Aligning Regulatory Architecture for Prepaid Payment Instruments in India

PAYMENTS COUNCIL OF INDIA

Contents

1. Introduction

Payment mechanisms in India have undergone a rapid change in the past decade fuelled by a facilitative legislative framework, proactive regulatory action and market innovations, all of which have sought to promote convenient, cost efficient, transparent and secure modes of payments. Usage of electronic payments has grown by almost 1500%, from 229 million transactions in 2004-05, to 3,788 million transactions in 2013-14[1].

A large part of the growth in e-payments has been due to the institution of bank-based electronic fund transfer channels such as RTGS (Real Time Gross Settlement), NECS (National Electronic Clearing Service) and NEFT (National Electronic Funds Transfer); although the past few years have witnessed a rising share of alternative electronic payment instruments, their growth has been considerably slower. There is high potential for PPIs (Prepaid Payment Instruments) to be adopted as a low-value, high volume product – a characteristic particularly suited to the nature of transactions in this country.

The past few years have witnessed an interlinking of policy and regulatory goals – increasing policy emphasis on financial inclusion by the Government, and the accelerated drive to achieve less cash economy have converged and as a result, there is a growing recognition that increasing usage of electronic payments and improving access to financial services are two sides of the same coin. This pursuit of a less cash and more financially included society in India has been instrumental in laying down the foundational framework for alternative electronic payment instruments. In its Vision Documents released every three years, the RBI has successively expounded the role of PPIs in driving the transition from cash to digital, and positioned PPIs as instrumental in concluding transactions in a safe and efficient manner.

The PPI guidelines, first released in 2009, provided a broad architecture for authorisation, issuance and operation of PPI systems in India. These guidelines classify PPIs on the basis of the definition of ‘settlement’:

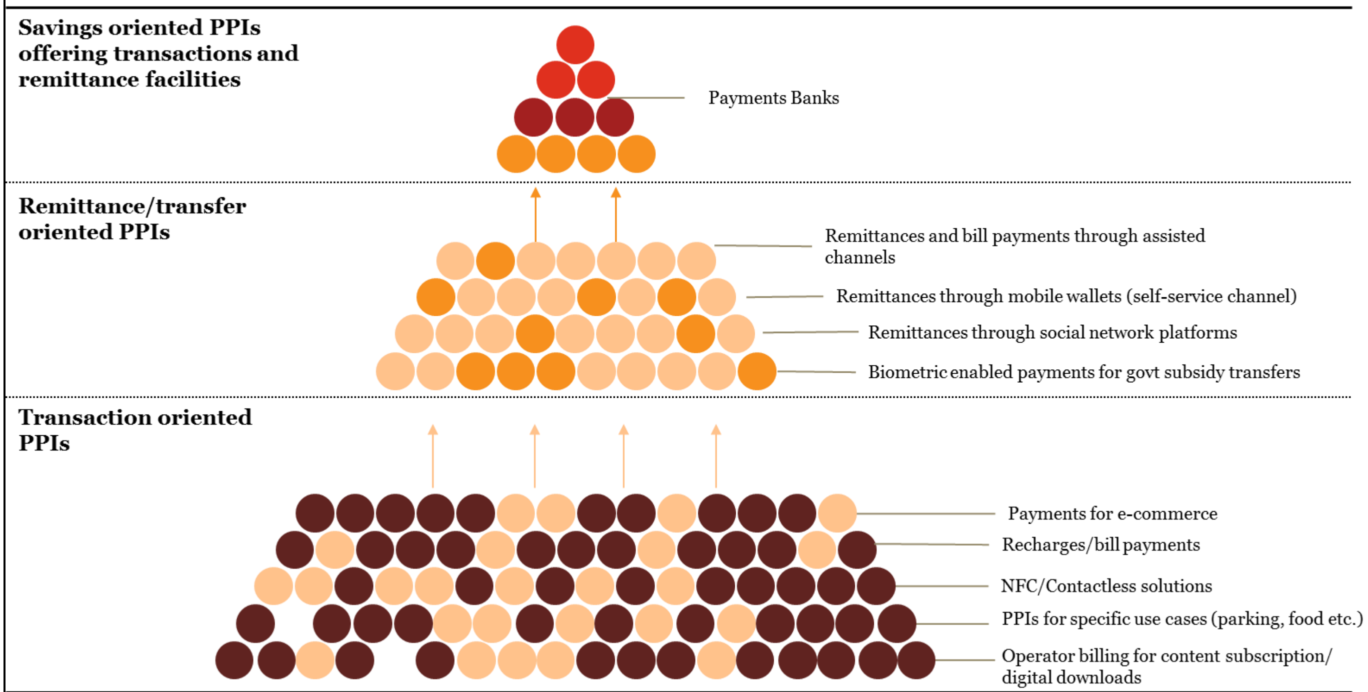
- Closed loop systems enable transactions and settlements to be conducted under a single merchant’s network and are therefore not regulated
- Semi-closed systems enable the usage of PPIs at multiple merchants, do not permit cash out, as well as interoperability for POS and ATM, and are regulated
- Open systems allow PPIs to be used in a manner similar to debit cards, and permit cash out; only banks are allowed to issue open system PPIs

