

UNDERSTANDING AND ADDRESSING COMPETITION & REGULATORY BARRIERS TO GROWTH OF PAYMENTS BANKS IN INDIA



CUTS  [®]
International

Contents

Abbreviations	3
Executive Summary	4
Payments Banks: A Quick Recap.....	4
Summary of Our Findings.....	5
<i>Customer acquisition</i>	5
<i>Service delivery</i>	7
<i>Last mile customer interaction</i>	9
Prioritisation of solutions.....	11
1. Background and Context.....	14
Project Methodology	14
Arrangement of Chapters	15
2. Differentiated Banking in India.....	16
State of Financial Inclusion.....	16
Differentiated Banking	16
Payments Banks	17
Concurrent Developments.....	18
Need for Optimal Competition and Regulation.....	19
3. Identification and Prioritisation of Issues.....	21
Background.....	21
Focus Areas	21
4. Customer Acquisition.....	23
Background.....	23
1. Requirement to submit physical documents	23
<i>Allow submission of documents through digital modes</i>	25
2. Lack of clarity on customer sharing and migration.....	26
<i>Allow customer sharing and migration on additional KYC</i>	27
3. Electronic KYC envisages customer consent through biometric means only	30
<i>Allow use of OTP for providing express consent</i>	31
4. E-KYC limited to Aadhar.....	32
<i>Facilitate source based KYCs other OVDs</i>	33
5. Unavailability of registration documents with small merchants	35
<i>Allow small merchant acquisition based on individual KYC</i>	36
<i>Exempt individual merchants from end of day customer balance limit</i>	36
<i>Monitoring of exclusive tie-up arrangements</i>	37
6. Submission of unreliable additional information to CKYCR	37
<i>Restrict the information to proof of identity and address</i>	39
7. Submission of scanned copies of documents and photos to CKYCR.....	39
<i>Allow submission of information in the format convenient to payments banks</i>	40
8. Requirement to quote PAN/ provide Form 60 for opening of bank account	41
<i>Discontinue the requirement to quote PAN/ provide Form 60</i>	41

5. Service Delivery	42
Background.....	42
1. Inability to offer recurring and time deposit services.....	42
<i>Allow offering of recurring and time deposit services.....</i>	43
2. Offering cross border remittance services independently.....	43
<i>Allow payments banks to obtain AD-CAT I license</i>	44
3. Issuance of passbooks, chequebooks and handling of cheques.....	44
<i>Clarify that issuance of chequebooks and passbooks is not mandatory.....</i>	45
4. Issuance of Debit Cards and Charges on Card-based Transactions.....	45
<i>Clarify that issuance of ATM/debit cards is not mandatory.....</i>	46
<i>Monitoring of exclusive arrangements</i>	47
<i>Facilitate expansion of digital payments acceptance infrastructure</i>	47
<i>Ensure transparency in charges.....</i>	48
5. Dealing with deposits in excess of Rs. 100,000	49
<i>Allow opening of pool account with payments banks.....</i>	50
6. Partnering for offering credit related origination services	50
<i>Clarify conditions for acting as BCs of universal banks.....</i>	50
<i>Allow payments banks to act as agents of non-bank finance companies</i>	51
7. Inability to offer differential interest rates for attracting micro-deposits	52
<i>Allow payments banks to incentivise micro-deposits.....</i>	52
8. Requirement of multiple approvals for cross-selling	52
<i>Moves towards regulatory cooperation for approval and reporting</i>	53
9. Data analysis and sharing.....	53
<i>Allow payments banks to undertake data analysis related functions.....</i>	54
<i>Monitor exclusive information sharing tie-ups.....</i>	54
10. Utility bill payments services	54
<i>Facilitate clarity in the role of NPCI</i>	55
6. Customer Interaction	56
Background.....	56
1. Roles of Physical Access Points and Controlling Offices.....	56
<i>Allow innovation in roles of physical access points and controlling offices</i>	57
2. Interoperability among BCs at the point of customer interface	58
<i>Allow interoperability among BCs at the point of customer interface</i>	59
3. Mechanisms of grievance redress	60
<i>Allow innovation and use of technology for grievance redress</i>	61
7. Conclusion and the Way Forward.....	63
Background.....	63
Reforming the Approach to Regulation	65
Universe of actors and actions.....	67
Prioritisation of solutions.....	67
Low Hanging Fruits.....	70

Abbreviations

AML:	Anti-Money Laundering
API:	Application Programming Interface
ATMs:	Automatic Teller Machines
BC:	Business Correspondent
BBPOU:	Bharat Bill Payment Operating Unit
BBPS:	Bharat Bill Payment System
CBS:	Core Banking Solution
CERSAI:	Central Registry of Securitisation Asset Reconstruction and Security Interest of India
CFT:	Combating Financing of Terrorism
CIA:	Competition Impact Assessment
CKYCR:	Central KYC Registry
DoT:	Department of Telecommunications
HDBS:	Horizontally Differentiated Banking System
IBA:	Indian Banks Association
KYC:	Know Your Customer
MDR:	Merchant Discount Rate
NBFCs:	Non-Banking Financial Companies
ND:	Non-Deposit
NPCI:	National Payments Corporation of India
NREGA:	National Rural Employment Guarantee Act
NRI:	Non Resident Indian
OTP:	One Time Password
OVDs:	Officially Valid Documents
PAN:	Permanent Account Number
PFRDA:	Pension Fund Regulatory and Development Authority
PMJDY:	Pradhan Mantri Jan Dhan Yojana
PoA:	Proof of Address
PoI:	Proof of Identity
PoS:	Point of Sale
PPI:	Prepaid Payment Instrument
QR:	Quick Response
RBI:	Reserve Bank of India
RIA:	Regulatory Impact Assessment
SEBI:	Securities and Exchange Board of India
SMS:	Short Message Service
UIDAI:	Unique Identification Authority of India
UPI:	Unified Payment Interface
USSD:	Unstructured Supplementary Service Data
VDBS:	Vertically Differentiated Banking System

Executive Summary

Payments banks: A Quick Recap

Payments banks are latest set of differential banks envisaged in India. They can provide deposits and payments services, but cannot offer credit to customers at their own account. They are expected to leverage technology and reach out to the last mile consumers for facilitating digital payments at affordable cost.

In November 2014, the guidelines for licencing and operations of payments banks were issued by the banking regulator, the Reserve Bank of India (RBI).¹ This was followed by a set of clarifications issued in January 2015.² By February 2015, RBI received 41 applications for payments banks licences.³ Of these, in-principle licences were granted to 11 applicants in August 2015.⁴

By May 2016, three applicants surrendered their in-principle licences. Viability concerns owing to high cost and low profit margins were some of the concerns cited for their withdrawal.⁵ Most of the remaining licencees are currently operating as prepaid payment instruments (PPIs) and mobile network operators (MNOs). It has been reported that some of the licencees have received the final approval for launch and will soon start their operations, soon.⁶

With support from Bill & Melinda Gates Foundation, India, Consumer Unity & Trust Society (www.cuts-international.org) undertook the evidence-based research study to review the regulatory framework for payments banks in India. The objective of this study is to identify competition and regulatory bottlenecks that could act as stumbling blocks to the growth of payments banks. CUTS further suggested recommendations for course correction in order to avoid such bottlenecks. In order to undertake research and gather evidence, the organisation used elements from tools, such as regulatory impact assessment (RIA) and competition impact assessment (CIA)⁷, which we have internally customised for emerging economies.

¹RBI Guidelines for Licensing of Payments Banks dated November 27, 2014, available at: https://rbi.org.in/scripts/bs_viewcontent.aspx?Id=2900

²RBI Clarifications on Payments Banks dated January 01, 2015, available at: <https://rbidocs.rbi.org.in/rdocs/Content/PDFs/PAYBANF010115.pdf>

³List of applicants for payments banks licences dated February 04, 2015, available at: www.rbi.org.in/Scripts/BS_PressReleaseDisplay.aspx?prid=33164

⁴Supra Note 7

⁵*Change in payments bank's business platform, the reason to drop plan: Vellayan*, The Hindu Business Line, June 07, 2016

⁶*Bharti Airtel becomes first entity to get payments bank license from RBI*, April 12, 2016, DNA, available at www.dnaindia.com/money/report-bharti-to-start-india-first-payments-bank-2201007

⁷The Competition Impact Assessment toolkit prepared by CUTS is available at: www.cuts-ccier.org/ComPEG/pdf/CUTS_Competition_Impact_Assessment_Toolkit-A_Framework_to_Assess_Competition_Distortions_Induced_by_Government_Policies_in_the_Developing_World.pdf and www.cuts-ccier.org/crew/pdf/FCR_Practitioners_Guidebook.pdf

Summary of our findings

We find that the key focus areas for payments banks in near future would be:

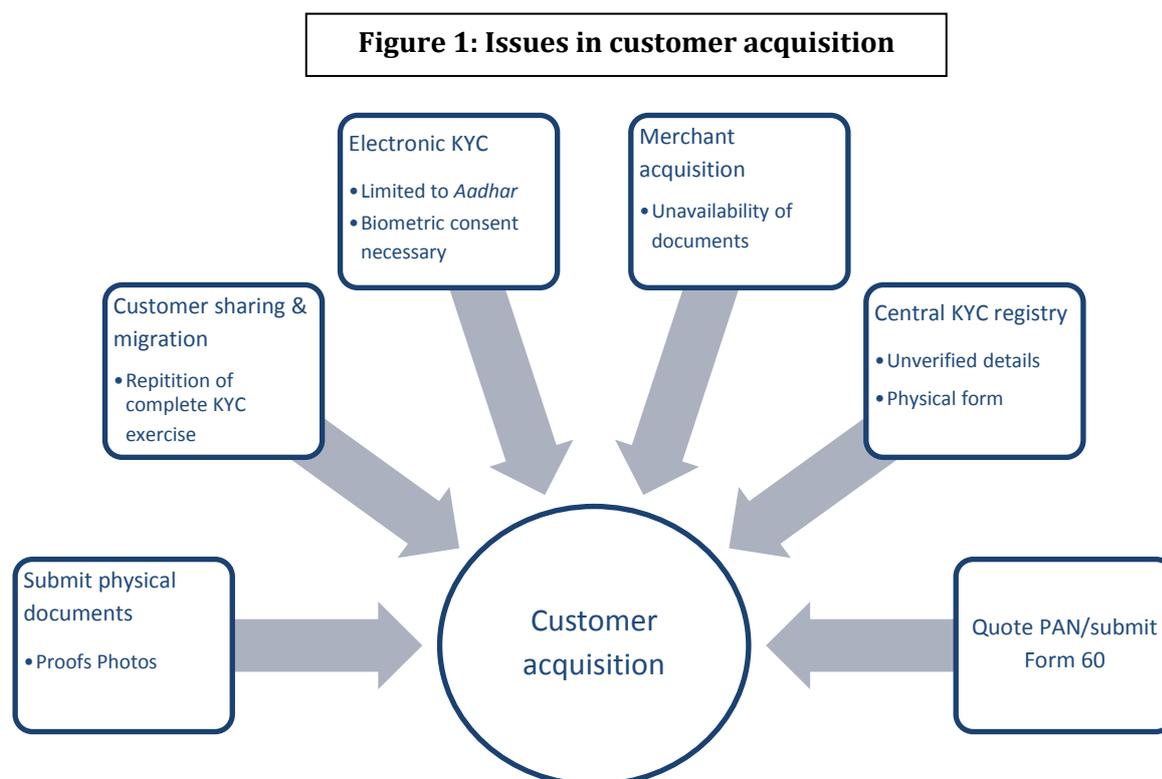
- customer acquisition;
- service delivery; and
- last-mile customer interaction.

In each of these areas, existence of sub-optimal regulations was found. Imposition of avoidable costs on stakeholders, differential treatment of payments banks without adequate justification and lack of regulatory clarity are some of the characteristics of sub-optimal regulations. CUTS also highlighted areas wherein market players could potentially abuse their dominant position and engage into anticompetitive practices, in order to stifle away competition. Consumers will have to eventually bear the burden of sub-optimal regulations in the payments banks sector.

Customer acquisition

Customer verification through Know Your Customer (KYC) process is pre-requisite for customer acquisition. It seems that regulations emphasise on use of paper for customer verification with digital tools being under-utilised.

Figure 1 represents issues identified in relation to customer acquisition, which could result in causing inconvenience to stakeholders and increasing costs, and act as barrier to growth of payments banks.



These eight issues have been further explained in Table 1, wherein CUTS has also proposed solutions to address such issues.

Table 1: Customer Acquisition		
S. no	Issues	Proposed solutions
1.	Requirement to submit physical proof of identity (PoI), proof of address (PoA) and photographs	<ul style="list-style-type: none"> • Allow submission of documents digitally
2.	Lack of clarity on possibility of customer sharing ⁸ and migration ⁹ without repetition of complete KYC exercise	<ul style="list-style-type: none"> • Harmonisation of KYC standards across sectors¹⁰ • In the interim, allow customer sharing/migration on additional KYC • Ensure express and informed customer consent for customer sharing/migration • Clarify that accountability remains with payments banks in customer sharing/migration • Prevent abuse of dominant position in case of refusal to share customer information
3.	Electronic KYC is limited to <i>Aadhar</i>	<ul style="list-style-type: none"> • Facilitate limited access to application programming interface of relevant government departments to financial service providers to facilitate source based KYCs • Use regulatory sandbox to test viability and industry preparedness¹¹
4.	Customer consent can be provided in electronic KYC only biometrically	<ul style="list-style-type: none"> • Allow consent through one time password route
5.	Informal small and medium enterprises do not possess enterprise related documents to enable opening of current accounts	<ul style="list-style-type: none"> • Allow opening of current account based on individual KYC and available enterprise related documents • Waive end of day customer limit for current accounts of individual merchants • Monitor account activity and red-flag suspicious transactions
6.	The Central KYC Registry (CKYCR) requires submission of unverifiable customer information	<ul style="list-style-type: none"> • The CKYCR should only collect such information relevant for verifying identity and address of the customer
7.	The CKYCR requires uploading of scanned copies of documents, signature and photo	<ul style="list-style-type: none"> • The CKYCR should allow submission of documents in the format preferred by payments banks

⁸ A situation wherein a customer is shared by two or more service providers, such as telecom operator and payments bank

⁹ A situation wherein a customer ceases to remain customer of a service provider (like PPI) and becomes customers of a new service provider (like payments bank)

¹⁰ Already, The Department of Telecommunications has recently allowed use of electronic KYC for sim card issuance. See, Department of Telecommunications, *Guidelines for e-KYC for mobile network operators*, 16 August 2016, available at: www.dot.gov.in/sites/default/files/u75/2016_08_16%20eKYC-AS-II.pdf

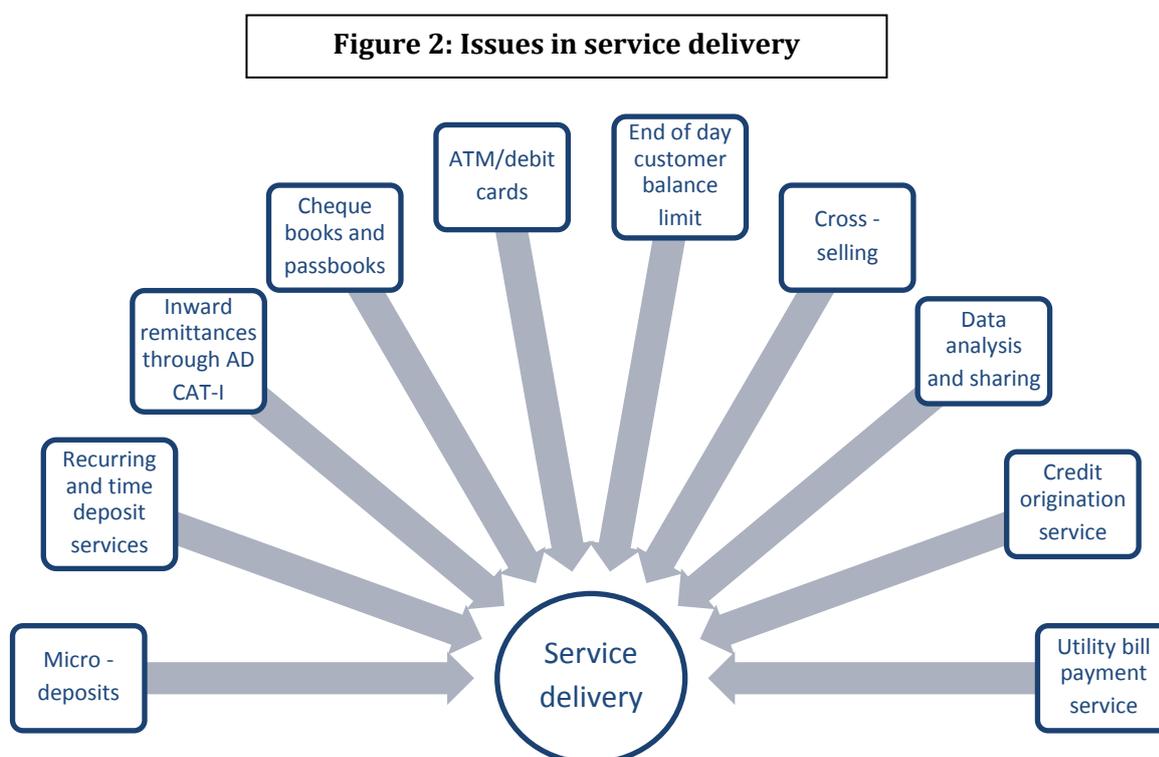
¹¹ RBI hints at regulatory sandbox at India Fintech Day, June 08, 2016, Finance Magnates, available at www.financemagnates.com/fintech/news/rbi-hints-of-regulatory-sandbox-at-india-fintech-day-as-kpmg-report-emerges/

Table 1: Customer Acquisition		
S. no	Issues	Proposed solutions
8.	Requirement to quote permanent account number (PAN)/fill prescribed form (Form 60) ¹² in its absence, for opening of bank account	<ul style="list-style-type: none"> KYC verification should be adequate for opening of bank accounts

Service delivery

Payments banks can offer specific services to its customers, in the manner prescribed by regulations. Lack of regulatory clarity on conditions subject to which some services can be provided by payments banks, also points to sub-optimal regulations.

Figure 2 represents the issues identified in relation to service delivery, which could increase stakeholder inconvenience and cost, and act as barrier to growth of payments banks.



These 10 issues have been further explained in Table 2, wherein solutions to address such issues are also provided.

