Recommendations on
Draft Guidelines for Licensing of "Payment Banks"

Submitted to the Reserve Bank of India
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Disclaimer

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I. Introduction

Poorest States Inclusive Growth Programme (PSIG) is being implemented by SIDBI with support from the DFID to enhance the income and employment opportunities of poor households in the underserved states of India. While SIDBI is the principal implementing agency of PSIG, ACCESS-ASSIST is assigned with the responsibility of coordinating the policy component of the programme.

As part of the policy agenda of the PSIG programme, we have been making efforts towards advocating for setting up of specialized/differentiated banks for enhancing financial inclusion. The latest draft guidelines released on July 17th 2014 on Licensing of Payments Banks are a positive development in this regard. The objective behind setting up of payments bank is to further financial inclusion by providing small savings account, payment/remittance services to migrant labour workforce, low income households, small businesses, and other unorganized sector entities and users by enabling high volume-low value transactions in deposits and payments/remittance services in a secured technology-driven environment.

ACCESS-ASSIST organized a Roundtable on Payments Banks on Wednesday, August 20, 2014 at Hotel Sofitel, Mumbai to discuss the draft guidelines and offer consensus based comments to the RBI. The list of participants who attended this discussion is provided in Annexure 1.

II. Recommendations on draft guidelines

The draft guidelines on Payments Banks are a great step towards creating institutional structures for offering financial services to the low income, unbanked and unorganized segments. The guidelines offer a good approach for allowing non-bank payment providers to evolve into payments banks. Some of the positive features of the guidelines are:

- Objectives of providing services to migrant labour workforce, low income households, small businesses, and other unorganized sector entities
- Coverage of deposits under the deposit insurance scheme of the DICGC
- Allowing participation in the payment and settlement system and access to inter-bank uncollateralized call money market and the collateralized CBLO market
- Allowing payments banks to function as Business Correspondents of banks for offering other financial services including credit
- Emphasis on establishing a robust operational risk management system
- Emphasis on high powered Customer Grievance Cell to handle customer complaints

Specific recommendations/feedback has been inserted after each point of the draft guidelines below. These are fully based on the deliberations held and suggestions received at the Roundtable, along with supporting written inputs received from some participants.

3. Eligibility criteria

….. financial soundness and successful track record of at least 5 years in running their businesses.

- Some of the existing BCs and PPI issuers may have less than 5 years track record of running the businesses; however they may qualify other fit and proper criteria and their promoter companies may have a sound background and vintage of over 5 years. RBI may consider **applying the min 5 years track record/experience criterion for the promoter company in such cases**.
- Also it may be considered and clarified whether the same promoter group can apply for a Small Bank license and Payments Bank license or only one

4. Scope of activities

Acceptance of demand deposits i.e. current deposits, and savings bank deposits.

- In view of the range of deposit services that the target clients need, **term deposits and recurring deposits should also be allowed to be offered by the Payments Bank**.

…. Given that their primary role is to provide payments and remittance services and demand deposit products to small businesses and low-income households, Payments Banks will initially be restricted to holding a maximum balance of Rs. 100,000 per customer.

- The limit of INR 1 lakh has been proposed in order to ensure that the banks serve the intended target segment of migrant labour, low income households etc. in line with the objectives. However, even in case of low income clients, the account balance at a specific point of time may exceed the limit of INR 1 lakh due to various reasons (such as receipt of windfall payments e.g. disaster relief funds, insurance claim payment, sale of land/property etc.; remittances in case of marriage in the family; saving up for specific purpose such as buying a house; accrual of interest on savings etc.) For Payments Banks to refuse account balance beyond the limit of Rs. 1 lakh in such cases will inconvenience the target clients. The **RBI may therefore consider building some flexibility in order to accommodate client interests and needs**. **This flexibility could be in the form of minimum percentage of accounts with balance up to INR 1 lakh.**

- Another view is that by denying customers the ability to have deposits more than one lac, a banking system designed to be Inclusive could unintentionally become Exclusive. For example in any community in a specific geographical area, it is understood that economic activity ensues as a result of "opportunities for transactions" arising out of the exchange of goods or services. While the majority of this population may not *need* an account that supports a balance of more than Rs 1 Lac, it may be useful to allow the affluent minority in the community to also be part of the *same* formal financial institution. Viability seems likelier for a financial institution that allows *all* members of a community equal *access* to the *only* formal financial institution in an area with a *conveniently located* access point. Examples of such transactions can include wage / contract work payments by a contractor to workers, by a landowner to agricultural labour, by an urban mill owner to millworkers etc. Allowing the more affluent of the area to be part of the same eco-system puts the financial institution in a better position to move towards the "*less cash*" ideal that the RBI strongly advocates. Besides, it allows Payment Banks to provide value to that segment of customers who have potentially better capacity to pay for services while being inclusive.

