Payment Banks in India – Demystified

[1]Dr.R.Srinivasan, [2]Prof.M.Subramanian,
[1]*Professor (Finance & Accounting) IILM Institute for Higher Education, Lodhi Road, New Delhi*
[2]*Associate Professor (Finance & General Management), IILM Institute for Higher Education, Lodhi Road, New Delhi–CUM- Research Scholar, PRIST University, Thanjavur.*

Abstract

The buzz word in Indian banking industry, during the recent days are "Payment Banks". Reserve Bank of India(RBI) seems to be very cautiously-active in granting licenses to (a) Payment Banks (b) Small Finance Banks in India. Common men are able to understand about the logic and business behind the Small Finance Banks, but about the Payment Banks every common man is raising their eye-brows (a) Who are these payment banks? (b) Already we have public sector banks, private sector banks, foreign banks and cooperative banks in India, is there a requirement for these payment banks? (c) What arethe value-added services these payment banks going to offer in the banking sector? (d) Are these payment banks only for enabling faster payments? (e) Will these payment bankers be a competitor for our existing banks? (f) Are these payment banks a game-changer in the Indian banking industry? (g) Are they really going to help the existing customers or driving for adding new unbanked customers, through financial inclusion? Like the above illustrative list of questions, lots and loads of queries are bubbling in our minds, for every now and then, these days. This paper aims at demystifying the concept of "Payment Banks in India". At the end of reading this paper, every reader would have clarity in their mind about the concept of payment banks.

Key words: *Small Finance Banks, Payment banks, Financial Inclusion, Value-added services, RBI*

1. Introduction

The underlying foundation of a country's financial system – including all institutions, information, technologies, rules and standards that enable financial intermediation – is its "financial infrastructure." A poor financial infrastructure imposes a considerable constraint upon financial institutions in many developing countries, hindering their efforts to offer financial services to underserved segments of the population and the economy. It also creates risks that can threaten the stability of the financial system as a whole. (1)

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The new crop of payments banks that will spring up over the next year or so, promises to change the country's banking landscape, altering the way transactions take place. At the core of this change will be the mobile phone. India's payments market today is estimated at $15.5 trillion (excluding inter-bank clearing and CCIL). The share of mobile banking, Bank of America Merrill Lynch estimates, may rise to 10% in seven years from 0.1% currently, with the value increasing 200 times to $3.5 trillion. People are likely to use mobiles for making payments through all key channels including even RTGS ad payments through paper may fall to less than 2%, the brokerage believes.(2)

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2. Objective of thestudy

As stated earlier, the sole objective of this paper is *to demystify the concept of Payment Banks in India*. At the end of reading this paper, every reader would have clarity in their mind about the concept of payment banks.

3. Scope of the study

Payment systems have moved from the backroom to the boardroom of all financial institutions due to the recognition of the critical role that a well-functioning payment system plays in supporting the financial and real economies, and also because of the increasing attention bank board's pay to the automation of banking operations and services and their impact on bank income and profits. From a broader perspective, a less than optimal use of payment instruments and/or inefficient or poorly designed systems to process these instruments may ultimately have an impact on systemic stability, economic development and growth.In April 2007, the World Bank's Payment Systems Development Group (PSDG) launched the first World Bank Global Payment Systems Survey among national central banks to collect information on the status of national payment and securities settlement systems worldwide. The outcomes of the first Global Payment Systems Survey were published in June 2008, and are available on the PSDG website at www.worldbank.org/ payment systems. Based on the feedback received by central banks, the Global Payment Systems Survey has greatly enhanced the knowledge on payment systems matters worldwide, and helped guide reform efforts over the last three years. In line with the undertaking made by the World Bank to periodically update the information collected through this Survey, the PSDG has conducted the second Global Payment Systems Survey, which was launched in July 2010. A total of 132 central banks representing 139 countries worldwide participated in this second iteration. (3)

Reserve Bank of India's move to set up 11 payments banks is expected to expand penetration of the banking sector in rural areas of the country, the World Bank has said. "The decision by the Reserve Bank of India to grant 'in principle' approval for 11 entities to set up payments banks, which would be directed at small savers in underserved (largely rural) markets, could help transform the rural remittances market," the World Bank said in a report on remittances released here yesterday.(4)

4. Payment Banks in India – Historical Background

On 23 September 2013, Committee on Comprehensive Financial Services for Small Businesses and Low Income Households, headed by Nachiket Mor, was formed by the RBI.(5) On 7 January 2014, the Nachiket Mor committee submitted its final report. Among its various recommendations, it recommended the formation of a new category of bank called payments bank.(6) On 17 July 2014, the RBI released the draft guidelines for payment banks, seeking comments for interested entities and the general public. On 27 November, RBI released the final guidelines for payment banks.