¹² In the absence of PAN, the customers are required to fill Form-60. See, Ministry of Finance, *Income Tax (22nd Amendment) Rules, 2015*, 30 December 2015

Table 2: Service Delivery		
S. no	Issues	Proposed solutions
1.	Restriction on offering differential interest rates for deposits below INR 100,000	<ul style="list-style-type: none"> Allow payments banks to offer attractive interest rates and other incentives to attract micro-deposits
2.	Restrictions on offering recurring and time deposit services	<ul style="list-style-type: none"> Allow payments banks to offer recurring and time deposit services, subject to adequate disclosures
3.	Requirement to route cross border remittance transactions through universal banks/ authorised dealers category – I (AD CAT-I)	<ul style="list-style-type: none"> Allow payments banks to obtain AD CAT-I license, subject to compliance with relevant conditions In the interim, prevent appreciable adverse impact on competition, if any, due to exclusive agreements between payments banks and universal banks/ AD CAT – I licencees
4.	Not clear if payments banks will be required to issue passbooks, cheque books and put in place cheque acceptance infrastructure	<ul style="list-style-type: none"> Clarify that payments banks will not be compulsorily required to issue passbooks, cheque books and should be able to incentivise innovative means of making digital payments and sharing account information using technology based solutions Prevent appreciable adverse effect on competition due to exclusive agreements for cheque clearance
5.	Not clear if payments banks will be mandatorily required to issue ATM/debit cards	<ul style="list-style-type: none"> Clarify that payments banks will not be compulsorily required to issue ATM cards/debit cards and should be able to incentivise innovative means of making digital payments¹³ Prevent appreciable adverse impact on competition due to exclusive agreements on card acceptance
6.	Lack of clarity on possible mechanisms to comply with end of day customer balance limit of Rs 100,000/US\$1,500, specifically on account refunds on failed transactions	<ul style="list-style-type: none"> Allow payments banks to maintain pool account wherein excess deposits on account of refunds, etc., could be made The deposits in such account could be capped to a specified percentage of total deposits in customer accounts Review the end of day customer limit periodically to ascertain its impact on stakeholders, through tools like RIA¹⁴

¹³ There are technologies available to facilitate cardless withdrawal from ATMs. Also, tools like Unified Payments Interface have been launched to enable digital cardless payments. Financial Express, *Unified Payments Interface goes live*, August 25 2016, available at: www.financialexpress.com/personal-finance/unified-payments-interface-goes-live-with-21-banks-5-things-to-know-how-it-works-for-customers/357673/

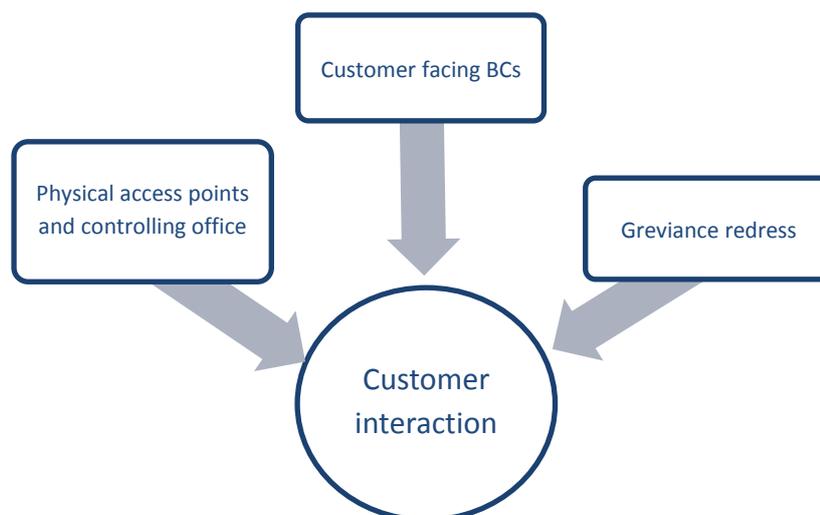
¹⁴ Draft RIA toolkit prepared by CUTS is available at: [www.cuts-ccier.org/BHC-RIA/pdf/Draft_RIA_Toolkit_\(for_public_comments\).pdf](http://www.cuts-ccier.org/BHC-RIA/pdf/Draft_RIA_Toolkit_(for_public_comments).pdf)

Table 2: Service Delivery		
S. no	Issues	Proposed solutions
7.	Requirement of multiple approvals and reporting for cross-selling of financial products/services	<ul style="list-style-type: none"> • Create a single window clearance and reporting mechanism to facilitate approvals and reporting for cross-selling • Prevent appreciable adverse effect on competition due to exclusive agreements on cross selling
8.	Lack of clarity on ability to undertake data mining	<ul style="list-style-type: none"> • Clarify that payments banks can undertake data mining internally, and share findings with external service providers, subject to express and informed customer consent
9.	Lack of clarity on conditions subject to which payments banks can enter into arrangements with banks/non-bank financial companies (NBFCs) to offer credit products and related origination services	<ul style="list-style-type: none"> • Clarify the conditions subject to which payments banks can act as business correspondents (BCs)/agents of universal banks • Allow payments banks to enter into collaboration/act as agents of NBFCs to offer credit products and related origination services • Prevent appreciable adverse effect on competition due to exclusive agreements for providing credit products and related origination services
10.	Lack of clarity on role of National Payments Corporation of India (NPCI) in utility bill payment infrastructure	<ul style="list-style-type: none"> • Ensure level playing field by NPCI of market players in utility bill payment market

Last mile customer interaction

Payments banks are required to set up physical access points and controlling offices, and can appoint BCs/agents to facilitate interaction with customers, including grievance redress. However, lack of regulatory clarity on scope of activities of such entities could increase inconvenience and cost of stakeholders.

Figure 3 represents issues identified with respect to customer interaction and grievance redress, which could increase stakeholder inconvenience and cost, and act as barrier to growth of payments banks.

Figure 3: Issues in customer interaction

These three issues have been further explained in Table 3, wherein solutions to address such issues are also provided.

Table 3: Customer interaction		
S. no	Issue	Proposed solution
1.	Lack of clarity if physical access points and controlling offices could perform additional functions	<ul style="list-style-type: none"> Allow use of physical access points and controlling offices for carrying out functions, in addition to those prescribed by regulations, subject to adequate disclosure and accountability
2.	Limitation on BCs to represent only one bank at point of customer interface	<ul style="list-style-type: none"> Allow BCs to represent multiple banks at point of customer interface, subject to compliance with adequate technology, disclosure and accountability standards Work towards operationalisation of white label BC regime In the interim, allow representation by existing BCs of at least one payments bank along with one universal bank Prevent appreciable adverse impact on competition due to exclusive agreements to share BCs
3.	Lack of clarity on modes of grievance redress which can be adopted	<ul style="list-style-type: none"> Allow payments banks to adopt innovation and digital modes of grievance redress, subject to adequate transparency, disclosure and accountability standards

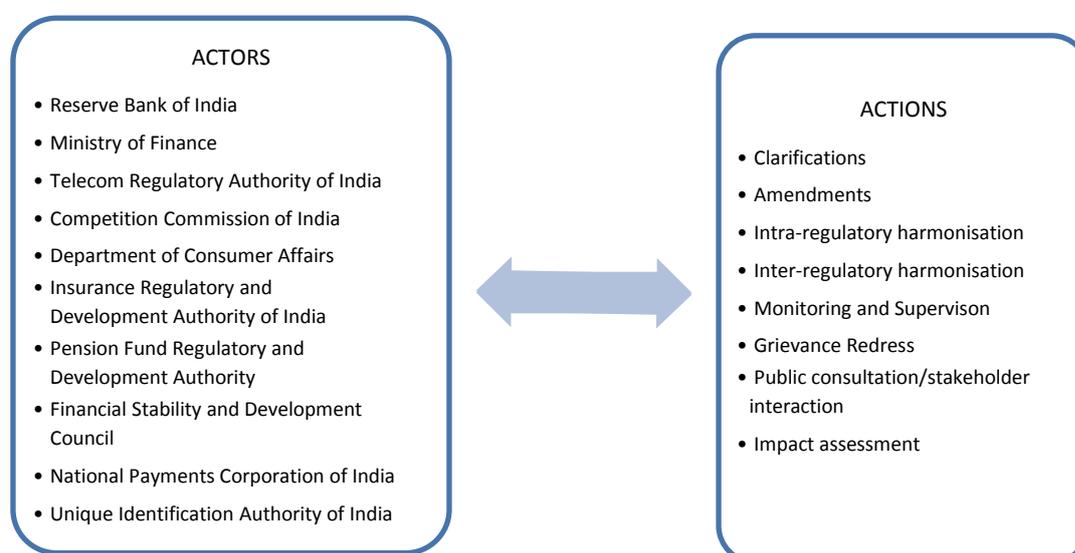
While some of the proposed solutions are essential, some are ‘good to have’ to reduce uncertainty in the sector.

It should be noted that in addition to regulatory changes and putting relevant infrastructure in place, public outreach, advocacy and capacity building initiatives will have to be undertaken, to ensure practice changes make payments banks model successful.

Prioritisation of solutions

CUTS envisage diverse regulatory actions from different regulatory agencies to put its proposals into practice, as indicated in Figure 4.

Figure 4: Actors and Actions involved in reforms



In addition to identifying actors and actions involved in reforming the regulatory and competition scenario for payments banks, CUTS has prioritised the proposed solutions based of urgency, broad infrastructure requirements and efforts required by stakeholders for adopting the change. The prioritisation is indicated in Figure 5.

Figure 5: Efforts required to implement solutions

- Allow Digital submission of documents
- Allow Customer sharing/migration with additional KYC
- Allow consent through OTP in e-KYC
- Allow opening of current accounts for small merchants based on individual KYC
- CKYCR to collect only relevant information and allow submission in convenient format
- Discontinue the requirement to quote PAN/submit Form 60

Low

- Allow interest differentiation
- Allow offering of time and recurring deposit services
- Allow obtaining AD - CAT I license
- Clarify that no requirement to offer physical passbooks/ cheque books
- Clarify the ability to internally undertake data analysis
- Clarify conditions to act as BCs of universal banks/NBFCs

Medium

- Harmonisation of KYC across sectors
- Adequate monitoring & red flagging of suspicious transactions
- Adequate monitoring to prevent anticompetitive conduct
- Allow maintaining a pool account for excess deposits
- Prevent anticompetitive conduct in utility bill payment market
- Clarify the independence in role of physical access points/controlling offices
- Allow representation of multiple BCs at point of customer interface

High

- Facilitate limited access to application programming interface between OVD issuing government departments and banks
- Periodic review of end of day customer limit and revision through tools, such as RIA
- Create single window clearance and reporting mechanism for cross-selling
- Improve coordination between different regulators to prevent issuing conflicting regulations and imposing avoidable costs

On the basis of such assessment and prioritisation, top 10 low hanging fruits for regulatory action have been identified, as listed in Table 4.

Table 4: Top 10 priorities for reform	
S. no	
1.	Allow OTP for providing express consent in e-KYC
2.	Allow small merchants to open current accounts on the basis of individual KYC and available additional documents, and exempt them for end of day customer balance limit
3.	Discontinue the requirement to quote PAN/filing Form 60 for opening of new bank account
4.	Limit the CKYCR form to information and address details of customers, and allow submission of details in format convenient to payments banks
5.	Allow payments banks to provide recurring and time deposit services
6.	Ensure payments banks get AD CAT-I licence for offering cross border remittance
7.	Clarity that payments banks can undertake data analysis and collaborate with banks/NBFCs for providing credit and relevant origination services
8.	Allow BCs to represent multiple banks at the point of customer interface
9.	Allow incentivisation of customers, including differentiated interest rates, for micro-deposits
10.	Allow customer sharing and migration subject to KYC check

1. Background and Context

Digital payments will be key enablers for extension of formal financial services to the hitherto excluded. Reliance on technology is expected to reduce costs of serving the poor and build transaction history to aid design of customised financial products and services for the poor.

The government has realised the potential of digital payments and thus, is working towards putting in place optimal policy and regulatory framework. This includes reducing the cost of digital payments,¹⁵ increasing competition by introducing specialised service providers,¹⁶ such as payments banks, harmonising norms for acquiring customers across sectors,¹⁷ promoting high-class technology for facilitating convenient, secured and swift digital payments at low cost.¹⁸

Despite best intentions and efforts, the regulatory framework can remain to be sub-optimal. This could mean imposition of avoidable costs on service providers, inefficient or ineffective protection of customers, differential treatment of similarly placed entities or similar treatment of differently placed entities. Such competition, regulatory and consumer protection infirmities could act as roadblocks to growth of digital payments. Thus, it is extremely essential to closely review the regulatory framework for digital payments.

With support from Bill & Melinda Gates Foundation, Consumer Unity & Trust Society implemented the research study to review the regulatory framework for payments banks in India with the purpose of identifying competition and regulatory bottlenecks that could act as stumbling blocks to their growth.

CUTS has further suggested recommendations for course correction in order to avoid such bottlenecks. In order to undertake research and gather evidence, CUTS has used relevant tools, such as RIA and CIA,¹⁹ which it has internally customised for emerging economies.

Project Methodology

A research-led evidence-based methodology was adopted to implement the research study. This involved undertaking in-depth secondary research and analysis, and fine-

¹⁵Ministry of Finance Office Memorandum, *Promotion of Payments through cards and digital means*, February 29, 2016, available at: http://finmin.nic.in/the_ministry/dept_eco_affairs/currency_coinage/Promo_PaymentsMeans_Card_Digital.pdf and *Government to bear transaction costs of payments received via cards*, Business Standard, August 17, 2016 available at: www.business-standard.com/article/economy-policy/govt-to-bear-transaction-cost-of-payments-received-via-cards-116081600555_1.html

¹⁶Supra Note 1. RBI has also designed operational framework for small finance banks and issued guidelines for on-tap licensing of universal banks.

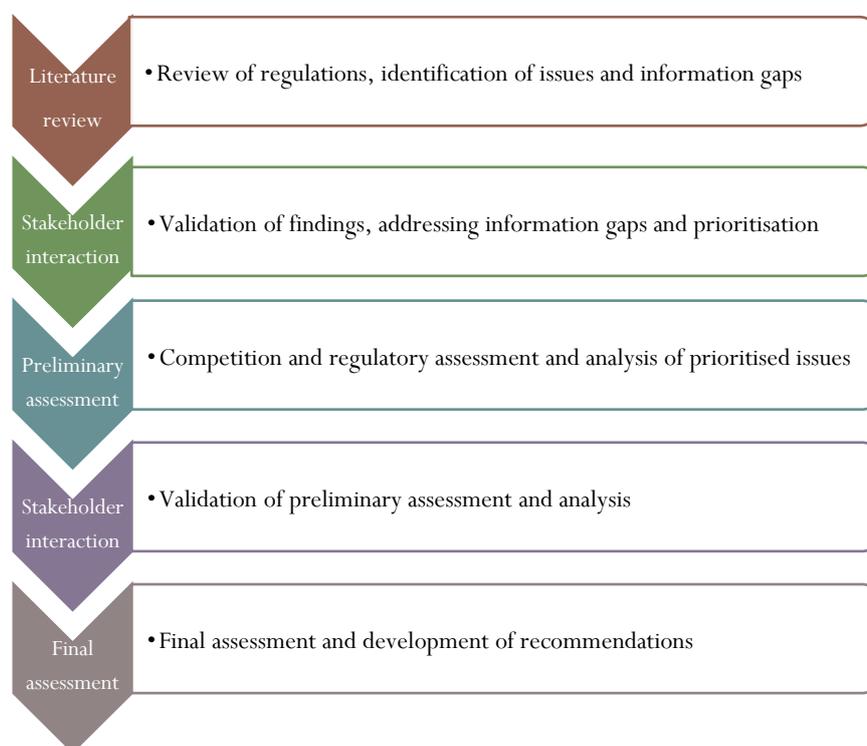
¹⁷Supra Note 10

¹⁸Supra Note 13

¹⁹Supra Note 7

tuning findings on the basis of periodic interaction with stakeholders, such as industry, regulators, policymakers, think tanks, academia, media and consumers. Refer to Figure 1.1 for diagrammatic representation of the project methodology.

Figure 1.1: Project Methodology



Arrangement of Chapters

Chapter 2 provides an overview of differential banking in India, with a focus on payments banks. It is followed by the chapter on identification and prioritisation of areas for competition and regulatory assessment. The chapter lists down different points in a lifecycle of payments banks wherein a competition and regulatory concern can arise, and prioritises some areas for further analysis. Chapters 4, 5 and 6 undertake in-depth competition and regulatory assessment of issues identified in areas selected for assessment. The assessment involves a brief description of the issue, potential adverse impact and possible solutions.

The last chapter presents a way ahead for deepening of research, and taking forward the recommendations under the project. It prioritises proposed recommendations on the basis of potential regulatory and infrastructure/compliance burden imposed on the stakeholders and highlights low hanging fruits for outreach and advocacy purposes.

2. Differentiated Banking in India

State of Financial Inclusion

Access to formal financial services has been traditionally recognised as a tool to uplift the poor out of poverty and facilitate access to finance at reasonable rates. However, it is being increasingly recognised as a public good, with higher efficiency benefits attached with greater participation in formal financial sector.²⁰ Financial inclusion helps in efficient allocation of finance, increases its availability and reduces average cost of supply and access, thus, ultimately benefitting the public.

Despite its benefits, India has not been able to make significant progress on financial inclusion. Till recently, close to 50 percent adults did not have access to a bank account.²¹ In order to address this challenge, the Government of India recently launched the *Pradhan Mantri Jan Dhan Yojana* (PMJDY), as a result of which more than 220 million bank accounts were opened and more than Rs. 400 billion were channelled in the formal financial sector. As a result, around 63 percent Indians have a bank account now.²² However, the potential of these accounts remains to be exploited.²³

India has experimented with several initiatives to promote financial inclusion in the past. These include regulatory mandates for priority sector lending, zero balance accounts, minimum branches in rural areas etc., through the universal banking structure. However, these initiatives provided limited attention to the risk involved and the need to achieve financial feasibility of service providers.²⁴

Differentiated Banking

Recognising the risks and costs involved in the universal banking structure to reach to the last mile, discussions were initiated on differentiated banking structures. Such structures were felt necessary to provide focussed and customised solutions to different

²⁰Botti and Bollino, *Financial exclusion and the cost of incomplete participation*, MPRA, December 2012. Available at https://mpr.ub.uni-muenchen.de/44065/1/MPRA_paper_44065.pdf

²¹ According to World Bank's Global Findex Report, as of 2014, merely 53 percent of individuals of 15+ years had a bank account. Only 14 and 6 percent in this group had access to formal savings and borrowings, respectively. For details, see:

<http://datatopics.worldbank.org/financialinclusion/country/india>

²²Intermedia Financial Inclusion Insights, 2016, available at: <http://finclusion.org/country/india.html>

²³Pawan Bakhshi and Anand Parameswaran, *Does financial inclusion really include*, The Hindu Business Line, May 31, 2016, note, "The PMJDY has seen more than 218 million new bank accounts opened and over 180 million debit cards activated as of May 2016, making it a massive exercise in financial inclusion. However, the potential of these accounts to drive regular and consistent banking habits, key to achieving universal financial inclusion, is yet to be exploited." Also, *Jan Dhan 1-rupee trick: Opposition wants answers and an inquiry*, Indian Express, September 14, 2016

²⁴ "There is a concern that the current approach which is exclusively reliant on full-service, national level, scheduled commercial banks using their own branches and a network of mostly informal agents...for several banks and several regions is building up an extremely high risk portfolio of assets, and a high cost infrastructure but is not doing much by way of building comprehensive access to finance for low-income households and small businesses...whenever financial inclusion goals are generally specified and strategies articulated, there is little acknowledgement of risk and cost-to-serve considerations."

yet specific needs of the unbanked, while shedding unnecessary functions, thereby cutting costs and developing niche services.

In 2007, this concept was first discussed, but it failed to take off. In 2013, recognising the need to reignite the debate on differentiated banking, the RBI released a discussion paper on banking structure in India.²⁵ In the same year, the Committee on Comprehensive Financial Services for Small Businesses and Low Income Households (the Nachiket Mor Committee) released its report with a comprehensive discussion on institutional designs of banks in India. It pointed out that universal banks have functional building blocks of payments, deposits and credit, which can be constructed in two broad designs. These are the Horizontally Differentiated Banking System (HDBS) and the Vertically Differentiated Banking System (VDBS).²⁶

In a HDBS design, the basic design element remains a full-service bank that combines all three building blocks of payments, deposits, and credit but is differentiated primarily on the dimension of size or geography or sectoral focus. In a VDBS design, the full-service bank is replaced by banks that specialise in one or more of the building blocks of payments, deposits, and credit. Across these designs, ten existing and potential banking designs were identified by the Nachiket Mor Committee. These are: National Bank with Branches, National Bank with Agents, Regional Bank, National Consumer Bank, National Wholesale Bank, National Infrastructure Bank, Payments Network Operator, Payments Banks, Wholesale Consumer Bank, and Wholesale Investment Bank.²⁷

Payments Banks

One of differentiated banking models suggested by the Nachiket Mor Committee was Payments Banks. They fall under the VDBS design, and are expected to provide deposits and payments services, but not credit.