- **Maximum balance limit on Current accounts be reconsidered**: Current Accounts operated by Payment Banks should not be constricted by Limits. Payment bank customers besides end consumers would be BCs and other service points and merchants who accept payment related transactions and deliver the on ground service to consumers. The money received or due to these customers is aggregated amount collected or due from multiple consumers which is likely to be managed and settled by Payment Bank. Current proposed limit of INR 1,00,000 would mean that Payment Bank cannot deal and manage its own customers' current or saving account which makes the whole proposed model unviable. More details supporting this recommendation are provided in **Annexure 2**.

Payments and remittances services

- **Both inward and outward remittances (international cross border and domestic) be allowed** to be offered by Payments Banks. The guidelines currently do not offer clarity on international remittances.

Functioning as BCs of other banks

- In addition to functioning as BCs of banks to offer credit and other banking services, **Payments Bank may also be allowed to offer other financial services such as micro insurance, pension, mutual funds as corporate agents/aggregators**. This will help improve the viability through additional income and also provide clients with comprehensive financial services.

6. Capital requirement

…. the minimum paid up voting equity capital of the Payments Bank shall be Rs. 100 crore. …. Further, the Payments Bank should have a net worth of Rs 100 crore at all times….

- Since payments banks will be required to maintain deposits to be compulsorily backed by 100% with CRR and SLR, the maintenance of Capital Adequacy Ratio of 15% of the risk weighted assets on a continuous basis and the leverage ratio of at least 5%, a fixed amount of Rs. 100 crores as the net worth at all times may cause unwarranted burden calling for over capitalization and capital infusion.

- Payments Banks are not likely to be profitable in the initial 2-3 years because of investments in technology, building a network of access points, customer awareness and acquisition etc. While it is important to create reasonable net worth requirements to support investments in technology and provide for operational risks, INR 100 crore may be disproportionate for Payments Banks since they will not assume credit risk.
- Also, technology is now available on pay per use basis; therefore substantial upfront capital investment in technology may not necessarily be required. This further reduces the requirement of net worth
- **It is recommended that a lower capital and net worth requirement of INR 50 crore be considered**, in line with the recommendation by the CCFS Committee.

7. Promoter's contribution

- The time frame of 3 years may be too short for bringing down the shareholding of promoters to 40%.
  - There is no credit risk in this business and hence diversified holding is not a requirement.
  - It is essential to highlight that the business of Payments Banks is new and its success is steeped in innovation requiring high investment in the initial period given that Payments bank needs to operate in unbanked rural areas which hitherto banks have not ventured due to high cost to serve. Such innovative and high investment businesses tend to require close involvement of the promoter, and diluting his interest in the bank may prove to be counterproductive to the business.
  - An extremely diluted shareholder group is likely to create an investment community of 'side interests' rather than clear investment commitment in making the business work.
- Additionally, it will be difficult for the promoter(s) to dilute their stake in the bank to multiple entities with shareholding of each not being more than 10%. For example, a promoter who wants to dilute 60% will have to find at least 6-7 investors which might be difficult considering the scale and the uncertainty of the business model of payments banks.
- Notwithstanding that we do not envisage that the rationale for shareholder dilution logically extends from commercial banking to Payment Bank, if dilution *is* needed, we would **recommend that the timeframe for dilution to 40% shareholding be brought up to 7 years (from the proposed 3 years),** and the timeframe for subsequent dilution be accordingly reviewed and amended.

9. Voting rights and transfer/acquisition of shares

- Capping voting rights in scheduled / Universal banks is to have an inbuilt governance mechanism to prevent shareholders influencing credit issuance and leading to greater asset risk detrimental to interest of depositors and the banking system. However, such risks do not exist for Payments bank, as they cannot offer credit and the deposits are insured with DICGC. Hence the cap on voting rights is not relevant to the Payments Bank model.
- For reasons with respect to high investment in initial years and considering close involvement required by the Promoters the risks taken by Promoters are significant.