These guidelines provide a much needed springboard for market players to launch PPI products and build a large customer base[2], while simultaneously spurring innovation. The domestic money transfer relaxations provided in 2011, and further easing of norms in 2012 also played a big part in pushing PPI usage across the country; this is clearly evident in the business and transaction growth over the past 12 months – P2P transfers now account for the fastest growing transaction type for PPI issuers. As adoption has grown, consumer preferences and market offerings have also become more specialised, targeting specific use cases within each segment. Today, various PPI products & services compete on multiple levels, such as use purposes, form factors, acceptance network and value added services. As a result, PPI service offerings have grown and expanded, covering a gamut of transactional requirements and fund-flow channels. *(See figure below).*

[1] RBI, Database of Indian Economy

[2] Since the issuance of guidelines, PPI adoption has increased steadily; in the last financial year itself, PPI usage grew rapidly to conduct an average of 319,000 transactions/day in April 2013, to 531,600 transactions/day in March 2014. Furthermore, today the market boasts of growing competition among 20+ authorised PPI players, strengthened by fast-paced innovation, all of which aims to increase customer convenience

Figure 1: Diversity in the PPI ecosystem



Though the regulatory and policy goals have been clearly set out, and aim to achieve an efficient system that brings down costs, increases the adoption of e-payments, encourages innovation and eventually creates an interoperable platform that deepens and widens formal financial services in India, market participants as well as policymakers agree that progress has been slower than anticipated. While social and cultural factors have played a part in this marked preference for cash, market participants are also experiencing certain operational inflexibilities that come out of the mismatch between the diversity of the consumer segment and the standardization that the regulatory framework imposes on the operating model. In particular, following challenges are being faced by participants:

- Specific regulatory mandates that preclude PPIs from being as easy to use as cash – for instance, KYC framework for transactions beyond specified limits is required to be bank like. Banks seek to establish account based relationships and KYC processes require paper or copies or scans of documents. This does not go well with the electronic format of PPI. On the analogy of Aadhaar enabled payments, electronic verification of any ID can create the differentiation for PPIs
- Similarly, lack of interoperability with third party networks also restricts PPIs from enabling widespread acceptance infrastructure.
- Lack of standalone cash out, and reliance on bank partnerships for the same, prevents building seamless customer experience and prevents consumers from fully adopting PPIs. This proves to be particularly true for domestic remittances, where the need for cash out is the greatest.
- Value limits based regime restricts usability of PPIs for end customers, who may find the maximum value caps too limiting to make purchases or remit monies. Instead, a use purpose based definition of PPI products that is calibrated for various risks may prove to be a better approach for the growth of the segment
- Licensing framework, though transparent and efficient is rigid, in so far as licensing particular products. As the industry goes through initial stages of investments, it may require greater flexibility to form alliances and partnerships, and the ability to merge and acquire. The framework for post licensing corporate action is not