The RBI decided to make a bold move by agreeing with this suggestion and designed a regulatory architecture in order to operationalise the payments banks. In November 2014, the guidelines for licencing and operations of payments banks were issued by the RBI.²⁹ This was followed by a set of clarifications issued in

Table 2.1: Payments Banks Licences²⁸

Aditya Birla Nuvo Limited
Airtel M Commerce Services Limited
Department of Posts
FINO PayTech Limited
National Securities Depository Limited
Reliance Industries Limited
Vijay Shekhar Sharma (Paytm)
Vodafone M-Pesa Limited
Cholamandalam Distribution Services Limited*
Dilip Shanghvi (Sun Pharmaceuticals)*
Tech Mahindra Limited*
* Have surrendered their licence

²⁵ The RBI Discussion Paper on Banking Structure in India is available at <https://rbi.org.in/scripts/PublicationReportDetails.aspx?UrlPage=&ID=713>

²⁶ The report of the Committee (Chair: Nachiket Mor) is available at: <https://rbiidocs.rbi.org.in/rdocs/PublicationReport/Pdfs/CFS070114RFL.pdf>

²⁷ *Ibid*

²⁸ List of in-principle licences for payments banks, available at www.rbi.org.in/Scripts/BS_PressReleaseDisplay.aspx?prid=34754

²⁹ RBI Guidelines for Licensing of Payments Banks dated November 27, 2014, available at: https://rbi.org.in/scripts/bs_viewcontent.aspx?Id=2900

January 2015 on the basis of queries received from the stakeholders.³⁰ By February 2015, RBI received 41 applications for payments banks licences.³¹ Of these, in-principle licences were granted to 11 applicants in August 2015 (see Table 2.1).³² By May 2016, three applicants out of 11 surrendered their in-principle licences and decided not to go ahead with the plans for offering payments banks services. Viability concerns, huge capital requirements, long gestation period, limited time period to evaluate the sector,³³ available ecosystem leverage, and market crowding were cited as concerns for such a step being taken by the three applicants.³⁴

Concurrent Developments

In addition to operationalising the idea of payments banks, the RBI granted licences to two private sector entities to launch universal banks,³⁵ designed regulatory architecture for small finance banks (another form of differentiated banks) and also provided in-principle approvals to 10 entities to launch small finance banks.³⁶ Further, RBI has recently issued guidelines for 'on-tap' licencing of universal banks in the private sector.³⁷

While regulators are experimenting with different models to expand the reach of formal financial sector, industry is doing its own bit. Non-traditional players, such as telecom service providers and prepaid payment instrument (PPI) issuers, mobile application developers have entered the market resulting in designing of new models of service delivery and adoption of innovation and technology.³⁸

The objective is to contain costs of service delivery, and thus, designing a viable business model for reaching to the last mile and ensuring superior customer experience. There is a huge push towards digitisation and making a quick transition from a data poor to data rich country, which could help in reaching out to hitherto excluded and also those sections of populations who use cash based financial services which leave no digital footprint/data exhaust. Use of data and offering of credit, insurance, pension and similar services on the basis of transaction history has the potential to change the economic growth model of the country.³⁹

³⁰Supra Note 2

³¹Supra Note 3

³²Supra Note 7

³³Supra Note 5

³⁴*Tech Mahindra becomes 3rd player to nix payment bank plans*, The Hindu Business Line, May 24, 2016

³⁵ Business Standard, *IDFC and Bandhan make the cut for banking licences*, April 03, 2014, available at: www.business-standard.com/article/specials/rbi-grants-bank-licence-to-idfc-bandhan-114040200963_1.html

³⁶ RBI Guidelines for Small Finance Banks is available at: https://rbi.org.in/scripts/BS_PressReleaseDisplay.aspx?prid=32614

³⁷ The Guidelines for 'on tap' licencing of universal banks in the private sector are available at www.rbi.org.in/Scripts/BS_PressReleaseDisplay.aspx?prid=37658

³⁸Claessens et al, *Financial Regulations for Improving Financial Inclusion: A CGD Task Force Report*, Centre for Global Development, 2016

³⁹The Hindu Business Line, *Digitisation will change the economic growth model: Nilekani*, July 29, 2016, available at:

www.thehindubusinessline.com/info-tech/digitisation-will-change-economic-growth-model-nilekani/article8918146.ece?homepage=true

Public sector is also not behind. The government has initiated world's largest national unique identity project, *Aadhar*. More than a billion individuals in India now possess an *Aadhar* card.⁴⁰ The NPCI has emerged as a leader in payments infrastructure solutions and developed several innovative products, such as Unified Payments Interface (UPI), which is expected to make payments instant, quick, and secure.⁴¹

Need for Optimal Competition and Regulation

Dr. Raghuram Rajan recently noted, "In the foreseeable future, we will bring formal financial services to every Indian who wants them. Financial inclusion will be an important element in ensuring access and equity – necessary building blocks for sustainable growth of our country."⁴²

All stakeholders in the financial sector, including regulators, public and private sector, appear to share the same vision. To enable transformation of such vision into reality, it will be necessary that interest of consumers, the stakeholder at the last mile, is considered pivot and none of the stakeholders are unfairly treated.

It appears that regulation in financial sector (and other sectors) has given limited consideration to such vision. At times, it has failed to take into account concerns of industry, differentially treated public sector from their private counterparts without reasonable rationale, did not adequately take into account implementation bottlenecks, and applied limited focus on consumer grievance redressal.⁴³ As a result, regulations have not been able to fully achieve the objectives, for which they were designed.

Payments banks model is a unique and foresighted experiment, and aims to address several earlier market failures. There is a need to ensure that it becomes successful for many more experiments by the regulator in the future in the larger public interest. Payments banks are truly first of their kind differentiated entity, which will compete and perhaps collaborate with universal banks, other differentiated banks, telecom service providers, and utilise innovative and state of art technologies to provide services to the poor. This would require an innovative and dynamic regulatory architecture along with complete transformation of regulatory mind-set in the financial sector.

Given that payments banks are differentiated banks, regulations would need to ensure that they are not unfairly treated at par with incumbent and new universal banks without sound rationale, and thus adversely affecting competition. Regulations will also need to ensure that payments banks do not use their differentiated position to the disadvantage of other entities and suppress competition. In doing so, regulations should not discourage the use of digital and cutting edge technologies.⁴⁴ Consumers' interest will need to be at the core of payments banks regulations.

⁴⁰ For details, see: <https://uidai.gov.in/>

⁴¹ For details, see: www.npci.org.in/UPI_Documents.aspx

⁴² Dr. Rajan's speech on the Changing Paradigm for Financial Inclusion, July 18, 2016 is available at: www.rbi.org.in/Scripts/BS_SpeechesView.aspx?Id=1010

⁴³ Report of Financial Sector Legislative Reforms Commission, 2013

⁴⁴ The Report of the Task Force of Centre of Global Development, 2016, notes, "*regulatory changes are often needed to enable the successful adoption and adaptation of innovations in digital finance, encourage their use, and increase competition among their providers, so that those new technologies can benefit the poor in particular*"

This cannot be achieved without ensuring optimal regulation and competition in the sector. As the regulator has already issued guidelines for operation of payments banks, it would be useful to review such guidelines from the perspective of competition and consumer protection. The objective should to identify and address any sub-optimal provisions in regulations and to prepare necessary ground for launch, operationalisation and sustainability of payments banks, and thus addressing any potential regulatory failure.

Consequently, CUTS International⁴⁵ implemented this research project with the primary objective to identify, understand and prioritise key competition and regulatory bottlenecks to growth of payments banks in India, and suggest possible solutions.

⁴⁵ For details, see: www.cuts-international.org

3. Identification and Prioritisation of Issues

Background

Regulation of any business starts even before its inception and typically continues even after its dissolution. Payments banks are no exception. The RBI issued guidelines for licencing and operations of payments banks. The guidelines prescribe, *inter alia*, entities eligible for licencing, conditions for licencing and operation, services that can be offered by payments banks, modes of service delivery, investments by payments banks, ownership and governance structure, foreign investments in payments banks etc.

Competition and regulation are two sides of a coin. Competition concerns in any sector do not arise when entities begin operating and competing with each other, but at a much earlier stage. Regulations impose eligibility criteria and hence promote and/or restrict competition between entities interested to operate in the sector. Regulations also set rules of the game and hence provide a framework within which the eligible entities are required to operate and compete, and facilitate exit of less competent market players.

As regulation and competition cover the entire life cycle of a business, so do concerns with respect to distortions of competition and inefficient regulations. Competition is not distorted only when an entity engages in an anticompetitive conduct, or abuses its dominant position, but also when similarly placed entities are dissimilarly treated by regulations and vice versa.

Likewise, sub-optimal regulation is not limited to a situation when an entity operates between regulatory cracks, or unfairly benefits from regulatory arbitrage at the expense of consumers, but also when regulation that is being proposed impose unreasonable costs on stakeholders in order to achieve the regulatory objective and when better alternatives exists.

Focus Areas

As indicated above, regulation and competition concerns can arise at any time during the life cycle of a business. Thus, it is extremely pertinent to identify, prioritise and address critical competition and regulatory concerns, to enable sustained growth of the market. Table 3.1 maps the lifecycle of a payments bank and highlights areas wherein regulation exists.

Table 3.1: Regulations Covering Life Cycle of Payments Banks				
Pre-launch	Customer acquisition	Ownership and Governance Structure	Service delivery	Last mile customer interaction
<ul style="list-style-type: none"> Eligible promoters and promoter 	<ul style="list-style-type: none"> Launch Customer sharing and 	<ul style="list-style-type: none"> Promoter contribution Foreign 	<ul style="list-style-type: none"> Permissible activities Prohibited 	<ul style="list-style-type: none"> Modes of outreach Customer

Table 3.1: Regulations Covering Life Cycle of Payments Banks				
Pre-launch	Customer acquisition	Ownership and Governance Structure	Service delivery	Last mile customer interaction
groups <ul style="list-style-type: none"> • Minimum capital • Minimum leverage ratio 	migration <ul style="list-style-type: none"> • Merchant acquisition • Modes of customer acquisition 	shareholding <ul style="list-style-type: none"> • Investment restrictions • Voting rights • Diversification of ownership • Board structure 	activities <ul style="list-style-type: none"> • Manner of service delivery • Investments and deployment of funds 	interface <ul style="list-style-type: none"> • Presence in rural areas • Grievance redress

The payments banks life cycle has already passed the pre-launch phase. 11 entities were originally granted in-principle licences of which three have already withdrawn their applications, as mentioned earlier. Of the eight entities remaining, some have already applied for final approval and are expected to launch and start their operations soon.

Also, regulations with respect to ownership and governance structure of payments banks are expected to be equally applicable to all payments banks, without discrimination. These regulations are likely to affect investors/promoters of payments banks more than the payments banks themselves.

The remaining areas of regulations, i.e. the launch and operations are areas wherein the payments banks will be impacted the most, and are expected to leverage their respective strengths and expertise to gain market share. Regulations and activities of payments banks in these areas are expected to directly impact the market and consumer, and thus, have the potential to determine the fate of payments banks model.

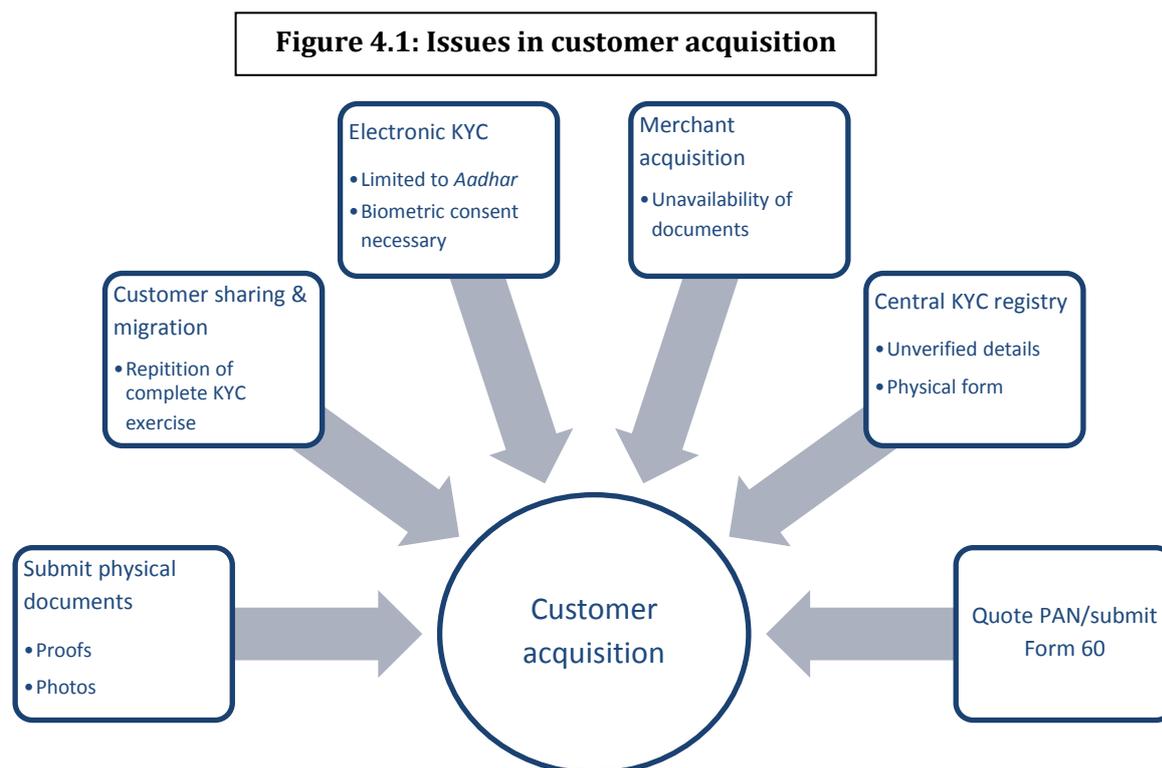
Absence of optimal regulation and competition in areas of customer acquisition, service delivery, and customer interaction could adversely impact the objective of payments banks of reaching to the unbanked and extending the formal financial services.

Consequently, on the basis of internal research, stakeholder interactions, expert committee, impact of different areas on competition and regulation in payments banks market, importance to consumers, and the need to ensure that payments banks model succeeds in its ultimate objective, it was decided to focus on the three areas: **customer acquisition, service delivery, and customer interaction** for the purpose of research as part of this study.

4. Customer Acquisition

Background

Customer acquisition is the process of opening of savings and current accounts by payments banks for individuals and other entities. Figure 1 represents issues identified in relation to customer acquisition, which could increase stakeholder inconvenience and cost, and act as barrier to growth of payments banks.



These issues have been further explained in sections below, wherein solutions to address such issues are also provided.

1. Requirement to submit physical documents

The RBI has prescribed detailed KYC/anti-money laundering (AML)/combating financing of terrorism (CFT) guidelines for customer acquisition. These requirements enable verifying customers' identity and address to ensure that the account will not be used for money laundering, terrorist financing and similar illegal activities.

Like other banks, payments banks are required to comply with these requirements. It seems that the regulations emphasise on use of paper for customer verification while digital tools being under-utilised. (see Table 4.1 for details)

Table 4.1: Physical documents required for customer acquisition

In order to establish an account-based relationship with individuals, payments banks will be required to obtain from individuals:⁴⁶

- (i) One recent photograph;
- (ii) One certified copy of an officially valid document, containing details of identity and address;
- (iii) Such other documents pertaining to the nature of business or financial status, as specified by the payments bank in its KYC policy.

The RBI guidelines on customer service also require banks to obtain two copies of photographs from depositors/account holders.⁴⁷

The RBI has prescribed six officially valid documents (OVDs), which an individual customer can furnish at its discretion for proving its identity and address. PAN card only proves the identity and hence, an additional PoA is required. All other OVDs prove identity and address (see Table 4.2 for details).

Table 4.2: OVDs Prescribed for Verification

OVD	Proof
Passport	Identity and address
Driving Licence	Identity and address
PAN Card	Identity
Voter ID Card	Identity and address
NREGA Card*	Identity and address
<i>Aadhar</i> Card	Identity and address

* To be signed by a state government officer

Typically, individuals submit hard copies of photographs, along with a printed and signed copy of OVD to the bank, or BCs/agents of banks, who collect the requisite documents from individuals, on behalf of banks and submit it to them. The bank employees or BCs, as the case may be, are required to put an officially seen and verified stamp on application and related documents, to certify verification of identity and address of the applicant. The procedure of collecting relevant documents from consumers involves handling paper/hard copies, which carries the risk of being lost, or disfigured, with time. The process is time consuming, inefficient, inconvenient and expensive to consumers, including banks.

It has been suggested that cost of in-person KYC for on-boarding a mutual fund customer is close to Rs. 750-1,500, per customer.⁴⁸A recent study by Microsave

⁴⁶RBI Master Direction on KYC, 25 February 2016, available at:

https://rbi.org.in/Scripts/BS_ViewMasDirections.aspx?id=10292

⁴⁷ RBI Circular on Customer Service to Banks, July 01, 2015, Item 5.3, available at: <https://goo.gl/sAe36a>

⁴⁸ "The on-boarding or KYC process in the mutual fund industry costs around Rs 700-1,500 per person currently, leading to restriction in the number of people investing in these. Consequently, only 10 million investors are there in the industry. This number can go up to 100 million because through the electronic

indicates that it takes a typical consumer 3-6 days to open an account at a bank branch. The total processing time for banks can be as high as 30 days, with costs ranging from Rs. 341 to 575.⁴⁹ This was validated during stakeholder interactions under the project, which revealed that the cost of customer acquisition for banking customers differs with the nature of KYC, and was in the range of Rs. 400 to 500. Assuming that the cost of customer acquisition for payments banks will be in the similar range, given the limited revenue generating capability of payments banks, such cost is expected to put significant pressure on resources of payments banks.

This cost will eventually be passed on to consumers in form of other charges, resulting in operating a payments bank account becoming inconvenient for consumers. Should the payments banks decide to bear the customer acquisition cost in part, or full, the financial resources available with the payments banks could deplete. This will adversely affect the expansion plans of payments banks and they might not be able to reach out to the unbanked areas of the country. Consequently, the ultimate objective of payments banks to further financial inclusion might be compromised.

Allow submission of documents through digital modes

There is a need to move away from in-person verification and promote use of technology to conduct KYC, as the former is subject to being misused and physical documents could get mutilated/lost.⁵⁰ The ubiquitous availability of mobile phones and growing reach of internet offers this opportunity.

Photograph of individual customer and the relevant KYC document could be allowed to be submitted by digital means for KYC purposes. This will significantly reduce the cost of customer acquisition for payments banks, and ensure completion of KYC process at minimum inconvenience to the customer and also lower costs to the licencees. Other countries have also started to allow remote verification for KYC purposes. For instance, in Colombia, customers are able to open mobile money accounts remotely using their

*route, the cost will be coming down to Rs 10 per person. So, inclusion will happen due to market forces", Market forces to speed up inclusion: Nilekani, Business Standard, February 19, 2016. Also, Mutual funds go online, The Financial Express, January 05, 2016, available at www.financialexpress.com/article/fe-columnist/editorial-mutual-funds-go-online/187955/. Also, "The Centre's plan to bring the Aadhar Bill in the Lok Sabha to enable authentication of 'KYC' in the financial sector will bring down borrowing cost, according the Minister of State for Finance Jayant Sinha. The use of Aadhar as identity proof would reduce KYC costs per transaction from around Rs.1,000 to Rs.30-40." See, Use of Aadhar for KYC authentication will cut costs. Also, Bindu Ananth, *Financial Inclusion: Reaching the last mile in financial services delivery*, Business Today, January 17, 2016 "For every loan of Rs 10,000 through a public sector bank rural branch, the cost is Rs 4,150 (41.5 per cent). For a private sector bank rural branch, it is about Rs 3,210 (32.1 per cent).... Now, imagine a customer whose investible surplus is Rs 10,000 a year. All this represents extremely expensive plumbing that tilts the scale in favour of wealthier customers who have larger account balances and investible surpluses....An ambitious branch manager in a bank would, with a few exceptions, always want to work in the Nariman Point branch than a rural branch." Also, Shruti Sharma, *Can banks see profit in financial inclusion*, Business Standard, August 26, 2015, highlights reasons for financial inclusion efforts being unviable for banks on account of high transaction costs, despite the PMJDY drive.*

⁴⁹Microsave, *KYC Harmonisation study*, August 2016

⁵⁰Tamal Bandopadhyay, *Why is bank fraud rising*, Livemint, January 11, 2016, available at: www.livemint.com/Opinion/EaKnumhLsdPMBz4j3M7N7K/Why-is-bank-fraud-rising.html; Ira Duggal, *Are bank frauds rising in India*, Livemint, October 15, 2015, available at: www.livemint.com/Money/zMQZG15Huf2pGhPdZRC9zL/Are-bank-fraud-rising-in-India.html

phones by online entering information on their ID card. The information is checked online by the e-money issuer.⁵¹

This would require amendment to the KYC guidelines and doing away with the requirement to obtain certified copies of OVDs. A clarification will need to be issued by the RBI that photographs and other documents could be digitally accepted.

There could be several modes of digital submission and verification of customer identity and address. It has been suggested by relevant stakeholders that a scanned copy/photograph of *Aadhar* card with an embedded quick response (QR) code should be recognisable by Unique Identification Authority of India (UIDAI), which should be in a position to provide and verify customer details.

In addition, the Government of India has launched the Digital India Programme with a vision to transform India into a digitally empowered society and knowledge economy. Technologies developed in this programme could be leveraged to promote digital submission of documents. Digital submission of documents is quick, safe and economical. Use of such technologies should be allowed, promoted and incentivised by regulations. In addition, public information and awareness campaigns would need to be undertaken to promote usage of such technologies.

2. Lack of clarity on customer sharing and migration

The guidelines for payments banks provide that these will have to undertake their own KYC/AML/CFT exercise similar to any other bank. It is not clear if sharing and migration of customers of promoters of payments banks to payments banks is prohibited. While there is ambiguity on regulations permitting incremental KYC exercise (over and above the KYC exercise conducted by payments banks' promoters) or requiring repetition of entire KYC process (despite the KYC exercise, if any, conducted by payments banks' promoters), it appears that regulations intend to create a level playing field between payments and universal banks, by mandating former to undertake KYC exercise like other universal banks.

