might not be clear if payments banks are required to comply with SLR requirements on overall outside demand and time liabilities. While it has to deposit 75% of demand deposit balances in SLR eligible securities, these securities might not be included in the calculation of outside demand and time liabilities. If SLR is required to be maintained on outside demand and time liabilities, then outstanding balances in PPI accounts will have to be invested accordingly. This might create differential treatment between non-payments bank operated PPI and those operated by payments banks.

Questions for stakeholders: Is there clarity in SLR requirement? What strategy will be adopted to comply with requirement of investment in proportion of overall outside demand and time liabilities?

8. Arrangements between payments banks and merchants

In order to cover costs of digital payments, Katakam (2016)¹¹ suggests four pricing models for covering such costs. These are: i) cost to be borne by customers; ii) cost to be borne by merchants; iii) cost to be borne by suppliers (of merchants); and iv) cost to be borne by mobile money service providers/ payments banks

The perceived cost of cash and cash handling (storage, transportation, security) and thus benefit of switching to digital payments is different for consumers, merchants, suppliers and payments banks. The cost and benefit increases in this given order.

For instance, customers perceive cash to be free, and any additional payment for making the transaction digitally would deter them from its use. Thus, Katakam suggests mobile money service providers to bear the cost of mobile payments. He further adds that interest earned on working capital loans to merchants, and incentives to merchants (like a certain free transactions per month) could be sustainable way to recover cost and move towards mobile payments, in long run.

However, there are regulations with respect to loans which Indian banks are eligible to provide, and conduct related party transactions. Also, additional incentives to merchants to motivate payments via bank account of a particular payments bank (to the exclusion of other) could result in competition concerns.¹² In addition, promoter/ promoter group entities of several Payments Banks could be having merchant operations. Consequently, it is not clear if such entities would be willing to enter into business arrangements with competitors of payments banks' promoted by them.

¹¹ Arunjay Katakam, *Merchant Payments: Choosing the Right Pricing Model*, GSMA, 14 January 2016, at <http://www.gsma.com/mobilefordevelopment/merchant-payments-choosing-the-right-pricing-model>

¹² It could be noted that exclusive business arrangements, restricting merchants' ability to enter into similar arrangements with other payments banks, are not *per se* impermissible under Section 3(4) of the Competition Act, 2002. The 'rule of reason' approach is followed while scrutinizing such vertical agreements. Also, it is not clear if adequate understanding and processes/ structures are in place to ensure interoperability between merchants and payments banks.

Questions to stakeholders: What strategy is being thought of by payments banks to incentive merchants and customers to use digital mode of payments?

9. Data privacy and sharing

As payments banks are expected to provide remittance services to consumers, they will have access to expenditure data of its consumers which could be valuable to entities operating in other sectors/ promoters/ promoter group entities of payments banks (such as banks and insurance firms– to ascertain creditworthiness, FMCG companies – to ascertain demand for products and services etc). However, limited guidance from RBI is available in this regard.

In order to monetize available useful information, payments banks might share it with expert data mining/ analysis entities and relevant sector operators/ promoters/ promoter group. While RBI clarifications require building of suitable firewalls and maintaining confidentiality, no detailed guidelines seem to be present on the issue of data privacy and data sharing between payments banks and other related or unrelated entities. Data privacy and protection is also important from the point of view of consumer protection and gaining customer trust since they have been entrusted with significant information by the consumers.

In addition, the RBI guidelines require payments banks to be ring-fenced from promoters and operate at arm's length. Consequently, they might not be able to share customer data with promoters. The situation gets complicated when a promoter acts as a BC of payments banks, as maintenance of data exclusivity could be difficult.

Questions to stakeholders: What systems are being put in place to ensure data privacy and confidentiality while putting available data to commercial use?

10. Transfer of data across geographies

Data protection is one of the critical concerns in digital payments ecosystem. While customer consent is one of its strong pillars, another important consideration is transfer of data amongst different jurisdictions within and between organisation/groups.