- Given that promoters are required to contribute a minimum of 40% of paid up voting equity capital, and that it might be the case that promoters' share in capital is in excess of the minimum requirement, it is requested that the cap on promoter's voting rights at 10% be removed. This would facilitate promoters to have control in the bank which is more equitable to their capital contribution. In light of the above, **it is recommended that promoters be allowed voting rights equivalent to that of their shareholding.**

13. Other conditions

Entities other than the promoters will not be permitted to have shareholding in excess of 10% of the voting equity capital of the bank.

- With a cap of 10% on shareholding by any other entity or a single investor would adversely impact the raising of capital and would also jeopardize the provision of allowing FDI investment to the extent of 74%. A restriction in the case of banks is justified considering the concept of preventing the large shareholders from exercising undue influence on credit decisions which may put the retail and other depositor's money at risk. Since Payments Banks are not assuming any credit risk, with all depositors' funds being secured either in the form of CRR or SLR, and additionally being covered under the deposit insurance scheme of Deposit Insurance and Credit Guarantee Corporation of India.
- It would be very difficult for a new model of Payments Bank to attract 3-5 investors and manage them during start- up phase of first 7-8 years. It would rather be easier to have maximum 1-2 key other investors to manage the entity well and also to deliver appropriate Return on Investment.
- It is therefore suggested that **non-promoter entities may be allowed to have shareholding of up to 26% of the voting equity capital of the bank.**

- Additionally, clarification is required on the maximum holding allowed by another bank in a Payments Bank. Banks can take equity stake in a Payments Bank to the extent permitted under Section 19 (2) of the Banking Regulation Act, 1949.
  - As per Section 19 (2) of the Banking Regulation Act, 1949, banks are permitted to take equity stake in a Payments Bank not exceeding thirty per cent of the paid-up share capital of that company or thirty per cent of its own paid-up share capital and reserves, whichever is less.
  - As per norms on cross holding of capital among banks, banks should not acquire any fresh stake in a bank's equity shares, if by such acquisition, the investing bank's / FI's holding exceeds 5 percent of the investee bank's equity capital.
  - In view of the cross holding norms there is a clarity required from RBI on whether this % holding of other bank in the Payments Bank will be 30% or 5%.

III. Other recommendations

- Since there is a question on the viability of business model for Payments Banks, the model will be immensely supported if Payments Banks are allowed to process the Government Direct Benefit Transfer payments. It will also need to be ensured that the banks receive adequate commission for delivering DBT payments.

- It will be important to also understand whether Payments Banks will be integrated in the Financial Inclusion Plans and village mapping for FI. It was discussed that the FIPs of commercial banks may conflict with areas of Payment Banks.

- Tax exemptions/incentives may be considered for Payments Banks in the initial years.

- It will be important to know the RBI view on allowing cash payouts from PPIs based on the recently concluded pilot on cash payout from prepaid payment instruments. It would be important to also understand any other product cross overs envisaged between PPIs and Payment Banks.

- It is suggested that the Payments Banks be allowed to operate on market based business models and government backed policies supporting free transactions not be imposed on these entities.

IV. Conclusion

The draft is a well thought out document. The laudable objectives are legitimate and apt for payments banks with a given organizational structure and business focus. While the RBI is not envisaging prescription of pricing/transaction charges, establishing the business model and viability of payments banks will be a big challenge for the entities.

Some aspects of payments banks require in-depth consideration. These relate to area of including differentiated limits for the current account holders (merchants, distributors etc.), allowing term deposits (FD/RD) and other products such as pensions, insurance. Additionally, time period for promoter capital dilution should be increased from 3 years to 7 years, which in turn will help is establishing a viable platform for payments banks. It is expected that the final guidelines will reflect the consensus of views across the sector and make it possible for promoters with a vision and commitment to make a difference in banking with the poor.

Annexure 1

List of Participants

Roundtable on Payments Banks

20th August 2014

S. No.	Name of Participant	Organization
1	Terasa John	British High Commission
2	Tara Nair	Gujarat Institute of Development Research
3	Sudha Damodar	Reserve Bank of India
4	Pritish Kandoi	ICICI Securities
5	Shailesh Pandey	FINO Paytech
6	S P Narayanan	Idea Cellular
7	T N Sasidhar	BASIX Sub-K
8	Puneet Chopra	MicroSave
9	Ragini Chaudhary	DFID India
10	Anu Gupta	DFID India
11	Y C Nanda	Sector Expert (Ex Chairman NABARD)
12	Anurag Agarwal	Intellecap
13	Anand Raman	Consultant
14	Abhipriya Gupta	EKO India Financial Services
15	Arun Sharma	IFC
16	Deval Seth	ITZ Cash
17	Andrew Walden	Pay Point PLC
18	Aditya Gupta	Transerv
19	Anish Williams	Transerv
20	Anurag Gupta	A Little World (ALW)
21	Amit Arora	GiZ
22	Prakash Kumar	SIDBI- PSIG
23	Vipin Sharma	ACCESS ASSIST
24	Radhika Agashe	ACCESS ASSIST