However, payments banks are inherently on a different footing when compared with universal. Payments banks cannot offer credit but saving facilities with limited features. This limits revenue generating capability of payments banks. Hence, they ought to be differently treated from the universal banks.

Payments banks licences have been granted to entities that have existing businesses and a basic KYC-compliant captive customer base, such as telecom service providers and PPI issuers. As payments banks is a low margin business, it was expected these would be in a position to leverage their existing customer base with minimal KYC procedure, thus keeping the costs low. The Nachiket Mor Committee has also noted that convergence of KYC requirements for multiple financial and non-financial regulators

⁵¹GSMA, *Are customer identification and verification requirements proportionate?*, Mobile Money Regulatory Guide, April 2016, available at: www.gsma.com/mobilefordevelopment/programmes/mobile-money/policy-and-regulation/guide/are-customer-identification-verification-requirements-proportionate

will make the process of customer acquisition and migration from one service provider to another much easier and cheaper.⁵²

Consequently, payments banks were expected to tap into the rapidly expanding base of telecom and e-wallet users who do not own a bank account.⁵³ However, absence of clarity on migration of telecom/e-wallet customers to banking customer without repetition of full KYC process is inefficient. The need to repeat the entire KYC procedure will be expensive and limit the ability of payments banks to compete with the universal. Thus, regulations currently intend to similarly treat differently placed entities, resulting in huge costs for payments banks, and eventually their customers.

Allow customer sharing and migration subject to additional KYC, express customer consent and clarity on risk

As indicated earlier, regulations do not expressly allow sharing and migration of customers of payments banks' promoters to payments banks, and require payments banks to undertake their own KYC exercise like any other universal bank.

The payments banks' licences come from distinct backgrounds. These include PPI providers, telecom service providers, and private sector players collaborating with universal banks (see Table 4.3 for details).

Table 4.3: Businesses of Payments Banks licences*		
Licencees	Original business	Partnerships
Aditya Birla Nuvo Limited	Business conglomerate, including financial services and telecom	Idea Cellular Limited
Airtel M Commerce Services Limited	Telecom	Kotak Mahindra Bank
Department of Posts	Government post department	-
FINO PayTech Limited	Technology solutions with service delivery through BCs	ICICI Bank and other banks
National Securities Depository Limited	Depository services	IDBI Bank
Reliance Industries Limited	Conglomerate, including telecom and retail	State Bank of India
Vijay Shekhar Sharma (Paytm)	Prepaid payment Instrument	-
Vodafone M-Pesa Limited	Telecom	-
* proposed/ as reported in news		

A review of KYC requirements for some of the businesses of payments banks' promoters reveals a lot of similarities with the KYC requirements applicable to banks.⁵⁴

Migration of PPI customer: RBI allows issuance of three types of PPIs, viz. closed, semi closed and open. These PPIs differ with transaction limit and are issuable upon

⁵²Nachiket Mor et al, Report of the Committee on Comprehensive Financial Services for Small Businesses and Low Income Households, Reserve Bank of India, page 60

⁵³ "In India, for example, there were 185 million smartphone connections in mid-2015 and a half billion more new connections are expected by 2020", GSMA, the State of Industry Report 2015

⁵⁴ This has also been validated under the Microsave KYC Harmonisation Study, August 2016

compliance with incremental KYC standards. Table 4.4 compares the KYC standards of such PPIs with those of the banks.

Table 4.4: Comparison between KYC Standards of PPIs and Banks			
KYC standards	PPI issuable with such KYC	Entity authorised to issue PPI	Bank account that can be opened with such KYC*
Minimum details about the customer	Semi closed PPI up to Rs. 10,000	NBFCs and Banks	Small account**
OVDs	Semi closed PPI between Rs. 10,001-50,000	NBFCs and Banks	Low risk***
Full KYC	Semi closed PPI up to Rs. 100,000	NBFCs and Banks	Account with complete features applicable to payments bank
	Open PPI up to Rs. 50,000	Banks	
<i>* With minimal additional procedural requirements</i>			
<i>** Accounts in which aggregate of all credits in a financial year do not exceed Rs. 100,000, aggregate of all withdrawals in a month do not exceed Rs. 10,000, and balance at any point of time does not exceed Rs. 50,000</i>			
<i>***Categorised as such based on parameters such as customer's identity, social/financial status, nature of business activity, and information about the clients' business and their location etc. Illustrative examples could be salaried employees whose salary structures are well defined, people belonging to lower economic strata of the society whose accounts show small balances and low turnover</i>			
<i>Source: RBI Master Direction on KYC dated February 25, 2016</i>			

Table 4.4 indicates that a semi closed PPI holder, with a limit of Rs. 10,000, could be migrated into a small account holder, with minimal additional obligations, as KYC requirements are significantly similar. Further, payments banks should be able to facilitate migration of semi-closed PPI holders to a fully operational payments banks account upon obtaining additional documents from such PPI holders.⁵⁵

However, it is not clear if the same is possible under existing regulatory architecture. Stakeholder interactions revealed that while some licencees are targeting migration after obtaining additional documents from existing customers, others intend to target a completely different customer base requiring repetition of full KYC process. To contain avoidable costs, it should be clarified that migration is allowed subject to complete KYC check, while avoiding duplication.

Sharing/migration of telecom customer: Like PPIs, the KYC requirements for a telecom and bank account customer are significantly similar.⁵⁶ The regulations issued by the Department of Telecommunications (DoT) prescribe that individuals are required to provide a self-attested photograph, PoI and PoA for getting a mobile connection, among other details.⁵⁷ In addition to OVDs acceptable in case of bank KYC, other documents as specified by the individual applicant could be acceptable as PoI and PoA, if found

⁵⁵ It has been reported that Paytm has started to approach its customers to share additional documents for upgrading to payment bank account. See, Shashidhar, *Paytm is pushing users to update their KYC details to increase their wallet limit*, Medianama, November 19, 2015

⁵⁶ This has also been validated under the Microsave KYC Harmonisation Study, August 2016

⁵⁷ Department of Telecommunications, *Instructions on verification of new mobile subscribers*, August 09, 2012, available at <http://saveaamadmi.com/DOTVERIFICATIONPOLICY090812.pdf>

satisfactory by telecom service provider. Consequently, should telecom connections be issued on the basis of OVDs acceptable by banks, sharing/migration of such customers to payments banks should require minimum additional efforts.

Express and informed customer consent for sharing/migration: Customer sharing and migration will essentially involve sharing/transfer of customer-related data/documents by a telecom/PPI service provider to payments banks. Such sharing/transfer of sensitive customer information should not be allowed without express and informed customer consent in advance. The customer should be made aware of implications of sharing/transfer of information and the consequent benefits and risks.

However, sharing/transfer of customer-related information between different service providers could be expensive. The customer will have to eventually bear such costs. The cost can be reduced if a central KYC repository is established for all KYC-related documents. A central KYC registry has been proposed to ensure uniformity in KYC standards across the financial sector, and storage of such records at single place.⁵⁸

In addition, a uniform KYC registry between financial and non-financial (telecom) sector has been recommended by several experts.⁵⁹ In fact, *Aadhar*-based eKYC has been recommended for KYC of mobile connections,⁶⁰ which should make customer migration between mobile operators and banks much more convenient. In this regard, there is a need to move towards harmonisation of KYC standards between different sectors.⁶¹

Accountability of payments banks on sharing/migration: While sharing/transfer of information between different service providers might be easy, it might result in complications with respect to sharing of risk and liability. For instance, in case of incorrect customer verification, resulting in breach of regulations, it is not clear if payments bank (recipient) or PPI/telecom service provider (who shared/sent such information with the bank), would be liable. While rights and obligations with respect to information from the provider to receiver of such information would be governed by the contract between parties, it would be difficult for payments banks to avoid their liability.

This is because applicable regulations require banks to conduct KYC at the time of customer acquisition. When a bank chooses a convenient route of migration wherein customer documents are transferred from one service provider to payments bank, attached benefits and liabilities under such documents also transfer. Moreover, it would be difficult to attribute liability to the former service provider when the fault is discovered after such entity has stopped servicing relevant customer.

However, in a scenario when the customer remains client of both service providers, and the KYC information is merely shared, the payments banks as well as telecom service provider/PPI, as the case may be, might be held accountable for the incorrect

⁵⁸ SEBI Board Meeting, *Common KYC in Financial Sector*, 2014, available at: www.sebi.gov.in/cms/sebi_data/boardmeeting/1403253279319-a.pdf

⁵⁹ Nachiket Mor Committee recommended uniformity in KYC standards in financial and non-financial sector

⁶⁰ *New mobile connections can be free with Aadhar eKYC: TRAI Chairman*, Times of India, April 08, 2016

⁶¹ Also, Microsave, *KYC Harmonisation Study*, August 2016

information. In both scenarios, payments banks continue to remain accountable for incorrect customer information.

Sharing/transfer of information to unrelated payments banks: The promoters of several payments banks' licencees are engaged in telecom/PPI businesses and have captive customer base. The payments banks will like to leverage upon such customer base. In case regulations allow customer sharing/migration, payments banks are expected to enter into necessary arrangements with their promoters for sharing of information, risk and obtaining customer consent in advance.

The promoters of payments banks might not be willing to share sensitive customer information (despite customer consent) with unrelated payments banks, hence putting them at disadvantage. While sharing of customer information is a commercial decision, it must be ensured that absence of sharing does not result in abuse of dominant position, by the entity which has access to such information, under the competition law. Lack of access to customer information will increase the cost of customer acquisition for such unrelated payments banks, which will eventually be passed on the customers.

Consequently, regulations should promote sharing of customer information with related as well as unrelated entities subject to express and informed customer consent, and clarity on sharing of risk between provider and recipient of such information.

3. Electronic KYC envisages customer consent through biometric means only

The RBI has realised problems and inconvenience involved in the traditional paper heavy KYC process. Thus, it has taken steps to move towards paperless e-KYC. At present, the e-KYC service of UIDAI is accepted as valid process of obtaining information stored in *Aadhar*. The individual is only required to provide the *Aadhar* card number and explicit consent for UIDAI to share relevant KYC related information with the bank.

As per RBI regulations, such explicit consent can be provided only through biometric authentication, post verification of which the UIDAI electronically shares relevant information with bank. This process is accepted as valid process of KYC verification.⁶²

Currently, a customer cannot provide express consent through any means other than biometric. Successful transmission of biometric consent is contingent upon the quality of machines capturing biometric details and internet connectivity. Robust internet speed is not ubiquitous at present and the high quality machines for capturing biometric details are expensive. Consequently, at times, customer biometric consent is not able to reach UIDAI or is rejected,⁶³ resulting in customer inconvenience and opportunity cost.

⁶²Supra Note 27

⁶³ Civil Society News, *We have become guinea pigs for biometrics*, available at www.civilsocietyonline.com/interviews/we-have-become-guinea-pigs-for-biometrics/. Also, Lola Nayar et al, *Aadhar, A Few Basic Issues*, Outlook India, 05 December 2011, available at <http://www.outlookindia.com/magazine/story/aadhar-a-few-basic-issues/279077>. Also, some states are lagging behind *Aadhar* enrolment. See, *Poor in Bihar hit as Aadhar-based direct benefit transfer lags*

UIDAI has in-built processes to take express customer consent through one time password (OTP) sent on registered mobile number of *Aadhar* card holder.⁶⁴ This facility is allowed by other financial regulators and they do not necessarily require in person verification (see Table 4.5 for details).

Table 4.5: Use of OTP for e-KYC
<p>The Securities and Exchange Board of India (SEBI), the securities regulator, does not require in-person verification, if:⁶⁵</p> <ul style="list-style-type: none"> • verification of the client with UIDAI is carried out through biometric authentication (fingerprint or iris scanning)⁶⁶ • verification of the client with UIDAI is carried out through OTP received on client's mobile number or on e-mail address registered with UIDAI provided, the amount invested by the client does not exceed Rs. 50,000 per financial year per Mutual Fund and payment for the same is made through electronic transfer from the client's bank account registered with that Mutual Fund <p>The pension regulator, Pension Fund Regulatory and Development Authority (PFRDA), has also clarified that any type of authentication as permitted by UIDAI is acceptable for the purpose of e-KYC. The information authenticated and transferred by UIDAI containing demographic details and photograph as a result of such e-KYC process shall be treated as sufficient PoI and PoA of the subscriber.⁶⁷</p> <p>Remote KYC is being allowed in other jurisdictions as well, including Pakistan.⁶⁸</p>

As indicated above, other financial sector regulators in India allow use of OTP for expressly consenting sharing of information between UIDAI and financial sector service provider, mostly with an upper limit on amount in the permissible transactions.

Allow use of OTP for providing express consent

The RBI has not allowed e-KYC through OTP as yet, on account of risks involved. Opening of a bank account is often the first interaction of customer with the formal financial sector, and the identity and address of customer needs to be verified with reasonable certainty to allow the customer to open bank account.

woefully, 03 September 2016, Financial Express, notes, '*Bihar is lagging in even getting its population to get Aadhaar numbers — the figure is a low 70% for the state*'.

⁶⁴ UIDAI, *Policy note on Aadhar E-KYC service*, November 2012

⁶⁵ Frequently Asked Questions issued by SEBI on circular dated January 22, 2016 on KYC Requirements – Clarification on voluntary adaptation of *Aadhar* based e-KYC process

⁶⁶ Samsung India launched Galaxy Tab Iris featuring iris-recognition technology that is ready for *Aadhar* authentication through an integrated and highly secure biometric device. See, *Samsung Introduces Galaxy Tab Iris Equipped with Iris Recognition Technology for Government and Enterprises in India*, Press Release by Samsung, May 25, 2016

⁶⁷ PFRDA circular dated February 05, 2015 on acceptance of e-KYC as valid process of KYC verification

⁶⁸ "Operators sought permission from the SBP to allow users with verified SIMs to request a branchless banking account remotely from their handset using a USSD string. A new account can be verified and authenticated against the NADRA database, which now links an owner's MSISDN, CNIC, and biometric data. On the back end, the customer is identified via a direct verification of the incoming registered MSISDN on NADRA and the corresponding CNIC number inputted by the customer. The account is then opened, without requiring a user to visit an agent outlet." Lara Gidvani, *The Promise of Biometric KYC and Remote Account Opening for Branchless Banking in Pakistan*, GSMA, July 09, 2015

However, payments banks limit the risks that are attached with bank accounts. Payments banks are not expected to offer credit and provide limited deposit services, with a cap on end of day balance. Hence, it might not be prudent to attach same kind of risk to payments banks, which is applicable to a bank account of universal banks. Placing payments banks at the same pedestal with universal banks might result in treating dissimilarly placed entities similarly. Compliance with high standards applicable to universal banks might be expensive for payments banks and thus, adversely affect competition with universal banks. Should same standards apply, payments banks might not be in a position to expand their reach, and fail to achieve their ultimate objective of advancing financial inclusion. Consequently, OTP mode could be allowed for providing express consent to UIDAI to share customer information with payments banks. As indicated earlier, SEBI has already allowed the same subject to a transaction limit.

In addition, owing to their inherent business model, payments banks would be monitoring the transactions (inflow and outflow of funds) of account holders. They are expected to develop an alert system to identify and highlight any suspicious account activity. Regulations can mandate the same and impose accountability on payments banks. Reliance on technology and imposition of accountability on payments banks should enable regulators to relax conditions for customers and allow OTP mode for providing express consent to UIDAI for sharing of customer information with the payments banks.

4. E-KYC limited to *Aadhar*

The e-KYC process has not been expanded to any OVD other than *Aadhar*. Consequently, any customer who does not possess a valid *Aadhar* number will not be in a position to benefit from the e-KYC process. *Aadhar* number is a 12 digital number, making it difficult to remember and store. This increases the probability of entering incorrect number, thus, attracting rejection from UIDAI database. This could result in customer inconvenience and opportunity cost.

OVDs are documents issued by Central or state government departments. It could be reasonably expected that relevant government departments would retain relevant information about the OVDs issued to citizens.

Already, many government departments have created searchable records for these documents on the internet. In addition, to enable citizen convenience, increase transparency and reduce corruption, several steps involved in obtaining OVDs have been made digital and the extent of human interaction has been reduced. This has been indicated in the Table 4.6.

Table 4.6: Information Available on the Internet about OVDs	
Passport	Procedure to obtain passport including online submission of documents at: http://passportindia.gov.in/AppOnlineProject/online/procFormSubOnl
Driving Licence	Limited details of holders available at: https://sarathi.nic.in:8443/nrportal/
PAN	Limited details of holders available at: https://incometaxindiaefiling.gov.in/e-Filing/Services/KnowYourPan.html
Voter ID	Limited Details of electors at: http://eci.nic.in/eci_main1/Linkto_electo_search.aspx
NREGA card	Details of holders available at: http://nrega.nic.in/netnrega/statepage.aspx?Page=C&Digest=GmpYzpzFJIVh16rY0MeSw

For instance, National Rural Employment Guarantee Act (NREGA) card with photo identification and address details of holder is available online, and accessible by public. Similarly, significant details of voter identification card holders, including name, age and house number, are available online and accessible by public.

The current process of reliance on customer and bank's agent to obtain copies of OVDs is not only expensive, but also carries security risk to the system. Instances of furnishing fake OVDs for opening of bank accounts have been on a rise.⁶⁹ Thus, there might be merit in considering source based KYCs, like e-KYC process, for OVDs in addition to *Aadhar*.

Facilitate source based KYCs other OVDs

At present, KYC process (other than eKYC) involves reliance on customer with respect to furnishing of correct information and agent/employee for verifying the information provided by customer.

There is a need to reduce individual involvement in KYC submission and verification process, and rely on information available at source, i.e. government department issuing the relevant OVD. International experience suggests that KYC from source is beneficial for stakeholders. For instance, in Sri Lanka, customers can leverage the SIM card registration database to open mobile money accounts remotely.⁷⁰ The Document Verification Service in Australia is a secure, national, real time, on-line electronic system to match key details of Australian identity documents issued to individuals. It covers visas, passports, medicare cards, driver licences, citizenship certificates, et al.⁷¹

KYC from source could be conducted if the relevant government departments, issuing OVDs, have readily available electronically searchable database of individuals to whom relevant PoI and PoA are issued (which is available in many cases). In addition, such government departments should be in a position to share customer information with

⁶⁹Supra Note 33

⁷⁰ Supra Note 34

⁷¹The Document Verification Service and individual customer and beneficial owner identification, details available at: www.austrac.gov.au/document-verification-service-and-individual-customer-and-beneficial-owner-identification

payments banks in real time upon receiving customer consent to share such information.

However, unlike UIDAI, government departments issuing OVDs might not possess biometric information of document holders, and thus might not be in a position to obtain express consent of customer biometrically. Alternate process could be developed to obtain customer consent for sharing of customer information with payments banks. These could include obtaining customer consent through OTP sent to the mobile number registered with relevant government department. In case mobile number is not available, customer consent could be obtained by matching the information available with the customer (such as, photo identification and/or other details) with the details available in database of relevant government departments.

In order to facilitate source based KYCs, the relevant government departments might have to share the relevant Application Programming Interface (APIs)⁷² with the payments banks. To begin with, only financial service providers may receive access to the APIs. This is already practiced for *Aadhar* e-KYC through UIDAI. This would require amendments to regulations, investment in infrastructure and building capacity of individuals, including relevant government officials. While this would be expensive and time consuming, the consequent benefits of source based KYCs would go a long way in keeping the customer acquisition costs under check, improving consumer convenience and ensuring consumer protection.⁷³

Possibility of a paperless and contactless KYC through any OVD would be a crucial step towards achieving paperless and contactless banking experience. For instance, completion of KYC process could result in individual getting a short message service (SMS) about the link to download payments bank application on its mobile phone, for beginning to use mobile banking services. While application-based mobile banking could be available only on select category of phones, important banking functions such as checking balance, viewing mini statements, initiating fund transfers etc. could be conducted through basic mobile phones by use of National Unified USSD platform.⁷⁴

Source based digital KYC will promote paperless and contact less account opening and consequently payments banks and customers will be required to enter into electronic contracts. Typically, there are two types of electronic contracts, i.e. click wrap and browse wrap contracts.