GSMA notes that a key challenge is that India currently lacks a unified legal and regulatory approach to data protection and privacy and instead imposes privacy principles and practices through no less than 50 laws for different verticals such as finance, health, e-governance, identity and telecommunications. It notes that regulations requiring localization of privacy (i.e. location of equipment within India etc) impose additional costs on operators.¹³ For instance, it has been reported¹⁴ that Paytm is hosting data centres in Mumbai and Delhi to ensure financial data remains within the country. Consequently, the country might need balanced data protection law. Despite prohibition of travelling of data, concerns regarding sharing of confidential consumer information might still arise. The news report¹⁵ further suggests that Paytm is planning to use

¹³ Pat Walshe, *The localization of privacy-observations from India*, GSMA, 24 November 2015, at <http://www.gsma.com/personaldata/the-localization-of-privacy-observations-from-india>

¹⁴ Shrutika Verma, *Paytm all set to go global through Aliyun*, Livemint, 26 January 2016, at <http://www.livemint.com/Companies/ccO6un5sRCUSRY4mgu34oL/Paytm-all-set-to-go-global-through-Aliyun.html>

¹⁵ Shrutika Verma, *Paytm all set to go global through Aliyun*, Livemint, 26 January 2016, at <http://www.livemint.com/Companies/ccO6un5sRCUSRY4mgu34oL/Paytm-all-set-to-go-global-through-Aliyun.html>

Aliyun's platform for data analytics, insights in customer trends across borders and offering merchant data base across borders.

Questions to stakeholders: What processes are being put in place for transfer of data within and across borders, between related as well as unrelated parties?

11. Handling of government subsidy transfer schemes

News reports¹⁶ suggest that the Indiapost Payment Bank is expected to handle government direct benefit transfers. This is expected to have multiple effects. Firstly, it is not clear how would the accounts opened under PMJDY will remain operational. Secondly, preferential treatment of Indiapost payments banks over other payments banks, could distort competition and result in uneven playing field amongst competitors in payments banks market. Also, a select set of consumers will be forced to open account with Indiapost Payments banks, whether willingly or otherwise.

Questions to stakeholders: What is strategy to counter policy induced distortions to competition in payments banks ecosystem?

12. Additional services by payments banks

Makhijani (2016) notes that, "*Payments banks will go beyond providing only financial services - the "extras" will count. They will drive continuous engagement with customers. This could take the form of reminders about customers' credit cards or cloud storage of clients' receipts. Innovation will be crucial to hook and retain customers. Payments banks will not just offer customer delight but pleasantly surprise them. The new norm will involve knowing a customer's expectations through online activities like buying patterns, etc. Such insights would help payments banks to customise offerings and effectively target customer communication.*"¹⁷

While payments banks have been allowed to undertake non risky activities without any financial commitments, it remains to be seen what kind of additional activities will be allowed by the RBI. Also, strategy for data mining and sharing will have to be reviewed to identify possibility of non-compliance with regulations. It is expected that payments banks will leverage on the experience/expertise of their promoter group to provide such additional services. It remains to be seen if any compliance related concerns emanate out of these arrangements.

Questions to stakeholders: What additional services are payments banks expected to offer? How do payments banks plan to comply with data protection and confidentiality related requirements while providing such additional services?

13. Preventing failure of information technology processes

News reports suggest that recently, international banks have been struggling with failures in IT systems, ranging from manual errors in transaction processes to full-scale computing meltdowns,

¹⁶ *Post Bank Likely to Handle DBT Schemes*, Times of India, 10 January 2016, at <http://www.gsma.com/personaldata/the-localization-of-privacy-observations-from-india>

¹⁷ Naresh Makhijani, *Enter the challengers*, Business Today, 2016, at <http://www.businesstoday.in/magazine/features/banking-industry-may-overhaul-due-to-payments-banks/story/228495.html>

in total affecting millions of customers by denying them access to basic services including sending and receiving payments, and logging in to their accounts to check on their finances.¹⁸

While RBI requires payments banks to have adequate processes in place to manage operational risk, owing to the limited margins available, payments banks might not have adequate motivation to invest in cutting edge technologies. As a result, such failures cannot be ruled out in payments banks ecosystem.

Errors might not happen only at the end of service providers, but consumers may also send payments in error, or to wrong accounts. Jurisdictions like UK are changing their regulations to help consumers in such cases,¹⁹ and Indian regulators might need to follow course.

Questions to stakeholders: What systems are being put in place to prevent erroneous transactions and refund aggrieved consumers?

