PAYMENT BANKS- A REVOLUTION IN FINANCIAL SYSTEM

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Abstract

Over the past year, the Reserve Bank of India has introduced innovation-friendly regulations, including nationalisation of banks, building of robust branch, network of scheduled commercial banks, co- operatives and regional rural banks etc. The Payments Bank regulations were particularly noteworthy as they finally provide a framework for a variety of organizations with distribution muscle to provide payment and deposit services at scale in India. 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. The existence of entrepreneurs with diverse backgrounds could ultimately be a test for which model works best, beyond conventional banking.

Introduction

A payment bank is a type of non- full service niche bank in India. A bank licensed as a payment bank can only receive deposits and provide remittances. It cannot carry out lending activities. This type of banks is created to help India reach its financial inclusion targets. It is targeted at migrant labourers, low- income households, small businesses and other unorganized sector entities.

Background

On 23rd September 2013, Reserve Bank of India formed a "committee on comprehensive Financial Services for Small Businesses and Low Income Households", headed by Nachiket Mor. On 7th January 2014, it submitted its final report with various recommendations. In that it recommended the formation of new category of bank called payment bank.

On 17th July 2014, the RBI released the draft guidelines for payment banks, seeking comments for interested entities and the general public. On 27th November 2014, RBI released the final guidelines for payment banks.

On 4th February 2015, RBI released the list of 41 applicants which had applied for a payment bank licence. It was also announced that an External Advisory Committee (ECA) headed by Nachiket Mor would evaluate the licence applicants. On 28th February 2015, during the presentation of the Budget it was announced that India Post will use its large network to run a payment bank. The ECA committee submitted its findings on 6th July 2015. The applicant entities were examined for their financial track record and governance issues.

On 19th August 2015, finally the RBI gave "in-principle" licences to 11 entities to launch payment banks. They are as follows:

1. Aditya Birla Nuvo
2. Airtel M Commerce Services
3. Cholamandalam Distribution Services
4. Department of Post
5. FINO Pay Tech
6. National Securities Depository
7. Reliance Industries
8. Dilip Shanghavi, Sun Pharmaceuticals
9. Vijay Shekhar Sharma, Paytm
10. Tech Mahindra
11. Vodafone M Pesa

The "in-principle" license is valid for 18 months within which the entities must fulfill the requirements. They are not allowed to engage in banking activities within the period. The RBI will consider grant full licenses under Section 22 of the Banking Regulation Act, 1949, after it is satisfied that the conditions have been fulfilled.

Key features of the Payments Banks guidelines are:

i) Objectives:

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.

ii) Eligible promoters :

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.

iii) Scope of activities :

a. Acceptance of demand deposits. Payments bank will initially be restricted to holding a maximum balance of Rs. 100,000 per individual customer.
b. Issuance of ATM/debit cards. Payments banks, however, cannot issue credit cards.
c. Payments and remittance services through various channels.
d. BC of another bank, subject to the Reserve Bank guidelines on BCs.
e. Distribution of non-risk sharing simple financial products like mutual fund units and insurance products, etc.

iv) Deployment of funds :

a. The payments bank cannot undertake lending activities.
b. Apart from amounts maintained as Cash Reserve Ratio (CRR) with the Reserve Bank on its outside demand and time liabilities, it will be required to invest minimum 75 per cent of its "demand deposit balances" in Statutory Liquidity Ratio(SLR) eligible Government securities/treasury bills with maturity up to one year and hold maximum 25 per cent in current and time/fixed deposits with other scheduled commercial banks for operational purposes and liquidity management.

v) Capital requirement :

The minimum paid-up equity capital for payments banks shall be Rs. 100 crore.

a. The payments bank should have a leverage ratio of not less than 3 per cent, i.e., its outside liabilities should not exceed 33.33 times its net worth (paid-up capital and reserves).

vi) Promoter's contribution: The promoter's minimum initial contribution to the paid-up equity capital of such payments bank shall at least be 40 per cent for the first five years from the commencement of its business.

vii) Foreign shareholding: The foreign shareholding in the payments bank would be as per the Foreign Direct Investment (FDI) policy for private sector banks as amended from time to time.

viii) Other conditions :

a. The operations of the bank should be fully networked and technology driven from the beginning, conforming to generally accepted standards and norms.
b. The bank should have a high powered Customer Grievances Cell to handle customer complaints.

ix) Procedure for application: In terms of Rule 11 of the Banking Regulation (Companies) Rules, 1949, applications shall be submitted in the prescribed form (Form III) to the Chief General Manager, Department of Banking Regulation, Reserve Bank of India, 13th Floor, Central Office Building, Mumbai – 400 001. In addition, the applicants should furnish the business plan and other requisite information as indicated. Applications will be accepted till the close of business as on January 16, 2015. After experience gained in dealing with payments banks, applications will be received on a continuous basis. However, these guidelines are subject to periodic review and revision.

x) Procedure for RBI decisions:

a. An External Advisory Committee (EAC) comprising eminent professionals like bankers, chartered accountants, finance professionals, etc., will evaluate the applications.
b. The decision to issue an in-principle approval for setting up of a bank will be taken by the Reserve Bank. The Reserve Bank's decision in this regard will be final.
c. The validity of the in-principle approval issued by the Reserve Bank will be eighteen months.
d. The names of applicants for bank licences will be placed on the Reserve Bank website.