⁷² API is a set of routines, routines, protocols, and tools for building software applications. An API specifies how software components should interact

⁷³ "Aadhar enabled eKYC could result in an estimated direct saving of over US\$1.5bn within the next five years. Apart from substantial cost savings for banks and financial institutions, Aadhar-enabled eKYC is significantly more efficient compared to current paper based KYC. Traditional customer enrolment processes followed by banks can take from two to four weeks before an account is activated, and all KYC details have been verified and stored for future retrieval. On the other hand, Aadhar eKYC enabled bank accounts can be activated and readied for transactions within a minute." Puneet Chopra et al, *e-KYC and Indiastack – A transformative blueprint for Emerging Markets*, Microsave, March 2016

⁷⁴ How to do banking using basic mobile phones, December 28, 2015, available at <http://economictimes.indiatimes.com/wealth/save/how-to-do-banking-using-basic-mobile-phones/articleshow/50331304.cms>

Click wrap contracts: Click wrap contracts require customer to provide express consent to terms and conditions subject to which relevant services will be provided and ready access to such terms, in case the consumer desires. In other words, as soon as an individual clicks on website link to download the mobile banking/related application, the customer would view a message box about agreeing with the terms and conditions and would be prompted to click 'I accept' tab to proceed with the download. The terms and conditions would be available for review below such message box. Such contracts are legally recognised under Indian commercial laws and information technology legislations.

Browse wrap contracts: In case of browse wrap contracts, general terms and conditions about the contract are uploaded on the website and accessible on website page separate to the website link which prompts download of the mobile banking/similar application. A browse wrap does not require consumer to provide 'express consent' to the terms and conditions and the mere act of clicking the website link to download the mobile application is considered to be deemed consent with its terms and conditions. The legitimacy of such contracts is ambiguous and they might not be recognised under Indian commercial laws.⁷⁵

Consequently, payments banks will have to ensure that they obtain express consent of consumers to terms and conditions of banks, before customers are in a position to download the bank's mobile application/similar application on their mobile phones. This will be necessary to ensure that the contracts between customers and banks are enforceable.

5. Unavailability of registration documents with small merchants

Payments banks are expected to have two categories of customers, those who make payments (such as individuals, covered earlier) and those who receive payments (such as shopkeepers). Shopkeepers who receive payments from their customers for a consideration are typically referred to as merchants.

Acquisition of merchants is important for payments banks to cover entire digital payments ecosystem and getting access to customer expenditure information. Such information has the potential to be monetised.

Owing to their business considerations, merchants typically open current accounts⁷⁶ (on behalf of their businesses) with banks, and they are expected to utilise services of payments banks for doing the same. Opening of current accounts require furnishing of

⁷⁵ As per as the provisions of the Indian Contract Act, 1872, a valid contract should have an offer, an acceptance, a lawful consideration and a lawful object. The Act has made it mandatory to make an offer and acceptance but has not determined any particular procedure of how the offer and the acceptance should be made. Thus, if one compares Browse-wrap agreement and Clickwrap Agreement, the latter makes it mandatory for the end user to give its express assent, by clicking the "I Agree" tab whereas, the Browse- wrap agreement has no such feature. Currently, India has no judicial history on the enforceability of the Clickwrap agreement but international experience reflects that generally the courts are hesitant to enforce Browse-wrap Agreements while allowing the enforcement of Clickwrap agreements.

⁷⁶Typically current accounts are non-interest bearing bank accounts which allow multiple transactions, including withdrawals, during the day

proof of identity and address of an individual representative of the business along with relevant document with respect to such business. These documents comprise registration certificates of the businesses with government departments, proof of payments of taxes and similar documents.

Payments banks are expected to target merchants of small and medium scale who are often informal in nature and do not possess business specific registration or taxation documents. This might result in such informal merchants not being able to benefit from the services of payments banks.

Allow small merchant acquisition based on individual KYC and available entity documentation

As indicated earlier, under the current regulatory regime, it might not be possible for small merchants to open current accounts with payments banks without furnishing registration and similar details of their businesses. Such documents are scarce as a significant proportion of businesses in India (close to 90 percent) are informal and unregistered.⁷⁷

To ensure that such merchants are not deprived of benefits offered by formal financial system, regulations could allow payments banks to open current accounts for such small merchants (sole proprietorships) only on the basis of individual KYC, and available information of the business entity. Allowing payments banks to offer such schemes will not dilute the risk standards since payments banks offer limited savings products and cannot offer credit. In any case, payments banks will be in a position to track transactions of the merchants on real time basis and should be able to flag any suspicious deposits or withdrawals from the bank accounts.

Payments banks offer limited services to its customers, including merchants, carry low risk, and thus should be differently treated from the universal banks. Allowing small merchants to open payments banks accounts on the basis of individual KYC and available entity information could be the first step in formalising such merchants, and also aid in achieving the objective of financial inclusion of connecting informal entities to formal financial system.

As indicated earlier, there is a need to promote use of technology for KYC check. This should be extended to merchant acquisition as well. Such processes will reduce the cost of KYC in a significant manner and promote genuine entities to enter financial sector.

Exempt individual merchants from end of day customer balance limit

Any merchant which is acquired on the basis of individual KYC might have to comply with the end of day individual customer balance limit of Rs. 100,000. It might be unreasonable to subject mid-sized merchants to comply this rule as they will receive payments from multiple customers during the day and in all likelihood will receive payments in excess of Rs. 100,000 in one day.

⁷⁷Ministry of MSME, Government of India, *Recommendations of the Inter-Ministerial Committee for Accelerating Manufacturing in MSME Sector*, September 2013

A closer look at the regulation reveals that such limit was envisaged only for individual customers and not for merchants. Merchants were always expected to register as non-individual customers and hence would have been exempt from such rule. However, should merchants register as individual customers (to avoid furnishing of business registration documents); the limit might automatically be applicable to them. Such differentiation within merchants creates an uneven playing field between similarly placed entities.

A better alternative to impose the end of day individual customer balance rule, without raising competition related concerns, is to apply such rule only in cases of savings accounts. All current accounts, whether opened by individuals or merchants, could be exempt from such rule. Alternatively, the current accounts could be subject to significantly higher end of day balance limit.

Monitoring of exclusive tie-up arrangements

While payments banks are expected to enter into tie-up arrangements with small and medium sized merchants, the possibility of payments banks pushing for exclusive tie-up arrangements cannot be denied. There is a high possibility of such arrangements in situations wherein promoters of payments banks' licences already have tie-ups with merchants, which are being targeted by payments banks.

While entering into exclusive tie-up arrangements is primarily a commercial matter, such exclusive tie-up arrangements become anticompetitive under the competition law only when they result in appreciable adverse effect on competition. As a result, there might be situations wherein exclusive tie up arrangements will not be anticompetitive and the excluded payments banks will not be in a position to acquire such merchants. This could limit interoperability between payments banks and restrict options available with customers. Consequently, regulators would need to continuously monitor the actions of market players to ensure that exclusive tie-up arrangements do not result in appreciable adverse effect on competition.

In addition, there is a need to promote uptake of technology which facilitate secured and swift digital payments in inter-operable manner, at low cost. Already, services like UPI are being offered by NPCI. There is a need to promote competition in payments technology industry to improve efficiency/quality and reduce costs.

6. Submission of unreliable additional information to Central KYC Registry

The government has set up a CKYCR to receive, store, safeguard and retrieve the KYC records of customers in digital form. The Central Registry of Securitisation, Asset Reconstruction and Security Interest of India (CERSAI) has been authorised to act as CKYCR.⁷⁸ Banks, including payments, are required to capture the KYC information of

⁷⁸ RBI Circular dated May 18, 2015 on operationalisation of CKYCR at www.iba.org.in/circular/SWA17715746_RBI%20letter%20dt.18.5.15%20on%20CKYCR.pdf, and Letter by Indian Banks Association to relevant banks, at www.iba.org.in/circular/SWA17715746_Cir%20949%20dt.20.6.2015%20on%20CKYCR.pdf

individual and non-individual customers for sharing with the CKYCR in the manner specified in KYC templates.

Banks, including payments, are required to capture the KYC information for sharing with the CKYCR in the manner specified in the KYC templates prepared for 'Individuals' and 'Legal Entities'. The KYC templates require significant information about the customer, which the payment bank might find difficult to obtain and submit (see Table 4.7 for details).

Table 4.7: Mandatory Fields in CKYCR Form⁷⁹	
Individuals	Entities
<ol style="list-style-type: none"> 1. Personal details <ul style="list-style-type: none"> - Name - Father/spouse name - Mother name - Date of birth - Gender - Marital status - Nationality - Residential status - Occupation type 2. Proof of identity 3. Proof of address <ul style="list-style-type: none"> - Current/permanent address - Correspondence/local address 4. Details of related person <ul style="list-style-type: none"> - Proof of identity of related person 	<ol style="list-style-type: none"> 1. Entity details <ul style="list-style-type: none"> - Name - Date of incorporation - Date of commencement of business - Place of incorporation - Country of incorporation - Country of residence as per tax laws 2. Proof of identity 3. Proof of address <ul style="list-style-type: none"> - Current/permanent address - Correspondence/local address details 4. Details of all related persons and each controlling persons resident outside India: <ul style="list-style-type: none"> - Type - Personal details <ul style="list-style-type: none"> o name o father/spouse name o mother name o date of birth o gender o marital status o nationality o residential status o occupation type - Proof of identity - Proof of address

While the idea of setting up a central KYC registry is commendable, and expected to result in significant benefits, the relevance for obtaining information like occupation, details of related person and controlling person is not clear and banks might have to incur significant time and cost to obtain such information.

Further, in case of individuals, the CKYCR form requires providing names of both parents as well as occupation of applicants. Most of the OVDs capture names of one of the parents, but not both. Also, OVDs and banks typically do not capture occupation of the individual to open a normal savings account. Even if such information is recorded, it

⁷⁹ Supra Note 27

is not clear how banks are expected to verify such information.⁸⁰ Thus, in its current form, CKYCR might end up storing non-verified information, which might not be of much use.

Restrict the information to proof of identity and address

It has been reported that the financial sector regulators are keen to implement KYC and CKYCR in its existing format soon.⁸¹ The collection of additional information, as required in its current form, will impose cost on the payments banks and consequently the customer. The objective of CKYCR is to store the PoI and PoA of the customer (and no additional information) to enable compliance with the KYC requirements, and it should be restricted to the same.

It should be noted that payments banks will focus on changing the customers' habit from cash heavy to less cash payments. Such a transition requires trust building exercise between consumers and financial service providers. Requirements to share personal details upfront might act as barrier to develop such trust and dissuade the potential customers from signing up to open bank accounts. Acquisition and verification of such hitherto uncollected information will be expensive and time consuming. Consequently, payments banks must be required to collect only such information from consumers which are absolutely essential.

With the advent of CKYCR, the cost of saving KYC data is expected to reduce from Rs. 150-200 to Re. 1 per upload, download or making any data modification.⁸² Avoidable requirements under the CKYCR must not take away this benefit.

7. Submission of scanned copies of documents and photos to Central KYC Registry

In addition to providing customer data in the prescribed template, the operating guidelines with respect to CKYCR require reporting entities, including payments banks, to upload scanned copies of supporting documents⁸³ (see Table 4.8 for details).

⁸⁰ This problem is not limited to banking industry and other financial service providers are also suffering from same problem, "Apart from the KYC data already provided under Sebi rules, all investors will now have to give mother's name and proof of permanent address in case their local address or the address for correspondence is not the same as permanent address. Among other details, the new norms also seek disclosure of 'maiden name'...The operational aspect of Central KYC may also impact the 'ease of doing business' campaign" Partha Sinha, *New central KYC rules hit investors, e-KYC process*, July 25, 2016, Times of India

⁸¹ All financial sector regulators are moving ahead with the existing format provided by CKYCR, and have directed the financial service providers to collect and store relevant information. For details, see SEBI circular dated July 26, 2016 on the subject

⁸² Samalad, *Single KYC for all financial products to be a reality soon*, Café Mutual, February 17, 2016

⁸³ CKYCR Operating Guidelines 2016, Version 1.1

Table 4.8: Guidelines for uploading of KYC record at CKYCR⁸⁴

- a) The data captured as per the common KYC template is to be uploaded on the Central KYC portal along with the scanned copy of the supporting documents (PoI/PoA). For an individual record, the signature and photograph is to be cropped separately and uploaded.
- b) The specifications for scanning the supporting documents and photograph are stated below:
- i. Document should be scanned in grey-scale with a scanning resolution of 150-200 DPI.
 - a. Photograph must be a recent passport size, preferably in colour. However, scanning has to be in colour mode.
 - b. Dimensions 200 x 230 pixels
 - c. Size of photograph should be between 20kb-50kb
 - ii. Acceptable file format : '.tif', '.tiff', '.pdf', '.jpeg', '.jpg'
 - iii. File Size (Maximum Limit): 350 kb for individual KYC record.
- c) The reporting entity can bulk upload the KYC details and scanned images. Images for each record will be required to be zipped separately. The master zip file will be digitally signed by the reporting entity.

The payments banks could receive customer details in physical or digital format (through e-KYC). The obligation on payments banks to upload physical documents (which they might not even possess in case of e-KYC) at the CKYCR portal has the potential to impose excessive costs on payments banks and result in inconvenience.

In addition, imposition of detailed specifications with respect to upload of customer information has the potential to restrict innovation in the sector and use of advanced and economical technologies for sharing of customer information. The cost of such exercise is expected to be eventually passed on the consumers. For instance, the payments banks might be forced to require customers to submit coloured photograph of a specific size.

Allow submission of information in the format convenient to payments banks

The payments banks must be allowed to provide the customer information to the CKYCR in the format most convenient to them. The CKYCR could then convert the relevant information in the format suitable to it and upload and same on its portal. This will aid in cost-savings for payments banks and allow use of latest technology for sharing of customer information.

⁸⁴ *Ibid*

8. Requirement to quote PAN/ provide Form 60 for opening of bank account

In order to open a bank account, other than a basic saving bank deposit account, the consumers are required to quote their PAN. This condition is also applicable to issuance of debit card, deposits in cash exceeding Rs 50,000 (US\$746) during any one day, among other transactions. In case of non-availability of PAN, a declaration in Form 60 is required to be made.⁸⁵

An officer/manager of the bank, including payments bank, will be required to ensure compliance with this requirement, and furnish a statement in Form 61 to relevant authorities. Such bank, including payments bank, is required to retain Form 60 for a period of six years from the end of financial year in which the transaction was undertaken.⁸⁶

It must be noted that this condition is applicable for opening of all new accounts by universal banks and payments banks and existing accounts of universal banks are left out of this requirement.

Discontinue the requirement to quote PAN/ provide Form 60

The objective of quoting PAN/submission of Form 60, as prescribed by Central Board of Direct Taxes (Ministry of Finance) appears to be related and verification of tax related documents submitted by individuals and prevention of tax evasion. However, such requirement has the potential to impose avoidable cost on payments banks and its consumers. The cost includes resources required to handle and store relevant forms by payments banks, submission of the necessary forms to relevant government agencies and related inconvenience.

There could be better alternatives to verify tax related documents and prevent tax evasion. However, the requirement to quote PAN does not appear to be one of them. Consequently, such requirement needs to be discontinued.

⁸⁵ Income Tax (22nd Amendment) Rules, 2015 dated December 30, 2015

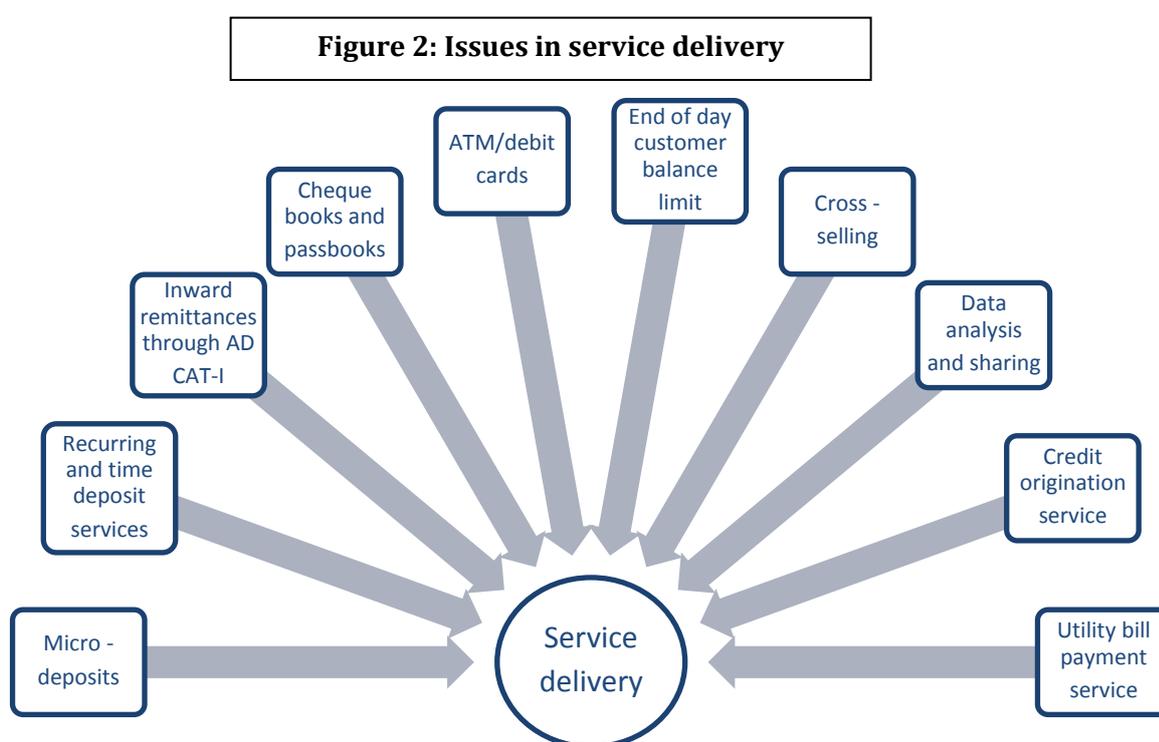
⁸⁶ *Ibid*

5. Service Delivery

Background

Payments banks can offer specific services to its customers, in the manner prescribed by regulations. Inability to provide certain services despite having the capacity has the potential to impose avoidable costs on stakeholders. Lack of regulatory clarity on conditions subject to which some service can be provided by payments banks, also points to sub-optimal nature of regulations.

Figure 2 represents the issues identified in relation to service delivery, which could increase stakeholder inconvenience and cost, and act as barrier to growth of payments banks.



These issues have been further explained in sections below, wherein solutions to address such issues are also provided.

1. Inability to offer recurring and time deposit services

Payments banks are expected to offer deposit and payment services to its customers. The RBI has clarified that payments banks can offer demand deposit services and will not be able to offer recurring and time deposit services to its customers.

Recurring and time deposit services are essential part of savings services and inability to offer these takes away the opportunity of designing innovative and attractive products from payments banks.

The objective of prohibiting payments banks from offering recurring and term deposit services is to ensure that they focus on demand deposits and payments as their core businesses. They are not expected to get involved in the race to offer high interest rates by leveraging their balance sheets. However, such inability puts them at a disadvantage when compared with other deposit/savings options, offered by universal banks, and soon to be launched small finance banks.

Poor needs a nudge to save/not spend. Such nudge is available in recurring and fixed deposits products. While the former requires making periodic payments, the latter disincentivises withdrawals. As a result, the inability of payments banks to offer such products, puts them at a disadvantage when compared with universal banks, and limits the ability of payments bank to facilitate financial inclusion.

Allow offering of recurring and time deposit services

In order to create a level playing field in the deposit market, and ensure that customers have multiple options to choose from, it is essential that payments banks be allowed to offer recurring and term deposit services.

Like demand deposits, an upper limit might be put on such services. Such options will allow payments banks to design attractive products for low and middle income consumers and ensure more persons are attracted to formal financial sector. This will also promote the cause of financial inclusion in the country.

2. Offering cross border remittance services independently

Payments banks are authorised to handle cross border remittance transactions in the nature of personal payments/remittances on the current account, subject to obtaining relevant approvals from the RBI. It has been further clarified that the cross border transactions would involve both inward and outward remittances depending on the type of authorised person licences issued by RBI. In addition, payments banks cannot accept deposits from non-resident Indians (NRIs).

The RBI grants authorised person licence to eligible entities to handle cross border remittance under the foreign exchange regulations. Universal banks are automatically provided authorised dealer category – I licence (AD CAT-I) and hence are authorised to handle cross border remittance transactions on their own accounts.

Non-bank financial entities are typically provided authorised dealer category – II licence for handling cross border remittance. Under this licence, such entities are required to route the transactions through universal banks/authorised dealer category – I licence holders.⁸⁷ Stakeholder consultations reveal that payments banks are being provided authorised dealer category – II licence and hence they are not being treated at par with universal banks to handle cross border remittances.