14. Insolvency of payments banks and agents

GSMA identifies three key risks to consumer's interests in digital payments ecosystem. These include: i) insufficient funds set aside in safe, liquid investments to meet customer demand for cash; ii) insufficient assets to repay customers in event of issuer (trustee/fiduciary's) insolvency; and iii) insufficient assets to repay customers in the event of bank's insolvency.²⁰

Regulations on payments banks aim to address these risks by ensuring that payments banks have sufficient capital, directing investments in safe and liquid assets and insuring depositors funds. However, it is not clear if depositors will get preference in the event of insolvency of banks. Regulations do not require explicit ring fencing of depositors' funds in case of insolvency. While the regulations encourage agent interoperability, there is limited indication about agent insolvency, lack or loss of funds at agents points.

Questions to stakeholders: Is there clarity on safeguarding of customer deposit on insolvency of payments banks and agents?

C. ADDITIONAL APPROVAL AND COMPLIANCE REQUIREMENTS

1. Payments banks can undertake other non-risk sharing simple financial services activities, not requiring any commitment of their own funds, such as distribution of mutual fund units, insurance products, pension products, etc. with the prior approval of the RBI and after complying with the requirements of the sectoral regulator for such products.

In order to undertake distribution of insurance products, payments banks will have to obtain certificate of registration under IRDAI (Registration of Corporate Agents) Regulations, 2015. A no objection certificate from RBI would be required along with application made to IRDA for

¹⁸ Tim Wallace, *Enough is enough: Banks told to stop payments systems crashing*, 24 January 2016, at <http://www.telegraph.co.uk/finance/newsbysector/epic/barc/12118306/Enough-is-enough-Banks-told-to-stop-payments-systems-crashing.html>

¹⁹ *Rules changed for people who make electronic payment mistakes*, ITV Report, 26 January 2016, at <http://www.itv.com/news/2016-01-26/rules-changed-for-people-who-make-electronic-payment-mistakes/>

²⁰ GSMA, *Safeguarding mobile money: How providers and regulators can ensure that the funds are protected*, January 2016

registration. Conditions are imposed on number of insurers (three) in different segments that agents can enter into arrangements with. However, agency application can be made for any one of the categories. Registration under additional category can be made after one year. Considerations for applications include necessary infrastructure, such as adequate office space, equipment, trained manpower, minimum training and examination passing by principal officer, etc. A corporate agent is required to take adequate steps for redress of grievance within 14 days of receipt of complaint. It has to maintain adequate records and separate books of accounts for insurance related business. The payment of remuneration to the agent is governed by regulations notified in this behalf by IRDA. There are also requirements to manage conflict of interest by ensuring disclosure to customers. The arrangements for distribution of products are required to be disclosed to IRDA. IRDA has also issued draft regulations on remuneration to insurance agents, and is in the process of finalising the same.²¹ Consequently, it appears it is quite cumbersome for any entity to enter into insurance distribution business, and specifically for payments banks, it could require investment in skills and capital.

It seems that no separate guidelines have been issued as yet on distribution of mutual funds. However, SEBI (Mutual Fund) Regulations provide that an asset management company shall not utilise the services of the sponsor or any of its associates, employees or their relatives, for the purpose of any securities transaction and **distribution** and sale of securities. However, an asset management company may utilise such services if disclosure to that effect is made to the unitholders and the brokerage or commission paid is also disclosed in the half-yearly annual accounts of the mutual fund. Consequently, if a payments bank intends to distribute mutual fund units of its related party, additional disclosures about commercial arrangements would be required.

The PFRDA has issued circular regarding incentives to banks for mobilization and registration of subscriber under the Atal Pension Yojana.²² However, no specific guidelines on distribution of pension products appear to have been issued. Also, according to RBI clarifications, payments banks can undertake other non-risk government services like AADHAR enrolment. It needs to be clarified what other services are payments banks eligible to provide.

Also, the RBI clarifications on the guidelines provide that the payments bank can charge for other distributional activities like insurance, pension funds etc. It will be governed by guidelines issued by other sectoral regulators like Insurance Regulatory Development Authority of India, Pension Funds Regulatory Development Authority respectively. Detailed guidelines have been provided by other regulators which have to be followed by them in paying the commission to their BCs or agents. For eg: IRDAI recently passed the IRDAI (Registration of Corporate Agents) Regulation 2015, which has amended the previous regulation which governed the appointment and other aspects, including payment of commission to the corporate agents. Consequently, payments banks will need to comply with multiple compliance requirements.