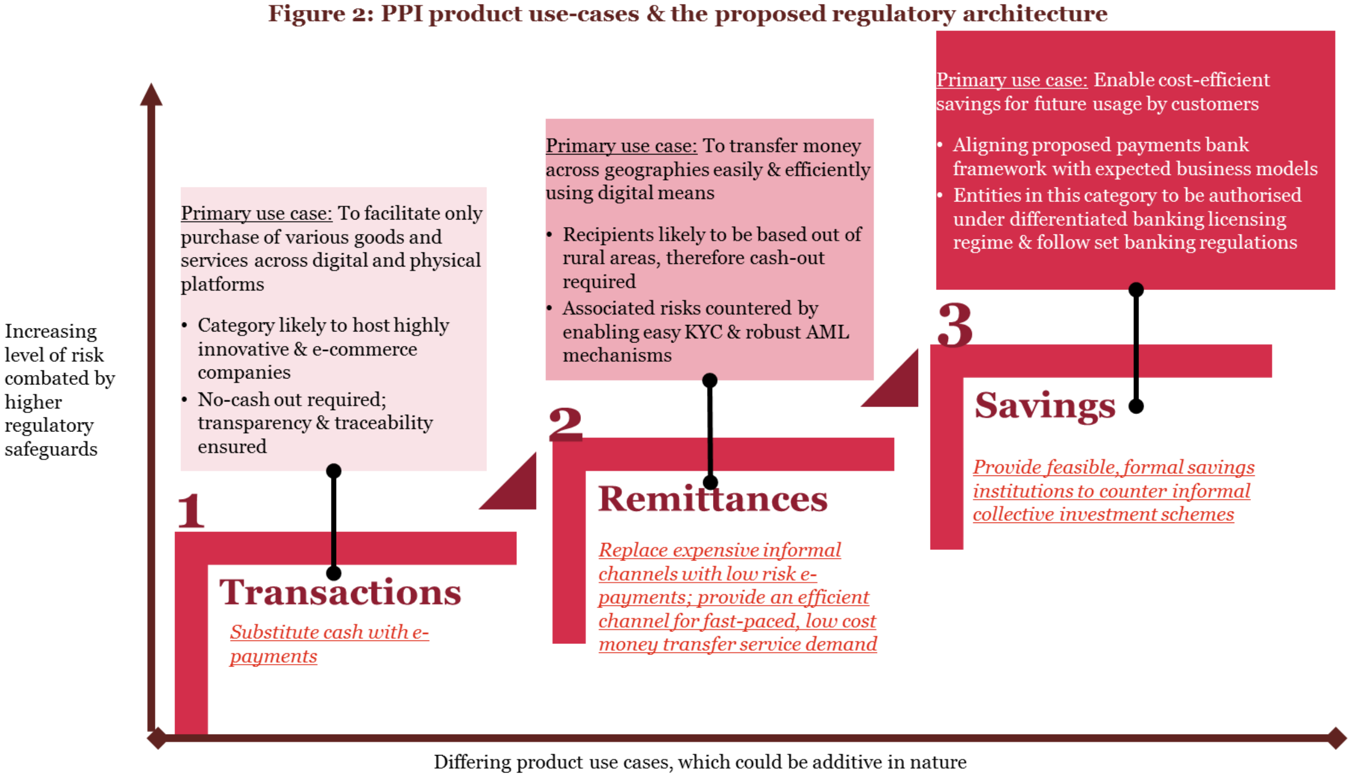
defined. The authorisation framework also does not differentiate between experienced and non-experienced companies, various customer oriented and corporate oriented products.

Many of the success stories in the PPI segment have come from players focusing on niche client needs that require simple products and the capacity to upscale without compromising on security. However, to make any significant dent in the habitual use of cash or informal channels of remittances or savings, the supply side of electronic instruments will need to go beyond the low hanging fruits and come up with game changing strategies focusing to differentiate on the following parameters as well:

- Creating ease of transaction that is as close to cash or easier than cash, to achieve breakthrough in altering behaviour
- Customer acquisition and on boarding that is seamless and painless to clients to deal with adoption challenges
- Acquiring mechanisms that obviate the need for cash
- Security features that are seamless and yet robust to promote long term trust in the system