⁸⁷ For details, see frequently asked questions on authorised dealers issued by RBI. Available at <https://rbi.org.in/scripts/FAQView.aspx?Id=54>

While the RBI has clarified that primary focus for payments banks needs to be domestic remittance market, it needs to be noted that India has a significant expatriate community which sends inward remittance. A substantial portion of this community is from lower and middle income class which currently faces a lot of inconvenience and cost in remitting money to their relatives in the country.

One of the objectives of payments banks is to facilitate domestic and cross border inward remittance by bringing the cost down and improving safety, reliability and speed of remittances. It appears that the prevailing regulatory architecture creates impediments in achieving such objective, and payments banks will need to incur significant costs to handle cross border remittances, as these would be routed through universal banks. Such costs will eventually be passed on to consumers who will find it expensive and inconvenient to undertake such transactions through payments banks.

Allow payments banks to obtain AD-CAT I license

There is a need to create level playing field between universal and payments banks to handle cross border remittance transactions. The dependence of payments banks on universal banks to handle such transactions creates unnecessary complications, and escalates the costs of handling such transactions for payments banks, and consequently the consumers.

The absence of competitive neutrality in inward remittance market limits the gains which could have accrued to consumers making cross border remittance transactions. Thus, payments banks should be in a position to automatically acquire authorised dealer category – I licence subject to them complying with necessary conditions and putting in place necessary infrastructure to handle cross border remittance.

3. Issuance of passbooks, chequebooks and handling of cheques

While payments banks are expected to promote paper less modes of fund transfer, it may not be possible to completely do away with the existing modes of fund transfer in foreseeable future. One of most popular modes of fund transfer is through cheques.

At present, universal banks offer different types of savings accounts, with some accounts providing free cheque book facilities and some not.⁸⁸ However, the basic savings accounts opened under PMJDY are required to provide free cheque leaves.

Issuance of cheque books is expensive. Banks are required to obtain and store sample signatures of customers to process cheque-based transactions. Even when banks do not

⁸⁸ ICICI Bank terms and conditions of basic savings bank account provide, “Cheque books will be couriered directly to the mailing address given by the Customer provided all formalities are completed. Subsequent cheque books can be requisitioned through the requisition leaf available in the cheque book or through ATMs subject to satisfactory conduct of the Account. Cheque books are normally issued free of cost, however, ICICI Bank reserves the right to recover the cost of the cheque book requisitioned.” available at: www.icicibank.com/Personal-Banking/account-deposit/savings-account/terms-conditions.page?#toptitle. The terms and conditions of zero balance saving account provides, “You get one chequebook of 15 leaves free every year. You can request for an additional cheque book (10 leaves) at Rs. 20 (plus Service Tax as applicable) per chequebook.”, available at: www.icicibank.com/Personal-Banking/account-deposit/basic-savings/index.page?

issue cheque books, they might be required to put in place cheque acceptance infrastructure to process third party cheques. Should a bank choose not to install cheque acceptance infrastructure, it might need to enter into arrangement with another bank, which has such infrastructure, to process cheque related transactions. This would require payment of fee/commission to such third party bank and hence additional costs on consumers.

Similar to physical cheque books, issuance of physical passbooks is also expensive for banks. A related cost is of installing printer to enable periodic updates of passbooks. Owing to the inconvenience and costs involved, banks typically prefer providing monthly account statements to customers. They also use digital modes to provide information about past transactions and account balance.

Clarify that issuance of chequebooks and passbooks is not mandatory

Payments banks must not be required to compulsorily issue cheque books and allowed to offer and incentivise innovative means of making payments. Similarly, payments banks must not be required to compulsorily issue pass books and must be allowed to offer and incentivise innovative means of obtaining transaction information and account related information.

Payments banks are entering into partnerships with universal banks, to offer cheque acceptance-related facilities. While entering into partnerships is an exclusively commercial matter, it must be ensured that such arrangements do not result in appreciable adverse effect on competition under the competition law. Even otherwise, sharing of infrastructure needs to be promoted in financial services industry to contain costs, avoid reinventing the wheel, and provide high quality services to the consumers.

In addition, payments banks are expected to leverage technology to promote real-time and secured transfer of funds and provide account related information to customers. The regulations must allow payments banks to incentivise the use of digital modes of payments and getting account information.

Advocacy and awareness campaigns will also be necessary to promote digital means of payments and obtaining account related information. While payments banks should be free to impose charges on issuing passbooks, chequebooks and processing cheques, such charges should be transparently disclosed upfront to the consumers.

4. Issuance of Debit Cards and Charges on Card-based Transactions

Universal banks typically issue ATM-cum-debit cards to customers while opening bank accounts for them. Such cards perform multiple functions of cash withdrawal at Automatic Teller Machines (ATMs) and payments to merchants at points of sales. Several non-financial functions can also be performed through the use of such cards at ATM points, like, balance enquiry, obtaining information about a specific number of previous transactions etc.

Most ATMs, at present, are interoperable in nature, i.e. an ATM card holder can access ATM set up by another bank to undertake transactions. This is expensive as the card issuing bank has to share the commission with bank whose ATM was used, and network

service provider. In addition, the commission earned at point of sale (PoS) through use of debit cards is also required to split between the card issuing bank, PoS machine issuing entity and network service provider.

In addition, a savings bank account customer cannot be charged by a bank for at least five transactions (inclusive of both financial and non-financial transactions) in a month if the customer uses an ATM of another bank. However, within this overall limit of five free transactions, for transactions done at ATM of another bank located in the six metro centres, viz. Mumbai, New Delhi, Chennai, Kolkata, Bengaluru and Hyderabad, the free transaction limit is set to three transactions per month. It has been noted that such policy of minimum free ATM transactions is inefficient and could lead to cross subsidisation of one set of consumers by others.⁸⁹

Stakeholder interactions revealed that payments banks would focus on promoting cardless modes of fund transfer and payments, such as mobile payment through use of mechanism like UPI etc. This is expected to reduce the number of entities involved in digital payments and also save the costs involved.

Should payments banks be required to mandatorily offer ATM-cum-debit cards to its customers, and thus comply with the minimum free transactions guidelines, they might need to incur significant costs. Such costs would eventually be passed on to the consumers, or could limit the reach of payments banks, if borne by them.

Clarify that issuance of ATM/debit cards is not mandatory

The RBI has clarified that payment banks will be subject to regulations applicable to universal banks. In addition, payments banks are authorised to issue debit but not credit cards. While all universal banks issue debit cards, it seems that there is no requirement to mandatorily issue such cards. Such cards are usually issued to reduce the pressure of cash withdrawal on bank branches and divert customer traffic to ATMs. This also ensures efficiency as ATMs are closer to customers than bank branches.

In absence of a policy directing banks to mandatorily issue ATM-cum-debit cards, complete discretion must be provided to payments banks for such decision, and they must not be mandatorily required to issue ATM/debit cards. Should they issue such cards, clear, complete and prior disclosure about applicable charges and terms and conditions must be mandated.

Payments banks will also be required to comply with RBI guidelines on minimum free ATM transactions, should they issue ATM cards. However, they should not be discouraged from disincentivising the use of ATM cards by imposing higher charges, when compared with other cardless modes of digital payments, subject to transparent and prior disclosure of charges levied, and the terms and conditions of using the other modes of digital payments.

⁸⁹*No free lunch: Rajan on ATM transactions*, Business Standard, 16 September 2014, available at 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."

Monitoring of exclusive arrangements

As indicated earlier, entities involved in a card related transactions are customer, card issuing bank, merchant, bank installing PoS machine, and network service provider. At times, related parties might be involved in card related transactions. For instance, merchant could be promoter group entity of card issuing bank or bank/entity installing PoS machine at merchants. Related parties can be involved in cardless digital payments as well. In such situations, merchants may disincentive consumers from using services of unrelated parties. This could unfairly limit/distort competition in the payments sector and benefit related parties.

While exclusive dealing agreements are invalid only when they result in appreciable adverse effect on competition, the regulators will need to closely scrutinise such agreements to evaluate impact on excluded entities and the consumers.

At times, in case of absence of interoperability, merchants might not be in a position to accept cards issued by banks with whom they have not entered into commercial arrangements. Lack of interoperability also escalates cost for market players and consumers. The regulations should promote shared infrastructure and interoperability in the merchants' payments sector.

While inability to accept card for any reason would cause inconvenience to consumer and the card issuing bank, regulations must ensure that such refusal to deal is not intentional and with the object to exclude genuine competition. While competition regulation cannot trigger sans appreciable adverse effect to competition, regulations must promote collaboration, sharing of infrastructure in order to keep the costs low and promote consumer convenience.

Facilitate expansion of digital payments acceptance infrastructure

The RBI has suggested several measures to promote setting up of payments acceptance infrastructure (like PoS machines) at merchant locations, which are points of customer interface. Table 5.1 highlights some of the RBI proposals.

Table 5.1: Options to Improve Payments acceptance Infrastructure⁹⁰
<p>The RBI has proposed following measures to expand installation of payments acceptance infrastructure in the country, among others:</p> <ul style="list-style-type: none"> • Mandating banks to install/acquire payments acceptance infrastructure/ terminals in proportion of their card issuance. • Promote setting up of an acceptance development fund to encourage wider deployment of card acceptance infrastructure

Mandating payments banks to install payments acceptance infrastructure in proportion of their card issue or partake in setting up of acceptance development fund, could have significant cost implications on banks, and consequently on consumers.

⁹⁰ RBI concept paper on card acceptance infrastructure, March 2016, available at <https://rbidocs.rbi.org.in/rdocs/PublicationReport/Pdfs/MDRDBEDA36AB77C4C81A3951C4679DAE68F.PDF>

Hitherto, there has been a shortage in supply of payments acceptance infrastructure. With the increase in service providers, including payments banks, small finance banks and universal banks, the supply of payments acceptance infrastructure is expected to increase. In addition, the RBI should allow third party service providers to supply payment acceptance infrastructure. Already, white label ATMs are in service. Similarly, third parties must be allowed to provide PoS machines and similar infrastructure.⁹¹

Technology with respect to payment acceptance infrastructure is rapidly changing and such infrastructure is becoming less expensive and efficient by the day. For instance, mobile PoS machines have been introduced,⁹² and NPCI has introduced UPI to allow instant and secure payments with mobile numbers, without the need of bank account information.⁹³ At present, only banks are allowed to use UPI, and it is expected that payments banks would also be allowed to do so.

Consequently, there is a need to take into account the existing and expected market developments, before imposing regulations, which could act as a burden on market players as well as consumers. Regulatory interventions must be used only in case of market failure, i.e. when market forces fail to meet the required objectives. Thus, regulations must create enabling conditions for the market forces to achieve the desired objective, i.e. increase in payments acceptance infrastructure.

Ensure transparency in charges

In order to facilitate digital payments, merchants are required to pay fee to digital infrastructure providers. This includes merchant discount rate (MDR), the fee charged to the merchant by the financial institution/bank which has set up the PoS or card acceptance machine at the merchant location for use of this infrastructure. Currently, RBI has capped the MDR payable on debit card transactions (see Table 5.2 for details).

Table 5.2: Cap on MDR for Debit Card Transactions⁹⁴
The MDR cannot exceed:
- 0.75 percent of the transaction amount for value up to Rs. 2,000,
- 1 percent for the transaction amount for value above Rs. 2,000.

The RBI is currently reviewing guidelines in relation to MDR and measures to improve payments acceptance infrastructure. It has suggested several regulatory options in this regard (see Table 5.3 in this regard).

⁹¹ 'In order to increase the reach of PoS) infrastructure to rural areas and promote electronic payments, it is proposed to: prepare a discussion paper on White Label PoS and place it in the public domain for comments', RBI Monetary Policy Statement 2013-14, available at:

<https://rbi.org.in/scripts/NotificationUser.aspx?Mode=0&Id=7956>

⁹² For instance, Ezetap provides mobile PoS machines, details available at <http://site.ezetap.com/>. Use of Mobile PoS machines has also resulted in positive experiences in other economies, see Gupta et al, *Transforming Payments through mPOS: Perspective from Indonesia*, CGAP, July 29, 2014, available at: www.cgap.org/blog/transforming-payments-through-mpos-perspectives-indonesia. Also, mobile-based payments solutions have been launched by market players, thereby eliminating the need to swipe the physical card at the PoS machine. See, *SBI launches mobile payments solution mVisa*, May 05, 2016

⁹³ Details about UPI are available at: <https://razorpay.com/upi/> and

www.mpf.org.in/pdf/NPCI%20Unified%20Payment%20Interface.pdf

⁹⁴ *Ibid*

Table 5.3: RBI Proposals on MDR Review⁹⁵
Differentiated MDR at select merchant categories (such as utility bill payments, hospitals etc.) at all locations
Differentiated MDR at select at select merchant categories in tier III to VI cities
Setting MDR for debit cards as a fixed/ flat fee for transactions beyond a certain value
Differentiated MDR for customer to government payments
Mandating unbundling of merchant charges
Rationalising MDR for credit card

Each of these proposals is expected to have an impact on banks, including payments banks, and consumers, which needs to be reviewed closely.

MDR is one the most debated topics in international payments regulatory regime. There have been allegations of MDR being too low, high as well as market players colluding to fix MDRs. Also, there have been cases of hidden charges and inadequate disclosure.⁹⁶ Regulations need to ensure that such abuse do not take place. RBI has recently called for unbundling of charges and ensuring greater transparency in MDR.⁹⁷

Consequently, there is a need to reform regulation of MDR. Better regulation involves designing several regulatory options through comprehensive consultation process, assessing impact of such options on the economy, and selecting such option which has the potential to result in maximum positive impact on the economy. Such exercise is known as RIA and practiced in several jurisdictions. It has been recommended for India as well.⁹⁸ Consequently, the RBI must undertake a comprehensive RIA before suggesting possible mechanisms to regulate MDR.

In addition, payments banks may enter into arrangements with related parties (promoters/promoter group entities) which act as merchants.⁹⁹ There is a possibility that related party merchants might be treated differently (preferentially), when compared with unrelated merchants. This could lead to competition concerns in the market. There is a need to monitor related party transactions to prevent appreciable adverse effect on competition.

5. Dealing with deposits in excess of Rs. 100,000

The payments banks guidelines cap end of day balance in customer account to Rs. 100,000. This is despite deposits of more than Rs. 100,000 being allowed during the day. However, the guidelines do not indicate any mechanism to ensure compliance with such limit or liability in case non-compliance. Payments banks are expected to design innovative mechanisms to deal with situations which might result in breach of such limit and ensure compliance.

⁹⁵*Ibid*

⁹⁶ European Commission, *Commission welcomes European Parliament vote to cap interchange fees and improve competition for card-based payments*, 10 March 2015, available at: http://europa.eu/rapid/press-release_IP-15-4585_en.htm

⁹⁷ RBI notification, *Merchant discount rate structure- unbundling of charges*, September 01, 2016

⁹⁸ Report of the Financial Sector Legislative Reforms Committee, 2013; Report of the Ajay Shankar Committee, 2016

⁹⁹ Reliance Industries Limited is in into retail business, and is expected to enter into merchant relationships with payments banks

The end of day customer balance limit could breach in several unforeseen circumstances. These include: customer bringing a large sum to deposit near to the end of day, refunds on account of failed transactions, et al. Stakeholder interactions revealed that several mechanisms could be designed to comply with the cap. These include opening of mirror accounts in universal banks (which partners with payments bank), or opening of pool account in universal banks or payments banks, etc.

However, it has been pointed out that all these options are expensive and time consuming. For instance, opening mirror accounts in universal banks will require repetition of KYC process by such universal banks. In addition, most of these accounts would remain dormant for most periods and thus would cost the bank for maintaining such dormant accounts. Further, there is lack of clarity if interest will accrue on the excess funds that are deposited in such mirror account or pool account.

Allow opening of pool account with payments banks

While regulations have put a cap on the end of day customer limit to ensure that the payment banks target small and mid-sized customers, it must be ensured that such cap does not result in inconvenience for customers. As indicated, stakeholder interactions reveal that such restriction might result in inconvenience for customers.

In order to avoid such situation, regulations may allow payments banks to open an interest-free pool account with payments banks up to a specific percentage of their total deposits, to manage excess deposits. Also, such regulation must be periodically reviewed to ensure that it does not result in inconvenience to consumers.

6. Partnering with financial service providers to offer credit related origination services

While payments banks cannot offer credit to customers, they might want to act as intermediaries between credit providers (universal banks and non-bank finance companies) and customers to provide credit related origination services.

Clarify conditions subject to which payments banks can act as BCs of universal banks

Payments banks may opt to act as BCs of universal banks. The scope of activities of BCs in normal course includes processing of loan applications, disbursal of small value credit, collection of small value deposit, receipt and delivery of small value remittances/other payments services. Table 5.4 points out partnerships which payments banks have entered with universal banks.

Table 5.4: Payments Banks Partnerships with Universal Banks	
Airtel M Commerce Services Limited	Kotak Mahindra Bank
FINO PayTech Limited	ICICI Bank and others
National Securities Depository Limited	IDBI Bank*
Reliance Industries Limited	State Bank of India
* <i>proposed</i>	

While payments banks guidelines allow them to become BCs of universal banks, the guidelines with respect to the appointment of BCs do not envisage a bank becoming BC of the other.¹⁰⁰ These guidelines envisage different categories of entities as BCs, such as individuals, cooperative societies, post offices, companies, non-deposit taking non-banking financial companies (ND-NBFCs), and envisage incremental accountability standards. Most stringent obligations are placed on ND-NBFCs for acting as BCs of universal banks (see Table 5.5 for details).

Table 5.5: Key Conditions for ND-NBFCs to Act as BCs for Universal Banks
1. It should be ensured that there is no comingling of bank funds and those of the NBFC-ND appointed as BC.
2. There should be a specific contractual arrangement between the bank and the NBFC-ND to ensure that all possible conflicts of interest are adequately taken care of.
3. NBFC-ND should not adopt any restrictive practice such as offering savings or remittance functions only to its own customers and forced bundling of services offered by the NBFC-ND and the bank should not take place.

It is not clear if payments banks, while acting as BCs of universal banks, will be subject to conditions similar to those of ND-NBFCs. The obligations upon payments banks to act as BCs of universal banks need to be proportional to the risk involved in such arrangements and need not be excessively prohibitive. As payments banks are deposit taking entities, perhaps, they might become subject to stricter conditions. The regulations need to clarify if that is the case.

Allow payments banks to act as agents of non-bank finance companies

It is not clear if the guidelines envisage payments banks to act as agents of any entity other than banks. For instance, several NBFCs offer customised credit products to their customers, upon evaluation of transaction history of such customers, including recurring deposits and payments.

Universal banks might not be in a position to consider transaction history as proof of creditworthiness. Payments banks would have copious amount of data on transaction history of customers which could be utilised for designing customised products for customers, including customised credit products.

However, currently regulations do not envisage banks to act as agents of NBFCs. This is because banks could traditionally offer all services which non-bank finance companies could offer. However, such is not the case with payments banks.

While it makes sense to disallow universal banks from acting as agents/business facilitators of NBFCs, treating payments banks similar to universal banks despite their inherent difference will put payments banks at a disadvantage. For payments banks model to work, it is extremely important that they are able to monetise the data available. Acting as agents of NBFCs to offer credit to customer on the basis of transaction history could be one of the mechanisms for this.

¹⁰⁰ For details, see RBI Master Circular on Branch Licencing, July 01, 2015

Inability of payments banks to adopt this route will create inconvenience for payments banks as well as customers who might not get other avenues to access formal credit on the basis of their transaction history. Consequently, payments banks must be allowed to act as agents of NBFCs subject to clear segregation and disclosure of duties and accountability provisions.

7. Inability to offer differential interest rates for attracting micro-deposits

One of the key objectives of payments banks architecture is to attract low income consumers, having capacity and requirement to save and transfer amounts of low value. While payments banks will be able to offer interest on deposits, regulations do not allow banks to offer differential interest rates for deposits up to Rs. 100,000¹⁰¹.

Allow payments banks to incentivise micro-deposits

Under the existing regulatory architecture, payments banks will not be able to offer any additional financial incentives for micro-deposits. As a result, they might lose their competitive edge as in any case interests on deposits are offered by universal banks as well. Lack of financial motivation may not nudge the customers to deposit money with payments banks.

Thus, regulations should allow payments banks to offer differential interest rates and other financial and non-financial incentives to attract micro-deposits.

8. Requirement of multiple approvals for cross-selling

Payments banks can undertake non-risk sharing simple financial services, 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.