²¹https://www.irdai.gov.in/ADMINCMS/cms/frmGeneral_Layout.aspx?page=PageNo2728&flag=1

²²<http://www.pfrda.org.in/WriteReadData/Links/Incentive%20Structure%20for%20APY5c598c21-5021-481a-8866-16213d2d1343.pdf>

Questions to stakeholders: Multiple approval requirements and preconditions might need to be complied with payments banks to offer additional services? Are payments banks looking forward to distribute insurance, mutual fund and pension fund products?

2. The payments banks are allowed to undertake utility bill payments etc. on behalf of its customers and general public.

The RBI has clarified that payments banks can apply for membership of any centralised/decentralised payment systems, including Bharat Bill Payment System (BBPS), after receiving the licence for commencement of business under Banking Regulation Act, 1949.²³ Consequently, payments banks require another approval to get membership of payments systems.

Questions to stakeholders: Are payments banks interested to become member of centralised/ decentralised payments system and will be willing to make application for the same?

3. Payment banks will be subject to relevant provisions under the Foreign Exchange Management Act (FEMA)

Section 3 of FEMA regulates dealing in foreign exchange. Only authorized persons can deal with foreign exchange. The clarification on payments bank provides that cross border transactions would involve both inward and outward remittances depending on the type of Authorised Person licenses issued by RBI. Consequently, it appears that payments banks will have to apply separately for being licensed as authorized person (both for inward and outward remittance) to handle foreign exchange. The central government has the power to impose reasonable restrictions on current account transactions in public interest.

However, at present, current account transactions are unregulated, and India is one of the largest recipients of inward remittances. Still, separate RBI approval would be required to enable payment banks handle such transactions. These could be perceived as high entry barriers.

Chapter III of FEMA provides for registration as authorized dealer and RBI has the power to issue directions to authorized persons, inspect APs, impose penalties, conduct search and seizure. The government has the power to give directions and make rules. The RBI issues AP (DIR) Circulars from time to time which PB-AP will need to comply with.

Questions to stakeholders: While payments banks be interested to obtain authorised person license under FEMA and comply with relevant requirements for facilitating cross border payments?

D. BUSINESS CORRESPONDENT RELATED ISSUES

1. In case of payments banks, cash-out is permitted at Point-of-Sale terminal locations as per extant instructions issued under the PSS Act.

²³https://rbi.org.in/scripts/BS_PressReleaseDisplay.aspx?prid=35792

As per the RBI Master Circular on Issuance and Operation of PPIs in India²⁴, In the case of open system prepaid payment instruments issued by banks in India, cash withdrawal at POS is permitted up to a limit of Rs.1000/- per day subject to the same conditions as applicable to debit cards (for cash withdrawal at POS). It is not clear if open system prepaid instruments and payments bank accounts will be treated separately for the purposes of cash out at POS terminals.

Also, the RBI Master Circular on Mobile Banking transactions in India²⁵ permits banks to provide fund transfer services which facilitate transfer of funds from the accounts of their customers for delivery in cash to the recipients. The disbursement of funds to recipients of such services can be facilitated at ATMs or through any agent(s) appointed by the bank as business correspondents. The recipient can be a non account holder also. Such fund transfer service can be provided by banks subject to the following conditions:-

1. In case of cash out, the maximum value of such transfers shall be Rs 10,000/- per transaction. Banks may place suitable cap on the velocity of such transactions, subject to a maximum value of Rs 25,000/- per month, per beneficiary
2. The disbursement of funds at the agent/ATM shall be permitted only after identification of the recipient. Banks may carry out proper due diligence of the persons before appointing them as authorized agents for such services. Banks shall be responsible as principals for all the acts of omission or commission of their agents.

Consequently currently in case of withdrawal at POS, the limit is different, and withdrawal at ATM/ agent, the limit is higher. In case of payments bank, POS personnel could be merchants as well as agents. It could be useful to clarify the withdrawal limit in such scenario.

Questions for stakeholders: Is there clarity on guidelines applicable to withdrawal of money at POS from payments banks accounts? What will be limit when POS merchants are agents/ BCs as well?

2. A payments bank may choose to become a BC of another bank, subject to the RBI guidelines on BCs.

It appears that payments banks can do their own payments banking business or become BC of other bank. It is not clear if both functions i.e., operating as payments banks and operating as BCs of other banks can be undertaken simultaneously.