On February 2015, RBI released the list of entities which had applied for a payments bank licence. There were 41 applicants. It was also announced that an external advisory committee (EAC) headed by Nachiket Mor would evaluate the licence applications.(7) On 28 February 2015, during the presentation of the Budget it was announced that India Post will use its large network to run a payments bank. The external advisory committee headed by Nachiket Mor submitted its findings on 6 July 2015. The applicant entities were examined for their financial track record and governance issues. On 19 August 2015, the Reserve Bank of India gave "in-principle" licences to eleven entities to launch payments banks (8):

1. Aditya Birla Nuvo Limited (Idea)
2. Airtel M Commerce Services Limited
3. Cholamandalam Distribution Services Limited
4. Department of Post, Govt. of India
5. Fino Pay Tech Limited
6. National Securities Depository Limited (NSE)
7. Reliance Industries Limited
8. Shri. Dilip Shanthilal Shanghvi (Sun Pharma)
9. Shri. Vijay Shekhar Sharma (Paytm)
10. Tech Mahindra Limited
11. Vodafone m-pesa Limited

5. Payment Banks – Purpose (as per RBI)

Reserve Bank of India says "The objectives of setting up of payments banks will be to further financial inclusion by providing (i) small savings accounts and (ii) payments/remittance services to migrant labour workforce, low income households, small businesses, other unorganised sector entities and other users."

6. Payment Banks – Promoters Eligibility Norms

As per Reserve Bank of India, the following are the promoters eligibility norms, laid down:

a. Existing non-bank Pre-paid Payment Instrument (PPI) issuers; and other entities such as individuals / professionals; Non-Banking Finance Companies (NBFCs), corporate Business Correspondents(BCs), mobile telephone companies, super-market chains, companies, real sector cooperatives; that are owned and controlled by residents; and public sector entities may apply to set up payments banks.

b. A promoter/promoter group can have a joint venture with an existing scheduled commercial bank to set up a payments bank. However, scheduled commercial bank can take equity stake in a payments bank to the extent permitted under Section 19 (2) of the Banking Regulation Act, 1949.

c. Promoter/promoter groups should be 'fit and proper' with a sound track record of professional experience or running their businesses for at least a period of five years in order to be eligible to promote payments banks.

7. Payment Banks – Do's and Don'ts

As per RBI norms, a payment banks do's and don'ts are listed hereunder :[9]

- They can't offer loans.
- They can't issue credit cards.
- They can raise deposits of upto Rs. 1 lakh, and pay interest on these balances just like a savings bank account does.
- They can enable transfers and remittances through a mobile phone.
- They can offer services such as automatic payments of bills, and purchases in cashless, cheque-less transactions through a phone.
- They can issue debit cards and ATM cards usable on ATM networks of all banks.
- They can transfer money directly to bank accounts at nearly no cost being a part of the gateway that connects banks.
- They can provide forex cards to travellers, usable again as a debit or ATM card all over India.
- They can offer forex services at charges lower than banks.
- They can also offer card acceptance mechanisms to third parties such as the 'Apple Pay.'

8. Payments Banks in India – Is it a game Changer?[9]

This is for the first time in the history of India's banking sector that RBI is giving out differentiated licences for specific activities. RBI is expected to come out with a second set of such licences — for small finance banks — and the process for those is in its final stage. The move is seen as a major step in pushing financial inclusion in the country.

It's a step to redefine banking in India. The Reserve Bank expects payment banks to target India's migrant labourers, low-income households and small businesses, offering savings accounts and remittance services with a low transaction cost. It hopes payments banks will enable poorer citizens who transact only in cash to take their first step into formal banking. It could be uneconomical for traditional banks to open branches in every village but the mobile phones coverage is a promising low-cost platform for quickly taking basic banking services to every rural citizen. The innovation is also expected to accelerate India's journey into a cashless economy.

India's domestic remittance market is estimated to be about Rs. 800-900 billion and growing. With money transfers made possible through mobile phones, a big chunk of it, especially that of the migrant labour, could shift to this new platform. Payment banks can also play a crucial role in implementing the government's direct benefit transfer scheme, where subsidies on healthcare, education and gas are paid directly to beneficiaries' accounts.