Insurance: In order to undertake distribution of insurance products, payments banks will have to obtain certificate of registration under IRDA (Registration of Corporate Agents) Regulations, 2015. A no objection certificate from the RBI would be required along with application made to IRDA for registration. Conditions are imposed on number of insurers (three) in different segments that agents can enter into arrangements with. 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 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.¹⁰² 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.

¹⁰¹ RBI Master Directions on Interest Rates on Deposits, 2016

¹⁰² www.irdai.gov.in/ADMINCMS/cms/frnGeneral_Layout.aspx?page=PageNo2728&flag=1

Reports suggest that Paytm entered into partnerships with various insurance companies, including ICICI Prudential Life, Religare Health, Reliance Life and Reliance General to aid the payment of insurance premiums online through its wallet. According to Paytm, it is looking to sign up over 15 companies. Paytm mentions that it will also enable a 'closed loop process' that will remind customers about when their insurance is due, other than providing customers with deals and offers when paying the insurance.¹⁰³ Paytm has obtained payments bank licence, and thus might require additional approvals to continue such services.

Mutual funds: The 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 unit-holders 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.

Pension: The PFRDA has issued circular regarding incentives to banks for mobilisation and registration of subscriber under the *Atal Pension Yojana*.¹⁰⁴

Moves towards regulatory cooperation for approval and reporting

As indicated, payments banks will be required to obtain multiple approvals from different regulators to be able to cross-sell financial products and services. They would also have to report to different regulators and comply with their respective disclosure requirements. This could increase the burden on payments banks and inflate the cost of doing business.

Consequently, there is a need for harmonisation of regulations and promoting inter-regulatory cooperation – moving towards a more common framework instead of each regulator looking after their own domain. There is a need for lightweight and innovative regulations for payments banks.¹⁰⁵

In addition, a single window clearance mechanism that allows payments banks to submit applications and ongoing compliance related documents at one place, without the need to submit the same set of documents to different regulators, has the potential to significantly reduce the burden on payments banks.

9. Data analysis and sharing

Payments banks are required to ensure that information collected from customers for the purpose of opening an account is treated as confidential. Details of such information cannot be divulged for the purpose of cross selling, or for any other purpose without the express permission of the customer.¹⁰⁶ It has been further clarified that

¹⁰³VivekPai, *Now pay for insurance premiums through Paytm*, Medianama, October 30, 2015

¹⁰⁴www.pfrda.org.in/WriteReadData/Links/Incentive%20Structure%20for%20APY5c598c21-5021-481a-8866-16213d2d1343.pdf

¹⁰⁵Brookings Report on Payments Banks, 2015

¹⁰⁶The Information Technology Act, 2000

optional/additional information can be obtained with the explicit consent of the customer after the account is opened.¹⁰⁷ Consequently, for use of any customer-related information, prior express and informed customer consent is necessary.

In addition, payments banks will have access to transaction history of the customer, which can be analysed to design targeted products and services for customers, including credit-related products. As regulations specifically prescribe activities that payments banks are allowed to undertake, it is not clear if payments banks are allowed to undertake data analysis, credit scoring and related activities and share results/scores with interested service providers.

Based on customer transaction history, payments banks might also be in a position to analyse and identify expenditure trends of specific class of customers, and share the same with interested service providers. This might not tantamount to sharing of sensitive individual customer information.

In case payments banks decide to outsource the data analysis and credit scoring function, they might have to share the customer-related information with third parties, for which express and informed customer consent would be required.

Allow payments banks to undertake data analysis related functions

Payments banks must be allowed to undertake data analysis and related functions and share results with service providers, subject to express and informed customer consent. Such ability will increase the revenue generation capability of payments banks and improve business viability. It will also prevent unnecessary movement of sensitive customer information which could remain housed within payments banks.

Monitor exclusive information sharing tie-ups

Existing promoters of payments banks (such as telecom service providers, PPI issuers) would already have access to transaction history and expenditure related information of their customers. On sharing/migration of customers, such entities might want to align with their related payments banks to leverage such customer information.

While exclusive arrangements are not disallowed, it should be ensured that unwillingness to share customer information with unrelated payments banks does not have appreciable adverse effect on competition.

10. Utility bill payments services

Payments banks are expected to provide utility bill payment services to their customers. In order to undertake such services, going forward, payments banks will be required to take licence to operate as Bharat Bill Payment Operating Unit (BBPOU) from NPCI, which will operate Bharat Bill Payment System (BBPS) linking BBPOUs with utility service providers. Consequently, payments banks will not be required to enter into individual agreements with each of the utility service providers.

¹⁰⁷ RBI Master Direction on KYC dated February 25, 2016, available on https://rbi.org.in/Scripts/BS_ViewMasDirections.aspx?id=10292

In order to take such licence, payments banks will be required to comply with relevant guidelines and regulations issued by NPCI. Consequently, NPCI will act as quasi-regulator as well as quasi-operator in the sector.

Facilitate clarity in the role of NPCI

NPCI will be regulating the utility bill payments market. It will also provide the technological back-end to link utility service providers to BBPOUs. The utility bill payment market is crucial for payments banks as well as customers, owing to the recurring number of utility payments involved. The customer data generated of such recurring payments could be monetised by payments banks to facilitate access to credit and other services to consumers.

NPCI is itself an operator in payments infrastructure market, and competes with other service providers, in this and other segments (such as retail payments).¹⁰⁸ It has been selected to exclusively provide services in utility bill payment market, and also act as a quasi-regulator.

NPCI will need to ensure that it does not abuse its dominant position, in bill payment sector or other related digital payment sectors. It must keep its services affordable, secure, quick and customer friendly; and ensure no unreasonable discrimination between its customers. NPCI should issue guidelines after effective prior consultation and taking into account costs and benefits of different regulatory options.

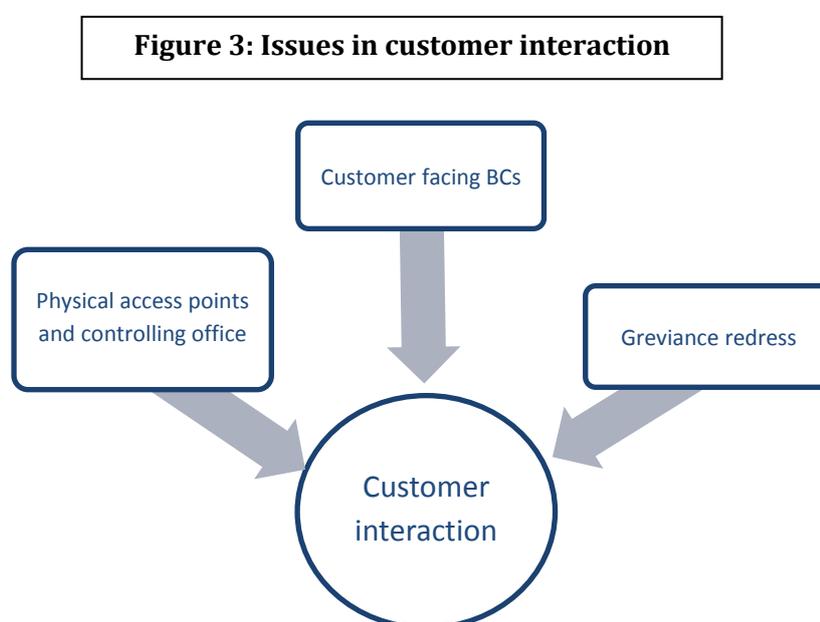
¹⁰⁸It has been reported that NPCI is attempting to link BBPS service with its UPI technology

6. Customer Interaction

Background

Payments banks are required to set up physical access points and controlling offices, and can appoint BCs/agents to facilitate interaction with customers, including grievance redress. However, lack of regulatory clarity on scope of activities of such entities could increase inconvenience and cost to stakeholders.

Figure 3 represents issues identified in relation to customer interaction and grievance redress, which could increase stakeholder inconvenience and cost, and act as barrier to growth of payments banks.



These issues have been further explained in the sections below, wherein solutions to address such issues are also provided.

1. Roles of Physical Access Points and Controlling Offices

The RBI requires payments banks to have at least 25 percent of its physical access points including BCs in rural centres. Physical access points include branches, ATMs, BCs and PoS centres. It also requires payments banks to establish a controlling office for a cluster of access points for control over various outlets and customer grievance redress. The controlling offices are required to be manned by employees of the banks. It has been clarified that as BCs are not employees of banks, their outlets cannot be designated as controlling offices.

While noting that universal banks are required to open at least 25 percent of branches in unbanked rural centres, the RBI has recognised different nature of payments banks and the available opportunity to leverage existing infrastructure of promoters of payments banks.

The RBI has issued a plethora of guidelines with respect to bank branches. Universal banks are required to make provision for adequate infrastructure, multilingual indicator boards, multilingual booklets, notice boards, printed copies of forms, complaint book, et al, at their branches. Providing such facilities is expensive and at times, becomes prohibitive in extending banking services to the unbanked and poor.

It is not clear if such guidelines are applicable to physical access points or controlling offices of payments banks. Further, difference of functions between physical access points and controlling offices is not clear. For instance, it is not clear if there is a prohibition on controlling offices to act as a branch/offer payments banks services.

Also, while controlling offices have been assigned the responsibility of customer grievance redress, the first point of customer contact will be physical access points. The regulations are silent on the role of physical access points regarding customer grievance redress. In the same vein, it has been highlighted that payment banks will be subject to Banking Ombudsman Scheme, 2006.

Allow innovation in roles of physical access points and controlling offices

Regulations should not prohibit innovation but should ensure transparency and consumer protection. The payment banks guidelines have provided broad principles for setting up of physical access points and controlling offices.

Discussions with stakeholders revealed that different strategies are being adopted to reach out to customers considering respective strengths of the stakeholders. For instance, some payments banks licencees are aiming to set up stripped down version of bank branch as physical access points. Such points will have bare minimum physical infrastructure, but strong back-end and connectivity. Some licencees are aiming to set up controlling offices in each of districts¹⁰⁹ and while others are aiming to set up a total of four-six controlling offices. Few licencees are aiming for strong online presence.¹¹⁰ Some of the licencees are aiming to have dual functioning at controlling offices (i.e. supervisory role as well as a full-fledged branch) while others are aiming to limit the function of controlling offices to supervision and customer grievance redress.

¹⁰⁹Indiapost Payment Bank is expected to have a network of more than 150,000 branches, with 140,000 in rural hinterland, see, Asit Ranjan Mishra, Remya Nair, *Why everyone wants a piece of Indiapost Payments Bank*, 04 June 2016, Livemint, available at: www.livemint.com/Industry/pFNOozznY7AYfwiSydzy80/India-Post-Payments-Bank-A-gamechanger-for-financial-servi.html

¹¹⁰ It has been reported, "Paytm's Payment Bank, however, will not act as a traditional bank that can be used for funds withdrawal. The Paytm Bank will be a digital banking system solely meant for buying products or services online and offline both without any notes exchanging hands....Our banking will be entirely dependent on the mobile app. We will also have Paytmka ATM, which won't be like current one's" See, Abhishek, *Paytm Payment Bank: The Beginning of the End of Currency Notes in India ?*, Dazeinfo, May 05, 2016, available at: <http://dazeinfo.com/2016/05/05/paytm-payment-banks-launch-india/>

Most of the payments banks recognise that physical access points are first point of customer interface and hence persons stationed at such points need to be trained in customer management and preliminary grievance redress skills. However, this should not result in complaint getting lost in the resolution process.¹¹¹

Payments banks are expected to leverage technology for customer servicing, including providing details of services available, responding to the customer enquiries, etc. They are expected to design different models of reaching out to customers and making banking convenient for them.¹¹²

Investment in physical infrastructure would be expensive and limit overall reach for payments banks, resulting in customer exclusion. Consequently, while payments banks should be required to comply with similar customer service standards applicable to universal banks, they should not be required to comply with physical infrastructure investment requirements.¹¹³

It can be deduced that competition in payments banks market will force service providers to put their best foot forward to serve consumers, depending on the available strategies and strengths. While regulations need not micro manage the payments banks business, they should require complete transparency and disclosure with respect to the functions assigned to physical access points and controlling offices.

2. Interoperability among BCs at the point of customer interface

Banks usually reach out the unbanked and rural customers through BCs. Entities like individuals, non-government organisations, cooperative societies, post offices, companies, ND-NBFCs, can be engaged as BCs.

The relationship between a bank and BC is very delicate, as a BC is first point of customer interface for bank. Consequently, stringent guidelines have been put in place for governing this relationship. The regulations cover scope of operations of BCs, risk sharing between BCs and banks, place of operations of BCs, payment of commission/fee to BCs, monitoring of BC operations, consumer protection and grievance redress standards. It is not clear to what extent the guidelines applicable in a universal bank and BC relationship will be extended to a payment bank and newly appointed BC.

With the advent of payments banks, the number and type of entities acting as BCs are expected significantly increase. Small merchants hitherto acting as mobile connection

¹¹¹RafeMazer et al, *Recourse in Digital Financial Services*, CGAP, February 02, 2016, available at www.cgap.org/publications/recourse-digital-financial-services

¹¹²It appears that branchless banks are being launched in India. See, *DBS launches mobile only bank in India*, FinTech Innovation, April 27, 2016

¹¹³ "Banks and other traditional providers should be allowed, as they choose, either to work solely with third-party agents and networks, to rely entirely on their own branches and agent networks, or to construct whatever mix of branches, proprietary networks, and third-party agents they deem consistent with their internal business strategy. Accountability for the quality of those agents and responsibility for the services they provide, however, must remain with the principal — the bank or the network operator, depending on the arrangement chosen. That way, the entire network can be indirectly regulated and supervised without the regulator having to monitor every agent in the network", *Financial Regulations for Improving Financial Inclusion: A CGD Task Force Report*, 2016

and data pack vendors are expected to act as BCs. Consequently, it has been report that payments banks licencees with mobile network providers as promoters have an advantage to over other licencees, with respect to establishing a BC network.¹¹⁴

In order to facilitate sharing of BC infrastructure, the regulations have allowed a BC to act as a BC for more than one bank. However, BC interoperability at the point of customer interface is subject to certain conditions, as set out in Table 3.12.

Table 6.1: RBI Guidelines on BC Interoperability at the Point of Customer Interface
<p>At the point of customer interface, a retail outlet or a sub-agent of a BC shall represent the bank which has appointed the BC. Interoperability 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 the following conditions:</p> <p>(i) The transactions and authentications at such retail outlets or sub-agents of BCs are carried out on-line;</p> <p>(ii) The transactions are carried out on Core Banking Solution (CBS) platform; and</p> <p>(iii) The banks follow the standard operating procedures to be advised by the Indian Banks' Association (IBA).</p>

The objective behind allowing only one bank to be represented at the point of customer interface, without necessary technological back-up, is to prevent any conflict of interest and to promote clarity and accountability in transaction.

The regulations with respect to customer facing BC interoperability will be applicable to payments banks as well. However, as payments banks offer limited banking services, their BCs will be expected to do the same, and will not be in a position to open a customer account on behalf of a universal bank.¹¹⁵

Allow interoperability among BCs at the point of customer interface

As indicated earlier, the RBI has laid down several conditions for appointment and operation of BCs. While it might not have envisaged the change the sector has undergone, the broad principles of bank-BC relation and operations remain unchanged.

Consequently, payments banks will have to take-up more responsibilities of training and preparing newly appointed entities in their BC role, within the broad guidelines issued by RBI for bank-BC model. Payments banks and BCs will need to be supported in this role, through training and capacity building initiatives.

Lack of interoperability at the point of customer interface for account opening and deposit services might be necessary when BC is offering services competing services and it might have been difficult for the BC to represent interests of one bank over other.

¹¹⁴ Microsave, *Will Mobile Network Operators Make it as payments banks?*, August 2016

¹¹⁵ Pakistan is one of the most interoperable mobile money markets in the world. This allows both consumers as well as service providers to benefit. See, Nautiyal, *Branchless banking interoperability in Pakistan: A promising start*, GSMA, April 07, 2016

In such situations, BC is rightly allowed to represent only such bank which had originally appointed it.

However, payments banks will not be offering the complete set of banking services. As indicated earlier, their services will be limited to offering demand deposits and payment services. Should they wish to offer other services, such as fixed deposits and credit, they will have to collaborate with universal banks. However, universal banks will not be able to offer such services without completion of KYC exercise and customer acquisition.

To enable offering of complete set of services to consumers, both payments and universal banks will have to enter into arrangement with the relevant customer facing BC. However, such BC might not be able to offer the complete set of services to consumers on account of restrictive regulations, that allow only one bank to be represented at the point of customer interface. Such inability of BCs to represent other universal banks and payments banks at same point would mean customers having to approach different BCs for access complete set of banking services. This would be expensive for customers and result in customer inconvenience. Such regulations will also put payments banks at competitive disadvantage against universal banks.

To avoid such scenario, it would be necessary that BCs of payments banks are allowed to represent the payments bank which has appointed it, and the universal bank with which such payments bank has entered into collaboration.

Experts have also called for move towards setting up of white label BCs, i.e. third party non-bank entities partnering with banks to provide interoperable BC services.¹¹⁶ Regulators should explore this idea as well. Agent interoperability is one of the tenets of efficient markets, which benefits both consumers as well as market players.¹¹⁷

3. Mechanisms of grievance redress

As indicated earlier, controlling offices of payments banks have been designated for customer grievance redress. The payments banks are also subject to Banking Ombudsman Scheme, and are required to set up high powered customer grievance cell to handle customer complaints. However, there is no further guidance on customer protection and grievance redress mechanism in the payments banks guidelines.

It has been clarified that if payments banks guidelines do not cover any specific issue, the guidelines issued to universal banks will be applicable. The RBI has issued several guidelines for universal banks on consumer protection and grievance redress. For instance, 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.¹¹⁸

¹¹⁶ Nachiket Mor Committee Report, 2013

¹¹⁷ Supra Note 115

¹¹⁸ RBI Master Circular on Customer Service in Banks dated July 01, 2015, available at: https://rbi.org.in/Scripts/BS_ViewMasCirculardetails.aspx?id=9862

As payments banks are expected to use technology and leverage their existing infrastructure for customer servicing and grievance redress, the extent to which such regulations will be applicable to payment banks is not clear.

Allow innovation and use of technology for grievance redress

Literature suggests that there is a huge potential for digital service providers like payments banks to innovate and invest in customer grievance redress. By investing sufficiently in their recourse systems, providers can benefit in several ways, including increased data on consumer behaviour and product preferences, fraud detection and mitigation, and increased product uptake and usage.¹¹⁹

There have been several innovations by digital financial service providers in India to redress consumer grievances and empower them. This include training agents to act as first line customer service executive, providing full back-end support to agents, and empower customers through use of technology.¹²⁰ Social networking sites can also be used as a platform for grievance redress. The viral nature of the platform allows any unattended complaint to cause severe damage to the brand. Innovative solutions aggregating customer feedback and grievances across such websites can help service providers remain on top of customer service and revolutionise the after-sales customer experience.¹²¹

It has also been noted that websites, mobile phones, missed calls, physical places, and collection points could be some ways to aggregate customer complaints for redressal. High level of automation would not only allow customers to access the grievance redress machinery at anytime from anywhere but also reduce the cost of grievance redress.¹²²

Experts have suggested several good practices to improve customer service and recourse systems, on the basis of experience of service providers in different jurisdictions. These include improving service reliability and robustness, making customer interface more user friendly, strengthening agent quality, management, and liquidity, et al.¹²³

Payments banks are expected to use technology and design innovative mechanisms to improve consumer redress mechanisms. It must be ensured that regulations do not stifle such possibility, subject to prior disclosure. Regulations should set out the broad context and principles in relation to grievance redress which the payments banks

¹¹⁹Supra Note 78. Also, Schneider, *Bots, Messenger and future of customer service*, Crunch Network, May 07, 2016

¹²⁰Vergheese et al, *Prioritizing customers: 3 lessons from Eko, India*, CGAP, March 15, 2016, available at: www.cgap.org/blog/prioritizing-customers-3-lessons-eko-india

¹²¹PWC, *Rethinking distribution: Smart solutions for smart customers*, 2015, available at www.pwc.in/assets/pdfs/publications/2015/rethinking-distribution-smart-solutions-for-smart-customers.pdf

¹²² RBI press release on Annual Conference of Banking Ombudsmen, 2016, available at: https://rbi.org.in/Scripts/BS_PressReleaseDisplay.aspx?prid=36256

¹²³ Zimmerman, *Five ways providers can do digital finance better*, CGAP, June 24, 2015, available at: *Launches Feature to stop erroneous transfers: Hakikisha*, CGAP, October 28, 2015, available at: www.cgap.org/blog/safaricom-launches-feature-prevent-errant-transfers-hakikisha

should be required to comply with. It should allow payments banks to innovate and use technology to ensure high quality customer service and grievance redress. Market innovations would need to address the risks involved in data security and the privacy.¹²⁴

Payments banks should be allowed to incentivise use of digital means for grievance redress.¹²⁵ However, regulators would need to closely monitor and evaluate the grievance redress mechanism put in place by the payments banks, to ensure the high level principles set out by RBI are met.