Also, RBI Master circular on Branch Licensing²⁶ provides that every BC should be attached to and under the oversight of a base branch. Also, there are stricter guidelines for engaging non deposit taking NBFCs as BCs. It is not clear if payments banks would be required to follow these guidelines for acting as BCs, or there would an entirely new set of regulations. In addition, there are conditions on interoperability of BCs at the point of customer interface (such as existing of core banking solution etc).

²⁴ https://rbi.org.in/Scripts/BS_ViewMasCirculardetails.aspx?id=9872

²⁵ https://rbi.org.in/Scripts/BS_ViewMasCirculardetails.aspx?id=9869

²⁶ https://rbi.org.in/Scripts/BS_ViewMasCirculardetails.aspx?id=9817

The scope of activities of BC in normal course of banking business includes processing of loan applications, disbursement of small value credit, collection of small value deposit, receipt and delivery of small value remittances/ other payments services. While payments banks cannot provide credit on their own account, it seems they will be permitted to provide credit up to a particular threshold if they are acting as BCs of commercial banks. However, clarity might be required in this regard.

The guidelines further provide that the banks are required to ensure the preservation and protection of the security and confidentiality of customer information in the custody or possession of BC. This could entail putting up structures and processes in case of payments banks, and could be difficult when payments banks are acting as BCs for promoter banks or vice versa.

The circular also provides that *“banks may pay reasonable commission/fee to the BC, the rate and quantum of which may be reviewed periodically. The agreement with the BC should specifically prohibit them from charging any fee to the customers directly for services rendered by them on behalf of the bank. The commission structure or incentive mechanism should be devised in a manner that mere increase in the number of clients served or the transaction volume does not drive the commission. The remuneration should combine fixed and variable parts dependent, inter-alia, on some indication or measure of customer satisfaction. Some part of the variable remuneration could be deferred or clawed back in case of deficiency of service. Banks (and not BCs) are permitted to collect reasonable service charges from the customers in a transparent manner.”*

Consequently, when payments bank enter into arrangements with other banks to act as BCs, their functions and remuneration structure will have to be guided by the above guidelines. BCs are closest to customers, whether they are payments bank acting as BCs, or BCs of payments bank, but these entities still will not be able to charge directly from consumer. This could be even more difficult when payments bank appoint merchants as BCs. Further, this would entail record keeping of customers transactions etc, depending of methodology of charging customers (it can be on transaction basis) for separately charging customers, which could be cumbersome.

In addition, the guidelines provide that transactions should normally be put through ICT devices (handheld device/mobile phone) that are seamlessly integrated to the Core Banking Solution (CBS) of the bank. The transactions should be accounted for on a real time basis and the customers should receive immediate verification of their transactions through visuals (screen based) or other means (debit or credit slip). This would require significant investment in technology by payments banks and internet connectivity.

Also, all off-line transactions are required to be accounted for and reflected in the books of the bank by the end of the day. This could create problems for complying with the end of day balance limit of Rs. 1 lakh. There are other customer protection requirements like introduction of retail agent physically by banks officials, which may increase burden on payments banks.

Questions to stakeholders: The compliance requirements for BCs are significant. What strategy payments banks aim to adopt while acting as BCs of other banks, and while appointing BCs?

3. Establishment of physical access points

Under existing guidelines on BCs, interoperability at the retail outlets or sub-agents of BCs (i.e. at the point of customer interface) has been allowed, subject to compliance with certain conditions.²⁷ However, on a preliminary review, it is not clear if a sub-agents of BC appointed by another bank, available to customers of payments banks in interoperable manner, would qualify for being designated as 'physical access point'. The alternate scenario of payments banks establishing exclusive physical access points could impose additional costs.

Questions for stakeholders: What is the strategy adopted by payments banks to establish physical access points?

4. Promoter group entities as BCs

The RBI clarifications allow payments banks to appoint promoter group company (promoter or other subsidiaries) as corporate BCs, on an arm's length basis and subject to RBI guidelines on BCs. However, there might be operational and accountability concerns in such a structure. For instance, the guidelines on appointment of non-bank financial companies as corporate BCs require avoidance of comingling of bank's and BC funds and contractual arrangements to take care of conflicts of interests.²⁸ It not clear how such arrangements would work if the bank and BC belong to the same group. In addition, promoters of payments banks are required to hold at least 40 percent of paid-up equity capital for first five years. Since this is the minimum and no maximum limit has been prescribed, it will put them in effective control of the bank.

