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CUTS International

RESEARCH PROJECT ON IDENTIFYING AND UNDERSTANDING COMPETITION AND REGULATORY BOTTLENECKS TO GROWTH OF PAYMENTS BANKS IN INDIA

Payments Banks: The Unfinished Agenda

1. Background

CUTS International[1], with support from Bill & Melinda Gates Foundation, implemented a research project to identify and understand the regulatory and competition bottlenecks to growth of payments banks in India.[2]

The project involved close interactions with stakeholders, including payments banks licensees and the Reserve Bank of India. The recommendations under the research project were released in September 2016.

On 06 October 2016, the Reserve Bank of India issued operating guidelines for payments banks (operating guidelines).[3] The operating guidelines were issued after extensive stakeholder consultations. CUTS had shared its findings and recommendations under the project with RBI. The operating guidelines made several changes to regulatory architecture of payments banks in line with project recommendations.

This document highlights outstanding reforms to the regulatory architecture of payments banks. The document is prepared based on summary review of operating guidelines of payments banks and the project recommendations which were not included in the operating guidelines.

2. Project recommendations not included in operating guidelines

Several recommendations of medium and long term nature were made under the project, which appear to have not included in the operating guidelines, based on a summary review. The table below highlights such recommendations.

Project recommendations not included in operating guidelines	
1.	Allow submission of Know Your Customer (KYC) related documents through digital means, such as photographs, emails
2.	Allow customers to provide consent to Unique Identification Authority of India (UIDAI) to share its information with payments bank through one time password route in electronic KYC
3.	Allow opening of current accounts for small merchants based on individual KYC, without the need for entity related documents
4.	Discontinue the requirement to quote PAN/ submission of Form 60 for opening of accounts/ issuance of debit cards
5.	Payments banks should be allowed to obtain KYC related details of customers from non-promoter telecom companies, subject to customer consent, and clarity on risk and accountability

[1] www.cuts-international.org
[2] http://www.cuts-ccier.org/PaymentsBanks/
[3] https://www.rbi.org.in/Scripts/NotificationUser.aspx?Id=10635&Mode=0

Project recommendations not included in operating guidelines	
6.	Central KYC Registry should not collect information other than that required to confirm identity and address. Also, allow submission of documents to CKYCR in a manner suitable for payments banks.[4]
7.	Allow payments banks to offer differential interest rates
8.	Allow payments banks to offer time and recurring deposit services
9.	Allow payments banks to act as business correspondents/ agents of non-bank finance companies
10.	Allow payments banks to obtain authorised dealer – category I license[5]
11.	Work towards harmonization of KYC across sectors (telecom, banking, insurance, securities, pension etc)
12.	Work with competition regulator to prevent competition distortionary policies and practices
13.	Prevent competition distortionary policies and practices in utility bill payment market
14.	Facilitate limited access to application programming interface of KYC documents issuing government departments and banks, to enable source based KYC in case of non-Aadhar related documents
15.	Conduct periodic review of end of day customer limit and revision through tools like Regulatory Impact Assessment
16.	Create single window clearance and reporting mechanism for cross-selling of financial services
17.	Improve coordination between different regulators to prevent issuing conflicting regulations and imposing avoidable costs
18.	Clarify if issuance of ATM cards is mandatory and applicability of minimum free withdrawals at ATMs of other banks

3. Additional issues based on summary review of operating guidelines

Based on summary review of operating guidelines, few other issues have emerged which might unfairly undermine the growth of payments banks. The same are listed in the table below.

Additional issues for payments banks based on summary review of operating guidelines	
1.	**Capital adequacy ratio**: The payments banks are required to maintain a capital adequacy ratio of 15 percent. This is higher than the ratio prescribed for universal banks (both old and new). The payments banks are not expected to engage in risky lending and investment activities, and scope of revenue generation is also limited. Thus, the high capital requirement could unfairly impose avoidable costs on payments banks, limit their reach, and thus ultimately undermine consumer interests.
2.	**Product approval**: At the time of submitting application for licence, the payments banks are required to submit to RBI a list of financial products they intend to offer, with a clear description. Any new products proposed to be introduced thereafter are required to be intimated to RBI for information. The operating guidelines provide that the RBI may place suitable restrictions on the design, functioning, or other features of the product including discontinuing the product. Such conditions are not imposed on universal banks, who often offer complicated products to

[4] The operating guidelines mention that all the extant regulations concerning KYC including those covering the Central KYC Registry, and any subsequent instructions in this regard, as applicable to commercial banks, would be applicable to payments banks

[5] The operating guidelines mention that the payments banks will receive authorised dealer category II license. They will need to comply with all conditions attached to such license and implement provisions of Foreign Contribution (Regulation) Act, 2010 (as applicable to commercial banks)

Additional issues for payments banks based on summary review of operating guidelines	
	consumers. The scope for product innovation is statutorily limited with payments banks. Unnecessary restrictions should not be further put on operational freedom. The discretionary powers of RBI in case of payments banks need to be cautiously used, and their abuse should be prevented.
3.	**Access points:** The annual plans for opening of physical access points by the payments banks for the initial five years would need prior approval of RBI. There is no such prior requirement on universal banks to get approval from RBI about their branch location/ location of business correspondents. Such differential treatment may impose unreasonable costs on payments banks, specifically in their initial years of operation.
4.	**Internet connectivity**: Business correspondents cannot undertake any offline transactions. Consequently, BCs cannot undertake transactions if there is no internet connectivity. While real-time internet connection is important for instant payments confirmation, and clear segregation of customer funds, significant population in India has no access to internet connection. Inability of payments banks BCs to operate in internet dark zones could prevent significant population from benefitting from their services.
5.	**Payment banks as BCs**: in cases where a payments bank is acting as the business correspondent for a bank, the BC engaged by the payments bank shall not open deposit accounts for the partner bank for whom the PB acts as the BC or undertake KYC documentation for that bank. Such restrictions are not applicable on other BCs. Operational restrictions limit innovation and prevent the service provider offer customised and low cost services, which should be avoided.
6.	**Management of excess deposits:** The operating guidelines mention that payments banks will have to make arrangements with other universal banks to manage amounts in excess of Rs. 100,000, subject to customer consent. Arrangements with other universal banks are expensive and require repetition of KYC exercise. The customers will have to eventually bear such costs. In the absence of customer consent, the customers will have to restrict their end of day deposit balance to Rs. 100,000, which will be inconvenient for consumers. In the alternative, payments banks could have been allowed to maintain a pool account with themselves to specific percentage of maximum allowable deposits to manage excess deposits. This could have reduced the costs and efforts on part of consumers.

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