Annexure 2

Restriction of INR 1 lakh on Current Accounts – Supporting notes

A typical ecosystem of retail payments involves the payment company, its super distributors, local distributors and retailers. The retailer offers merchant payment services e.g. IRCTC or BSES or BMC bill payments. Here the entire system is prepaid with no party taking credit risk. This means all stakeholders deposit money in advance and limits are allotted to undertake payment transactions. The efficiency of the model works best when all the current accounts of all the stakeholders are in 1 bank so that there is no cycle lag in funds transfer and money is managed and circulated with better efficiency. Restriction of the account balance will therefore hamper the core business of payments bank – Payments.

There are also disbursement instances – case being a government department disbursing subsidy or milk co-operative disbursing money to its farmers (a case study illustrating this is provided in the section below). All such remitter entities operate in a manner where beneficiary details and funds are put in a pool A/C (current A/C) and then the Service provider (payment bank in this case) will do disbursement to individual accounts. Imposition of limits will hamper such transactions as well.

Case Study: Need for Corporate accounts to manage daily farmer payments

Problem: While Amul has automated the process of Milk collection and computing the amount to be paid to the farmer on a daily basis, the payments are currently being done in Cash which results in delays. Procurement of milk typically happens in rural areas where the penetration of banking and financial services is minimal; hence there are limited options currently available to Amul to make payments to Farmers electronically and which could range from approximately Rs. 50 to Rs. 1,000 per day.

Need: To set up accounts for farmers enabling them to directly receive payments for milk supply from Amul and enabling Amul manage daily payments to eligible farmers.

Solution: TranServ in collaboration with Kotak Bank issued RuPay Prepaid Cards to all Amul Dairy farmers and enabled Amul to make daily payments to farmers supplying milk at the cooperative societies. This is similar to a payroll processing solution wherein on a daily basis Amul confirms to the Bank the amount that needs to be paid to each farmer and the bank would debit the Amul account and transfer the funds to the respective farmers.

This solution allows Amul to seamlessly, digitally and securely send payments directly to the farmers without any intermediaries and also get a confirmation on when the farmer received the payment. The farmers receive payments the same day the milk was supplied and get a confirmation SMS alert as soon as their account is funded. Being a RuPay Card the farmer could access the funds in the account at either a BC location or any ATM/Point of Sale across the country.

To enable the daily payments by Amul to farmers, Amul needed to set up a Corporate Account with the Bank and into which Amul would pre-fund a certain amount. Also, at the Bank level, a mapping is done of the famer ID as defined by Amul and the account number of the famer with the Bank.

On a daily basis, Amul shares a list of eligible farmer IDs and the amount to be paid against each farmer ID. The Bank needs to ensure that the total amount scheduled to be paid is available in the Corporate Account which has been set up by Amul at the Bank. In case of funds being available in the Amul Corporate account the same is debited and the respective amounts are transferred into each individual famer’s account. In case the Amul Corporate account does not have sufficient balances, the daily payment file would not be processed and Amul would be requested to fund its corporate account accordingly.

Fund Flows: The following sections illustrate the flow of funds from Amul to Farmers and utilization of that fund at ATMs and POS terminals.

Amul’s Primary A/c (in any bank)	Dr		Funding the Program account at the Bank for the sole purpose of farmer payments
Amul Program Account		Cr.	
Amul Program Account	Dr		Respective accounts of the farmers will be credited.
Customer A/c		Cr	
Individual Farmer A/c		Dr	Settlement with RuPay on usage at RuPay ATMs and POS
Rupay Settlement A/c		Cr	

Conclusion: The Corporate account into which funds are received in advance for a particular program is essential for payroll kind of program and enables faster processing of instructions. Corporate needs to park funds with the Bank which are commensurate with the size and scope of payment program.

Given the current guideline where Payment Banks cannot set up accounts of value greater than Rs. 100,000 will limit Payment Banks from being able to set up Corporate accounts and Settlement account for Rupay which are essential to manage payroll type of programs and which is a great need in small / rural locations.