Also, this is the first time since banks were nationalized, that private sector business groups have bagged the RBI's nod for banking services.

9. Payment Banks – Are they threat& competition to existing banks? [10]

Reserve Bank of India (RBI) Governor Raghuram Rajan said on allayed bankers' concern about competition from payments banks, especially in deposit mobilisation, saying these banks would play a complimentary role to the existing banking system. Most banks offer four per cent on savings bank deposits and commercial banks are concerned payments banks could offer more to lure customers.

Rajan's statement comes later after the central bank gave 11 entities licences to start payments banks. These banks will primarily provide remittance services. Though they can accept deposits of up to Rs 1 lakh from an individual, they cannot offer loans.

"I don't think these 11 new banks are threats to existing banks," Rajan said at the State Bank of India (SBI) Banking & Economic Conclave, when asked by SBI Chairman Arundhati Bhattacharya on how new banks would shape up competition in the banking sector. SBI and Reliance Industries have formed a joint venture for a payments bank; the lender will hold 30 per cent stake in the venture.

"After a long discussion, the board (the RBI board) concluded these new banks will be additional; they will complement the existing system by traversing the last mile. The reason for that is there is nothing universal banks cannot do that payments banks can. But there are some things payments banks can't do that universal banks can," Rajan said.

"Payments banks will be useful, as they could bring new players into the system. Those with existing businesses can reduce the cost of access and, therefore, payments banks will serve as feeder to universal banks," he added. "The board took the view that 'let's give the licence to a telecom company, a business correspondent, and an IT company and let's see how the space develops'."

Bankers are concerned that with the advent of new players, competition for retail deposits could hot up. "We have opened so many accounts under Jan Dhan Yojana, which are essentially savings accounts; these are just about getting active. At SBI, 56 per cent of these are still inactive. Now, we are pushing to make them active; we are getting 11 new players in the payments bank space. With so much competition, there will be poaching and we do not know the methodology of it, how that will happen. It might cannibalise the existing business," said Bhattacharya

10. Payment Banks in India – How to manage cost?[11]

The Reserve Bank of India (RBI) has suggested payments banks that have been granted the in-principle licence to ensure there is sharing of infrastructure among banks. The regulator believes this will help achieve the spirit of financial inclusion more efficiently.

"The idea by the banking regulator is that there should be sharing of resources and functional interoperability which will also allow us to keep the costs under check," said one of the applicants, who had attended the meeting last week.

For payments banks keeping a check on the cost will be an important concern. As part of the mandate, these banks need to reach the unbanked area where infrastructure sharing will become a key to ensure cost efficiency, say analysts.

Shinjini Kumar, leader (banking and capital markets) at PwC India, explains this sharing of infrastructure will lead to more efficiency in the system. "New banks will be required to fulfil the expectation of payment access points within 15 minutes of walking distance. This will necessitate better automated teller machine (ATM) infrastructure. Common infrastructure such as white label ATMs (WLAs), micro ATMs and cash recyclers may be desirable to achieve this goal, driving the creation of common infrastructure and collaboration," Kumar said in a report.

The sharing of infrastructure has already begun with certain payments and small finance banks looking at tying up with WLA players. The cost structure works out for the niche banks with the cost of setting up an ATM being Rs 3-5 lakh while the cost of maintaining it is Rs 25,000-40,000 a month. However, if the bank opts for a tie-up with the WLA operator, then they only have to pay the interchange fee (the amount a bank has to pay a white-label ATM operator if its customer makes a transaction on the latter's ATM).

Recently, out of the 42 applicants for payments bank licence, RBI granted in-principle licence to 11 applicants. Payments banks can accept deposits of up to Rs 1 lakh and offer current and savings account deposits. They can also issue debit cards and offer internet banking. But they are not allowed to lend or issue credit cards.

On the other hand, payments have asked RBI for further flexibility in the investment regime. According to the current rules, payments banks need to invest 75 per cent of the demand deposit balances in government securities and treasury bills with maturity up to one year.

11. Conclusion

With the entry of payment banks, the process of shifting money from bank accounts to wallets will become truly seamless, and thus it is extremely possible that many customers may open payment bank accounts in addition to their regular bank accounts. They may segregate small-ticket payments from other bank payments by holding separate accounts. This is a key value proposition and would be really a game change in Indian Banking System.

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