Since the promoters are also eligible to act as BCs/ agents of payments banks, the payments banks would be effectively accountable for actions of such promoter-agents. This could create ambiguity in establishing ultimate accountability. At the same time, the imposition of liability, in case of default, will pose difficulty due to the aforementioned complex relationship between the promoters and the bank.

Questions to stakeholders: In case promoter group entities are planned to be appointed as BCs, what accountability and data protection mechanisms are put in place?

5. Training and capacity building costs for agents

A survey has estimated that only 59% of the banking agents in India have received training, which is the lowest out of all other countries that were a part of the survey.²⁹ To ensure success of payments banks, the scenario has to be rectified. Therefore, the payments banks may have to make significant investments to develop and train customer facing agents, to handle technology and acquire customers.³⁰

Questions to stakeholders: What training and capacity building initiatives are planned for agents?

²⁷ These include: availability of requisite technology, on-line conduct of transaction and authentication on core banking solution platform, and compliance with standard operating procedures as set out by Indian Banks' Association.

²⁸ RBI circular dated 24 June 2014 on financial inclusion by extension of banking services.

²⁹ The countries included Bangladesh, Kenya, Pakistan, Uganda and Tanzania. The report is available at: <http://bit.ly/1jUKGm5>

³⁰ Daniel Radcliffe, *Game changers*, Indian Express, 01 September 2015

E. STRUCTURAL ISSUES

1. The payments bank cannot set up subsidiaries to undertake non-banking financial services activities.

All non banking financial services undertaken by payments banks, like insurance and mutual fund distribution, etc and collection of data for financial purposes will have to be done by payments banks as one entity. However, different non-banking financial services are required to be separately managed at arm length. This could increase complexity in business of payments banks.

In addition, the other financial and non-financial services activities of the promoters, if any, should be kept distinctly ring-fenced and not comingled with the banking and financial services business of the payments bank.

While payments banks cannot have separate entities to manage its different business, it will have to put adequate firewalls to prevent comingling of services, not only within the organisation, but also outside the organisation to ring fence the activities from promoters.

Questions to stakeholders: What structures and processes are being thought of to avoid comingling of services in payments banks ecosystem?

2. Shareholding of promoters in payments banks

According to the guidelines, promoters can have shareholding as per their arrangements. However, banks as promoters of payments banks cannot have more than 30 percent shareholding. Further, no one can have more than 10 percent voting rights. This could complicate the ownership structure of payments banks.

Questions for stakeholders: What ownership and voting structure for payments banks is being planned, especially when banks are part of promoters of payments banks?

F. COMPETITION WITH OTHER BANKS

1. Payments banks are not allowed to accept NRI deposits

At present, the Scheduled Commercial Banks provide services like non-resident external savings account and non-resident ordinary savings account. The former is used to park rupee deposits earned outside India and the latter is to deposit rupee income earned in India. However, it seems that payments banks are not allowed to offer similar facilities to NRIs. The clarifications also suggest that the payments bank cannot accept any NRI deposits. In-bound remittance into accounts maintained by residents with payments bank will be considered as deposits.

There appears limited rationale for this restriction as remittances from outside India to the country are of high volume and value. This also could result in uneven playing field between commercial banks and payments banks with respect to the NRI market.

Questions to stakeholders: What is the rationale behind prohibiting payments banks from accepting NRI deposits? How does payments banks aim to address this limitation?

2. Collaboration required for growth of digital payments

Hasnain (2016)³¹ recommends collaboration between different stakeholder groups to facilitate uptake of e-commerce and digital payments in Pakistan, and elsewhere in the region. GSMA (2015) also notes that government and regulators need to work towards clear national strategy; supportive legal environment; promote awareness; and improve affordability, to facilitate digital payments. It highlights that cross-industry partnerships are fundamental to developing joint solutions, unified services, and awareness campaigns. It further points out that there are two main areas of collaboration: the first is enabling the retail front-end to accept digital payments; an example is mobile point of sale (mPOS). The second opportunity lies in establishing a back-end system that settles payments from all branchless banking providers and their merchants so that a truly interoperable payment system is developed.³²

GSMA has also developed a code of conduct for mobile money providers which covers issues like: soundness of services, security of mobile network and channel, and fair treatment to customers.³³ Adoption of such code of conduct developed collectively by service providers is expected to increase collaboration to improve quality of service provided by payments banks. However, in situations when such collaborations results in fixing cap or base of price or division of market, they might distort competition.