¹²⁴Nika, *Accessibility of mobile money services in 2015: Agents and technical interfaces*, GSMA, May 05, 2016, notes, “apps bring some new security challenges to the providers and customers. Malware, internet- and OS-based attacks could potentially compromise user data.”

¹²⁵ Use of technology will generate transaction data which will be used to target consumers in a better manner. It has been argued that people deserve to be compensated for the data they produce. See, Harten, *Big data for Good: How impartial institutions can contribute*, CGAP, March 17, 2016

7. Conclusion and the Way Forward

Background

The previous chapters identified, prioritised and discussed key competition and regulatory bottlenecks to growth of payments banks. They also suggested solutions to the bottlenecks identified. Table 7.1 summarises 21 issues identified and the suggestions made for achieving optimal regulation and competition in the sector.

Table 7.1: Summary of issues and proposed suggestions		
Customer acquisition		
S. no	Issue	Proposed solution
1.	Requirement to submit physical PoI, PoA and photographs.	<ul style="list-style-type: none"> Allow submission of documents digitally
2.	Lack of clarity on possibility of customer sharing ¹²⁶ and migration ¹²⁷ without repetition of complete KYC exercise	<ul style="list-style-type: none"> Harmonisation of KYC standards across sectors¹²⁸ In the interim, allow customer sharing/migration on additional KYC Ensure express and informed customer consent for customer sharing/migration Clarify that accountability remains with payments banks on customer sharing/migration Prevent abuse of dominant position in case of refusal to share customer information
3.	eKYC is limited to <i>Aadhar</i>	<ul style="list-style-type: none"> Facilitate limited access to application programming interface of relevant government departments to financial service providers Use regulatory sandbox to test viability and industry preparedness¹²⁹
4.	Customer consent can only be provided in electronic KYC biometrically	<ul style="list-style-type: none"> Allow consent through one time password route
5.	Informal small and medium enterprises do not possess enterprise-related documents to enable opening of current accounts	<ul style="list-style-type: none"> Allow opening of current account based on individual KYC and available enterprise-related documents Waive end of day customer limit for individual merchants Monitor account activity and red-flag suspicious transactions
6.	The CKYCR requires submission of unverifiable customer information	<ul style="list-style-type: none"> The CKYCR should only collect such Information relevant for verifying identity and address of the customer
7.	The CKYCR requires uploading of scanned copies of customer documents,	<ul style="list-style-type: none"> The CKYCR should allow submission of documents in the format preferred by banks

¹²⁶ Supra Note 8

¹²⁷ Supra Note 9

¹²⁸ Supra Note 10

¹²⁹ Supra Note 11

Table 7.1: Summary of issues and proposed suggestions		
	signature and photograph	
8.	Requirement to quote PAN/fill prescribed form ¹³⁰ in its absence, for opening of bank account	<ul style="list-style-type: none"> • KYC verification should be adequate for opening of bank account and the requirement to quote PAN/submit Form 60 should be discontinued
Service delivery		
9.	Restriction on offering differential interest rates for deposits below Rs 100,000	<ul style="list-style-type: none"> • Allow payments banks to offer attractive interest rates and other incentives to attract micro-deposits
10.	Restrictions on offering recurring and time deposit services	<ul style="list-style-type: none"> • Allow payments banks to offer recurring and time deposit services, subject to adequate disclosures
11.	Requirement to route cross border remittance transactions through universal banks/authorised dealers category – I (AD CAT-I)	<ul style="list-style-type: none"> • Allow payments banks to obtain AD CAT-I licence, subject to compliance with relevant conditions • In the interim, prevent appreciable adverse impact on competition, if any, due to exclusive agreements between payments banks and universal banks/ AD CAT – I licencees
12.	Not clear if payments banks will be required to issue passbooks, cheque books and put in place cheque acceptance infrastructure	<ul style="list-style-type: none"> • Clarify that payments banks will not be compulsorily required to issue passbooks, cheque books and they should be able to incentivise innovative means of making digital payments and sharing account information • Prevent appreciable adverse impact on competition, if any, due to exclusive agreements between payments banks and universal banks for cheque clearance
13.	Not clear if payments banks will be mandatorily required to issue ATM/debit cards	<ul style="list-style-type: none"> • Clarify that payments banks will not be compulsorily required to issue ATM cards/debit cards and they should be able to incentivise innovative means of making digital payments¹³¹ • Prevent appreciable adverse impact on competition, if any, due to exclusive agreements between payments banks and merchants for accepting specific cards
14.	Lack of clarity on possible mechanisms to comply with end of day customer balance limit of Rs. 100,000/US\$1,500, specifically on account refunds on failed transactions	<ul style="list-style-type: none"> • Allow payments banks to maintain pool account wherein excess deposits on account of refunds etc. could be made. The deposits in such account could be capped to a specified percentage of total deposits in customer accounts • Review the end of day customer limit periodically to ascertain its impact on stakeholders, through tools like RIA¹³²
15.	Requirement of multiple approvals and reporting for cross-selling of financial products/services	<ul style="list-style-type: none"> • Create a single window clearance and reporting mechanism to facilitate cross-selling • Prevent appreciable adverse impact on competition, if any, due to exclusive agreements

¹³⁰ Supra Note 12

¹³¹ Supra Note 13

¹³² Draft Regulatory Impact Assessment toolkit prepared by CUTS is available at: [www.cuts-ccier.org/BHC-RIA/pdf/Draft_RIA_Toolkit_\(for_public_comments\).pdf](http://www.cuts-ccier.org/BHC-RIA/pdf/Draft_RIA_Toolkit_(for_public_comments).pdf)

Table 7.1: Summary of issues and proposed suggestions		
		between payments banks and other financial service providers
16.	Lack of clarity on ability to undertake data mining	<ul style="list-style-type: none"> Clarify that payments banks can undertake data mining internally, and share results with external service providers, subject to express and informed customer consent
17.	Lack of clarity on conditions subject to which payments banks can enter into arrangements with banks/ NBFCs to offer credit products and related origination services	<ul style="list-style-type: none"> Clarify the conditions subject to which payments banks can act as BCs/agents of universal banks Allow payments banks to enter into collaboration/act agent of NBFCs to offer credit products and related origination services Prevent appreciable adverse impact on competition, if any, due to exclusive agreements between payments banks and universal banks/NBFCs for providing credit products and related origination services
18.	Lack of clarity on role of NPCI in utility bill payment infrastructure	<ul style="list-style-type: none"> Ensure level playing field by NPCI of market players in utility bill payment market
Customer interaction		
19.	Lack of clarity if physical access points and controlling offices could carry out additional functions	<ul style="list-style-type: none"> Allow use of physical access points and controlling offices for carrying out functions, in addition to those prescribed by regulations, subject to disclosure and accountability mechanisms
20.	Limitation of BCs to represent only one bank at point of customer interface	<ul style="list-style-type: none"> Allow BCs to represent multiple banks at point of customer interface, subject to compliance with adequate technology, disclosure and accountability standards Work towards operationalisation of white label BC regime In the interim, allow representation by existing BCs of at least one payments bank along with one universal bank Prevent appreciable adverse impact on competition, if any, due to exclusive agreements between payments banks and BCs
21.	Lack of clarity on modes of grievance redress which can be adopted	<ul style="list-style-type: none"> Allow payments banks to adopt innovation and digital modes of grievance redress, subject to adequate transparency/disclosure and accountability standards

Reforming the Approach to Regulation

As indicated in the Table 7.1, regulations need to allow use of innovation and digital technology to enable containing of infrastructure costs. This should be conducted while maintaining necessary competition in sector, without letting go of the opportunity to share infrastructure and promoting interoperability between market players.

It has been recognised that the combination of innovation and sound regulation in financial services enables the private sector to improve economic opportunity and well-

being for poor in many countries.¹³³The suggestions made in this report aim a move towards such modern regulatory approach.¹³⁴

However, digitisation and use of technology brings with itself the risk of sensitive data of consumer being subject to misuse.¹³⁵ CGAP has also identified risks specific to digital finance consumers which needs to be addressed.¹³⁶ Consequently, regulations would need to ensure that consumer protection, data protection and privacy remains at their core.¹³⁷

GSMA notes 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.¹³⁸While it has been noted that payments banks regulations

¹³³Supra Note 17. Also, Knight, *Regulating FinTech: Creating a Regulatory Regime that Enables Innovation While Providing Appropriate Consumer Protection*, Mercatus Centre, George Mason University, 12 May 2016, notes, “The current period of innovation, driven by the application of technology to financial services in new ways, has the potential to significantly improve financial access, inclusion, and quality for consumers. Undue regulatory burdens will discourage entrepreneurs and firms from devoting resources to providing new services and products or utilising technology to try to expand services to underserved markets. While the OCC should monitor developments closely, it also should avoid impairing innovation. Any foregone beneficial innovation will extract a cost on consumers, especially those who are most poorly served by the current system. At the forefront of the OCC’s considerations should be concern over the risk that consumers could be denied better, cheaper, more effective services than are currently available, simply because of unnecessary impediments to innovation.” The government is already looking to promote payments through cards and digital means, see Ministry of Finance Office Memorandum, February 29, 2016, available at:

http://finmin.nic.in/the_ministry/dept_eco_affairs/currency_coinage/Promo_PaymentsMeans_Card_Digital.pdf

¹³⁴ The recommendations under this report have found support in industry experts as well. Rajesh Aggarwal notes, “I have also been talking to new 11 payment bank teams. We have an opportunity to leapfrog, provided we don’t kill them with heavy regulation, with old-fashioned banker-style thinking. We need to totally redefine and reimagine – what is a bank, what is a branch, what is a passbook, what is a chequebook, what is KYC, what is a transaction., new Payment banks will face many overt and covert challenges from existing players. I hope that new payment banks are not killed in the womb, by traditional treatment of KYC, Passbook, Chequebook, Branch concepts. Let us hope that banking regulator RBI will issue lightweight regulation for payment banks.” Rajesh Aggarwal, *JAM – using Jan Dhan Bank Accounts, Aadhar and Mobiles to create new products and services, and new ways of doing things*, March 2016

¹³⁵Shadma Shaikh, *Why mobile apps require access to your data and device tools*, Economic Times, 06 May 2016, notes, “Letting apps access more data on your phone than required could lead to security risks and expose your personal information. Almost all mobile apps transmit and receive data between phones and remote servers. It has never been more crucial to understand the risks involved in giving mobile apps indiscriminate access to your data and device tools”

¹³⁶ It has identified seven principal risk areas, which digital finance consumers face at present. These include: i) Inability to transact due to network/ service downtime; ii) Insufficient agent liquidity or float; iii) Complex and confusing user interface; iv) Poor customer recourse; v) Non-transparent fees and other terms; vi) Fraud that targets customers; and vii) Inadequate data privacy and protection. Mckee et al, *Doing Digital Finance Right*, CGAP, June 2015, available at: www.cgap.org/publications/doing-digital-finance-right

¹³⁷ Pat Walshe, *The localization of privacy-observations from India*, GSMA, November 24, 2015, at: www.gsma.com/personaldata/the-localization-of-privacy-observations-from-india. Privacy concerns have also been raised in *Aadhar* related information, See, Tongia, *Updating Aadhar for better privacy*, The Hindu, March 28, 2016, available at: www.thehindu.com/opinion/op-ed/updating-aadhaar-for-better-privacy/article8402375.ece

¹³⁸ 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>

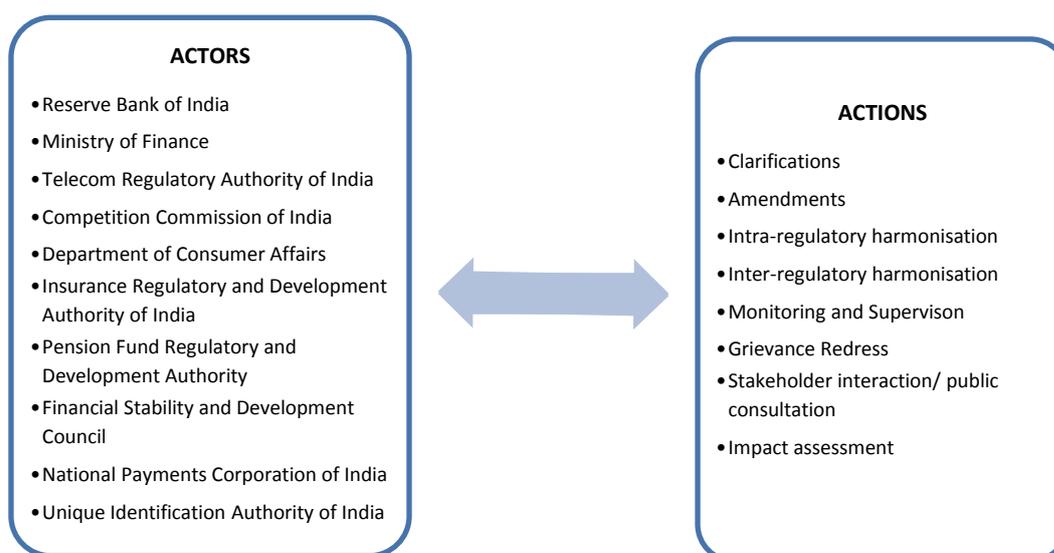
require express consent of consumer for sharing of consumer data, the regulators would need to ensure enforcement and fix accountability in case of breach.

In addition, with use of technology, innovation and increased competition, the number and nature of products and services offered to consumers will increase. BCs will be primary point of consumer contact, and they would be required to explain terms and conditions of the products to consumers. They will also be expected to act as first line of consumer grievance redress. With the advent of interoperability, BCs will be required to represent different service providers, to ensure consumer choice, and will face liquidity pressure.¹³⁹ Consequently, training and capacity building of consumers and BCs would be crucial.

Universe of actors and actions

In addition to finding possible solutions, different regulatory agencies with diverse regulatory actions have been identified that will be involved in putting CUTS proposals into practice, as indicated in Figure 4.

Figure 4: Actors and Actions involved in reforms



Prioritisation of solutions

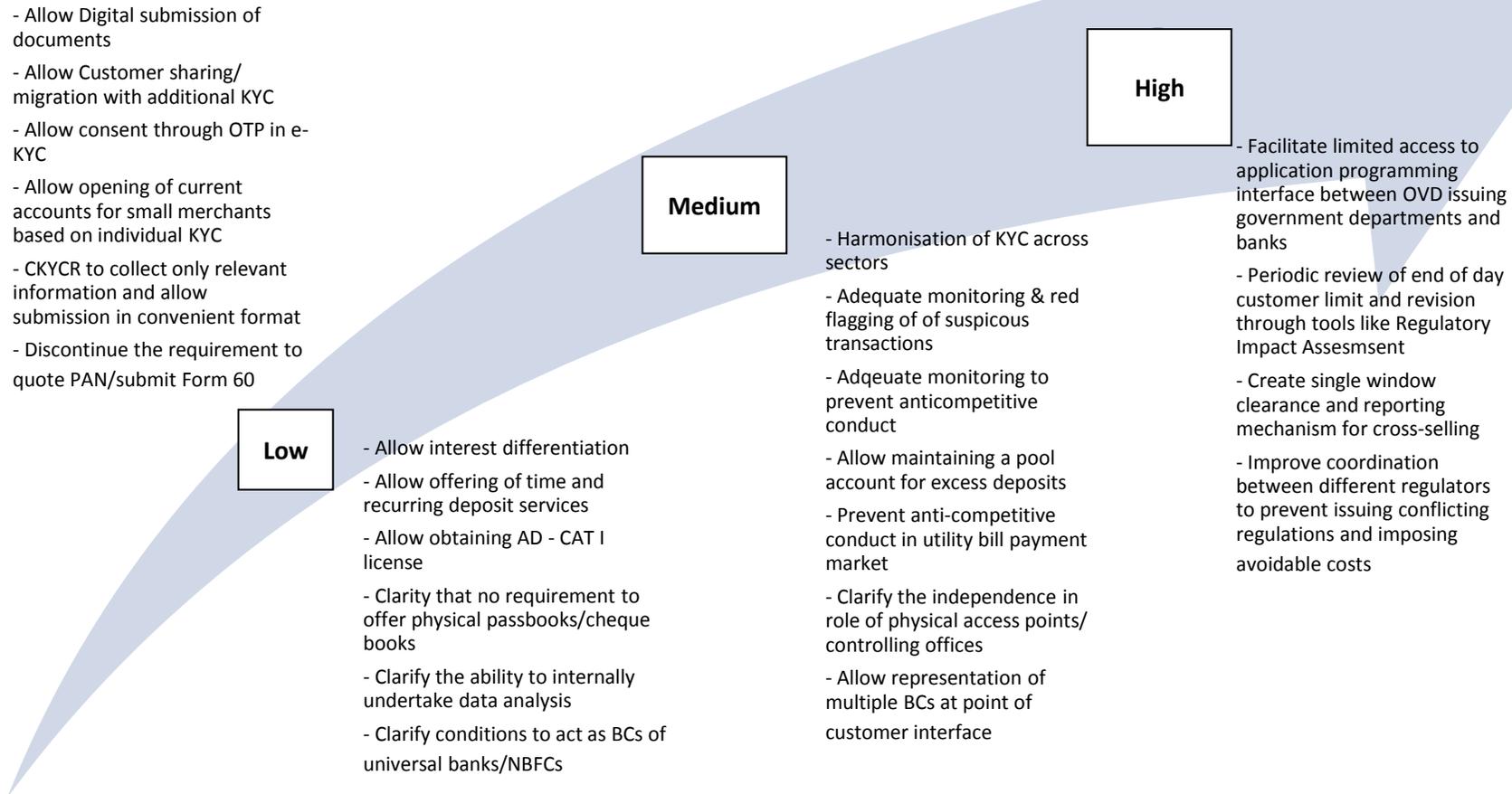
The recommendations made in Table 7.1 would need to be prioritised in order to identify the low hanging fruits and stakeholders would need to work towards their adoption. Suggestions requiring minor regulatory amendments without any additional infrastructure costs could be identified as low hanging fruits. However, those recommendations which would require incurring of additional infrastructure cost and/or significant regulatory changes could be clubbed as medium term to long term

¹³⁹ Removal of agent interoperability requires higher interoperability, Schiff, 2015

solutions, depending on the time and efforts required for setting up the necessary infrastructure.

Figure 5 attempts to highlight the potential regulatory and infrastructure/compliance burden expected to be imposed on relevant stakeholders on account of recommendations under the report. The estimation of burden is based on internal research and consultation with experts and other stakeholders.

Figure 5: Efforts required to implement solutions



As indicated earlier, the proposed solutions include amendments to regulations, issuance of clarifications, improvement in monitoring and supervision, inter-regulatory coordination and working with stakeholders to improve efficiency. While some of the proposed solutions are essential, some are ‘good to have’ to reduce uncertainty in the sector.

It should be noted that in addition to regulatory changes and putting relevant infrastructure in place, public outreach, advocacy and capacity building initiatives will have to be undertaken, to ensure practice changes make payments banks model successful.

Such initiatives will need to be strategically targeted to specific stakeholder groups, especially consumers, who will need to be informed of the relevant changes, costs and benefits involved, and slowly nudged from cash heavy banking model to less cash banking practices.

Low Hanging Fruits

On the basis of aforementioned prioritisation, top 10 priority low hanging fruits for regulatory action have been identified, as listed in Table 4.

Table 4: Top 10 priorities for reform	
S. no	
1.	Allow OTP for providing express consent in e-KYC
2.	Allow small merchants to open current accounts on the basis of individual KYC and available additional documents, and exempt them for end of day customer balance limit
3.	Discontinue the requirement to quote PAN (fill requisite form in its absence) for opening of new bank account
4.	Limit the CKYCR form to information and address details of customers, and allow payments banks to submit information to CKYCR in the form suitable to them
5.	Allow payments banks to provide recurring and time deposit services
6.	Ensure payments banks get authorised dealer category – I license for offering cross border remittance
7.	Clarity that payments banks can undertake data mining and collaborate with banks/NBFCs for extending credit to customers and provide relevant credit origination services
8.	Allow BCs of payments banks to represent other banks at the point of customer interface
9.	Allow incentivisation of customers, including differentiated interest rates, for micro-deposits
10.	Allow customer sharing/migration subject to additional KYC check