Significance of payment bank:

Since there is no restriction on the income levels of those who wish to open accounts in payment banks, those who have salary accounts in regular bank accounts can also open an account in a payment bank.

Individuals can use the payment bank account to make daily or monthly cash transactions, either through debit card or through mobile. This can also help guard against debit card fraud, since you can keep a smaller balance in these accounts.

Students living away from home would also be able to use facilities of payment banks to pay their fees. Small businesses — that have five or six employees — can operate salary accounts in payment banks, instead of paying out cash.

While a full-fledged commercial bank offers all these services, they charge fees and also have stringent Know Your Customer (KYC) norms.

In a payment bank, KYC norms may be simplified and charges may be lower, says Ajay Srinivasan, director, Crisil Research. "Payments banks will target the non-banking population. So, they might have lenient KYC norms. Also, as they will be more technology-intensive, their fees would be lower than regular banks."

For a retail chain, a payment bank can also be a good way to retain customers. "If a customer deposits money with a supermarket and uses its banking facilities, they will remain loyal to the store. The store can also offer other services to the customer. So, you can pay your bills while shopping. Similarly, mobile companies also want to retain customers, as the cost of acquiring a new customer is higher," says Abizer Diwanji, national head of financial services, EY India.

Payment banks may also offer a higher rate of interest on savings bank accounts, in order to attract customers, adds Diwanji.

However, Pramod Saxena, the founder and chairman of payment services firm Oxigen Services says the real attraction for customers, will not be the interest on deposits, but the convenience of carrying out banking transactions at their doorstep.

"Payments banks will earn interest on deposits and will definitely pass this on to their customers. But since they cannot earn from credit (which is the biggest revenue stream for banks), one can't say if payment banks can offer higher interest rates," Saxena says.

The biggest advantage of a payment bank is that it can provide the last-mile connectivity,

which regular banks cannot. So, it is possible that your neighbourhood store can function as a bank branch. While many of them already offer payment services through companies like Oxigen, now, as banks, these will be regulated.

Challenges for payment bank:

Despite these advances, wide-scale digital payment services remain unproven in India. If newly licensed Payments Banks are to succeed, they will have to overcome some basic challenges specific to the digital payment business. These include:

India's cash addiction. India remains a cash-based society. There is an overwhelming preference for physical cash, even in urban centers where alternatives exist. Even the e-commerce leader, Amazon, offers cash on delivery whereby goods are delivered to your doorstep and you hand cash to the delivery agent.

One option for migrating cash-based customers to digital accounts is to charge rock bottom digital transaction fees for basic P2P. telesome somali land for example, sought to migrate cash-based customers into digital channels by offering digital payment transactions for free which led to rapid uptake and usage, with the average Telesom customer conducting 40 digital transactions per month. Telenor Pakistan recently eliminated its digital transaction fees as well.

The over-the-counter (OTC) trap. India's cash addiction makes it more likely that newly licensed Payments Banks might fall in what Microsave calls "the OTC trap." An OTC transaction is where the customer does not have an account, but simply hands over cash to an agent who then facilitates the transaction on the customer's behalf. Because OTC services solve a key pain point by giving customers the ability to transfer money instantly (the same pain point which fueled mobile money uptake in East Africa), it can become difficult to get customers to shift into account-based transactions.

Low-cost domestic remittance alternatives. Latent demand for e-payments must be evaluated against the accessibility and quality of the alternatives. Compared to many other countries, Indians already have relatively low-cost remittance alternatives.

Large upfront investment and long road to profitability. The verdict from the international experience is clear: Payments Banks will need to invest significantly upfront to build a business correspondent or agent network and, if all goes well, it could easily take three to five years before the business is cash-flow positive.

Figuring out partnerships with banks on credit-issuance. Given the reasonable quality of India's informal payment solutions and preference for cash, Payments Banks may not be able to drive customers into digital accounts by offering payment services alone. We suspect large-scale migration of Indian customers over to Payments Bank accounts will require a more complete offering, including savings and credit services. Because Payments Banks cannot offer credit on their own, this will require partnerships with credit-issuing banks

Payments Banks present an exciting opportunity for digital financial inclusion in India. We know that some major mobile operators, business correspondent companies, prepaid issuers and others are preparing their applications. We hope they have an eye on the challenges flagged here and are willing to learn from the experience of mobile money in other countries.

Conclusion:

For all accounts held by the payment banks, the banks would be stipulated to pay an annual interest to the account holder. While the Reserve Bank of India is yet to define the quantum of interest rates payable by payment banks to their customers, an interest rate of 4% similar to the one offered by public sector banks is likely. The one big difference between payment banks and ordinary banks would be the fact that payment banks would not be eligible to offer any loans to its customers. To avail any kind of a retail loan, the consumer will have to approach a full-fledged bank instead.

With increasing competition in the core banking services especially in semi urban and rural sectors, traditional banks have to keep them abreast with superior customer service and constant innovation in introducing new schemes. With this increasing competition among banks and banking services, customers are likely to benefit with quality, promptness and convenient financial services.

As the government is working towards a direct repayment of subsidy on various schemes to the bank account of consumers, poor sections of society who not having a bank account would gain with the introduction of payment banks. Since most of laborers working away from home use post offices or third-party channels to initiate a funds transfer to their native places, payments banks once approved and introduced in the near future will change the face of rural India.

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