Questions to stakeholders: What collaborations are envisaged for enhancing collaboration between payments banks ecosystem?

3. Transfer of funds between commercial banks and payments banks

Recently, there were news reports that commercial banks refused transfer of funds to PPIs.³⁴ This situation might happen in the case of payments bank as well, and commercial banks might refuse transfer of funds to unrelated payments banks. Also, payments banks might refuse transfer/ acceptance of funds, on the argument of complying with regulatory restrictions (end of day balance of Rs 1,00,000).

Questions to stakeholders: What strategies are planned to prevent adoption of anti-competitive practices in the market?

G. COMPETITION WITH PRE-PAID PAYMENT INSTRUMENTS ISSUERS

1. Payments banks are allowed to issue PPIs as per instructions issued from time to time under the PSS Act. However, the outstanding balances in PPIs should be flexibly invested/ deployed between SLR eligible Government securities/Treasury Bills and bank deposits (both demand and time) in such a manner that it is able to comply with

³¹ Sophia Hasnain, *Recommendations for supporting the growth and development of digital commerce in Pakistan*, GSMA, 18 December 2015, at <http://www.gsma.com/mobilefordevelopment/recommendations-for-supporting-the-growth-and-development-of-digital-commerce-in-pakistan>

³² GSMA, *Building digital societies in Asia: Making commerce smarter*, 2015

³³ GSMA, *Code of conduct for mobile money providers, Version 2*, October 2015

³⁴ Are e-wallets beginning to worry banks, 15 November 2015, Livemint, <http://www.livemint.com/Industry/36uXHTf6QUJdr2dEpen8yJ/Are-ewallets-beginning-to-worry-banks.html>

the requirements of CRR and SLR on its "overall outside demand and time liabilities" including its deposit balances and outstanding balances in PPIs issued.

Payments banks will be allowed to issue different kinds of PPIs, under PSS Act, and as per relevant RBI circulars. Such RBI circulars also provide for manner of deployment of outstanding balances in PPI accounts. Currently, PPIs might not be subject to SLR/ CRR requirements, even when commercial banks issue PPIs, but when payments banks will issue PPIs, in addition to their existing business of payments facilitation, deployment of outstanding balances in PPIs could be kept in mind to ensure compliance with CRR and SLR requirements. This might tantamount to differential treatment.

In addition, while payments banks can be provided a license to operate PPI, according to clarifications, payments banks and PPIs cannot co-exist in the same promoter group. This means while payments bank can operate an additional PPI, no other entity within the promoter group will be allowed to operate PPI.

Questions to stakeholders: What is the rationale for differential treatment of non-payment bank operated PPI and one operated by payments bank?

2. Market disruption by apps developers/ Over the top (OTT) service providers

While payments banks are expected to facilitate payments from customers to merchants and between banks and PPIs, mobile apps are expected to make such transactions seamless, fast and secure. As noted by the Novais (2016),³⁵ in Latin American region, apps have been developed to facilitate barcode generation for merchant payments and P2P transfers, barcode scanning for bill payments, and expansion of mobile money accounts to all customers, regardless of their mobile network operators.

Such apps will have access to customer information and arrangements between such app developers, payments banks and payments banks promoters could be subject to regulatory scrutiny from the perspective of consumer and data protection. Differential regulation of apps developers/ OTT service providers and payments banks could also create uneven playing field and benefit the former.

Also, players like NPCI are developing cutting edge technologies like Unified Payment Interface, which could ease process of making payments across banks,³⁶ and could reduce the demand for payments banks.

Questions to stakeholders: What steps are being planned by payments banks to manage competition from app developers and similar players?

³⁵ Tiago Novais, *Mobile Money smartphone apps: Trends from Latin America*, GSMA, 11 January 2016, at <http://www.gsma.com/mobilefordevelopment/mobile-money-smartphone-apps-trends-from-latin-america>

³⁶ Anup Roy, *NPCI launches Unified Payments Interface*, 19 February 2015, at <http://www.livemint.com/Politics/zqtaHv3lJk615BOUUXPntj/NPCI-launches-Unified-Payments-Interface.html>

H. MULTIPLE REGULATION

1. Payment banks will be subject to relevant prudential guidelines/ instructions issued by the RBI

The RBI clarifications provide that all other guidelines, such as, providing basic saving bank deposit account, free ATM transactions, risk based supervision etc, as applicable to commercial banks will also apply to payments bank. Also, payments banks are expected to do the normal banking business as stated in Section 5 of the BR Act 1949 (except lending), which includes acceptance of deposits repayable on demand or otherwise and withdrawal by cheque, draft, order or otherwise, and hence will be subject to guidelines pertaining to these functions. Such overarching application of RBI guidelines might result in treating dissimilarly placed entities (commercial bases vis a vis payments banks), similarly.

Questions to stakeholders: Is there clarity on which additional guidelines issued by RBI, will be applicable to payments banks?

2. Payment banks will be subject to guidelines/ instructions issued by other regulators from time to time

Other regulators which might issue instruments to payments bank include Telecom Regulatory Authority of India, Ministry of Finance, Department of Consumer Affairs, State Governments, which might result in multiple, and perhaps, overlapping regulatory scenario.

In addition, the Income Tax Department recently issued a notification that in case of uploading more than Rs. 50,000 in a year in PPIs, PAN of such PPIs is required.³⁷ It is not clear if this rule will apply to payments bank as well, as commercial banks are governed by different guidelines.

Questions to stakeholders: Is there clarity on which guidelines issued by other regulators, will be applicable to payments banks?

3. Payments banks need to be registered as public limited companies.

At present, banks need to be registered as companies under the Companies Act, and not necessarily public companies. However, all banking companies operating at present are public companies. The compliance requirements for public companies are higher than for private companies.

Questions to stakeholders: Is there clarity on what additional compliance will be applicable to payments banks, owing to them necessarily being public companies?

4. Payment banks will be subject to relevant provisions under the Banking Regulation (BR) Act.

³⁷Prepaid instrument providers approach tax authority on new PAN rule, 14 January 2016, see <http://www.livemint.com/Politics/rYOlALpzoeDcCpbE4T3YFO/Prepaid-instrument-providers-approach-tax-authority-on-new-P.html>

The BR Act is applicable on all banking companies. It has provisions on eligibility of directors, regulation on opening of branches, places of business, submission of accounts and balance sheet, power of RBI to give directions, remove management and other persons from office, impose penalties. It also provides certain powers to central government. It appears that such powers are to protect interest of depositors, thus should be prima facie applicable in case of payments bank also.

However, there is a specific Part V on application of the act to co-operative banks, earlier set of differential banks. It provides for certain modifications subject to which BR Act applies to co-operative banks. Payments banks are also a set of differential banks, and they do not undertake a significant banking function, i.e. lending, however no separate part exists for them.

Questions to stakeholders: Is there clarity on which provisions under BR Act, will be applicable to payments banks?

5. Payment banks will be subject to relevant provisions under the Reserve Bank of India (RBI) Act

The RBI Act provides for setting up of RBI and its powers. Chapter III A authorizes RBI to collect credit related information from banks. Further, chapter IIIB is applicable to deposit taking NBFCs. Chapter V of the RBI Act empowers RBI to impose penalty on banks.

While payments bank will not be providing credit, but can make investments in short-term government securities and deposit funds with other banks, to a limited extent. It might be useful to clarify the extent to which RBI Act will be applicable to payments banks.

Questions to stakeholders: Is there clarity on which provisions of RBI Act, will be applicable to payments banks?

6. Payment banks will be subject to relevant provisions under the Payments Systems Settlement Act (PSS Act)

Like existing banks, payments banks will act as system participants for the purpose of PSS Act. The PSS Act gives RBI access to any information with the system participants, power to enter and inspect their premises, etc.

While some of the existing PPI issuers might already be linked to payment system, it is expected to be a novel experience for new entities. The RBI issues directions to payments systems and system participants from time to time.

Questions to stakeholders: Is there clarity on which provisions under PSS Act, will be applicable to payments banks?

7. Payment banks will be subject to relevant provisions under the Deposit Insurance and Credit Guarantee Corporation Act (DICGC Act)

Deposit with banks up to Rs. 1,00,000 guaranteed by DIGCG on payment of premium, under the DICGC Act. Accordingly, payments banks will have to pay required premium.

Questions to stakeholders: Is there clarity on which provisions under DICGC Act, will be applicable to payments banks?