The ability to differentiate is inherent to the PPI segment as products are targeted at consumer segments based on their convenience, habits and needs. Also, service providers themselves come from varying backgrounds and expertise such as retail, telecom, technology or banking correspondent networks. Further, risks inherent in these broad segments are also diverse. The case being made here is that based on the risk present in each business segment, regulatory requirements and supervisory oversight could be tailored, reducing the load on the market participants and regulators alike. Those wanting to operate in the high risk zone can be subject to bank-like regulation, currently being proposed for the PPIs transitioning to payments banks. On the other hand, those focusing on retail transactions through nodal/escrow accounts with no cash out facilities can be subject to light touch regulations *(See figure 2).*

Figure 2: PPI product use-cases & the proposed regulatory architecture



Future growth of PPI usage is expected to be highly correlated to how well service providers are able to differentiate along these factors. Regulatory architecture will be an important determinant of how the market is able to address customer pain points in a cost-effective and viable manner.

Proactive engagement between the industry and the Reserve Bank of India has led to progressive easing and liberalization as well as clarification of doubts. However, most of such easing has been incremental and based on value limits. A case is sought to be made here that the approach to regulating pre-paid instruments needs to be differentiated and risk based from the start. Given the segmentation of the market observed so far and based on global experience, there is good case to be made for reviewing the framework based on different use purposes.

While debating and recommending such a framework, industry participants have taken into account the broad vision of the RBI and also in particular the following goals:

- Bringing people into the net of formal financial services and catalysing financial inclusion
- Substituting cash with e-payments
- Enabling interoperability to support widespread usage of e-payments
- Enhancing the scale and usability of PPIs at the remittance beneficiary end, either through cash-out or transaction acquisition
- Creating easy to use products and services to catalyse savings

2. Diversity and Differentiation in PPI Services: Making a Case for Risk Based Regulations

2.1. Major emerging product use cases

As discussed in the previous chapter, emerging trends indicate that PPI products can now be divided into three different categories on the basis of use-purposes – transactions, remittances & savings. Service providers often offer products in more than one of these categories or combine products that can cater to one or all segments, thus operating in a matrix of risk. Before discussing the risks presented by each product use, it is useful to take a look at the potential of each segment.

a. Transactions

On a daily basis, close to 500 million[3] transactions are concluded in India – a majority of which comprises of consumers making essential purchases of food and grocery at merchant locations, paying utility bills, enabling financial payments & facilitating online purchases. However, till date, less than 5%[4] of these transactions are conducted via electronic means, with consumers and merchants alike being more comfortable transacting in cash. This figure gets starker in rural areas, where only 0.43% of the households report using electronic payments to conclude transactions[5]. In terms of value, e-payments account for a measly 0.52% of total household expenses in the country[6]. Although increasing awareness has led to a rise in usage of digital channels to access information and even shop, there has been a less than proportional increase in the usage of electronic means to

[3] Estimates based on RBI and Ministry of Finance data
[4] Ministry of Finance, Government of India
[5] *Road to less cash*, 2013, Visa and ItzCash
[6] *Road to less cash*, 2013, Visa and ItzCash

conclude payments. For instance, although credit cards, debit cards, internet banking and PPIs have been enabled for making online payments at e-commerce websites, CoD (Cash on Delivery) continues to be the dominant mode for paying for these purchases. Other transaction types (such as bill payments) too suffer from this seemingly 'sticky' customer preference for cash over any other mode of payment. Alternative options such as electronic payment instruments would need to offer convenience and security, in order to change customer behaviour and shift current preference from cash to non-cash modes of payments.

Currently, the transaction-based PPI segment hosts a number of different players, providing multiple functionalities, which has helped build a basic foundation for the ecosystem and charted roles and responsibilities of various stakeholders. The past five years have also generated some level of awareness amongst various customer segments and widened the acceptance network considerably.

b. Remittances

At a projected 400 million, India's internal migrants will soon constitute more than half of the total internal migrants globally[7]. Furthermore, these internal migrants, accounting for a third of India's total population, send an estimated amount of INR 700 – 1200 billion in remittances annually[8]. 'Seasonal migration' has become a much needed livelihood strategy, and mobility an integral part of work cycle for many rural workers. It has been estimated[9] that there are up-to 100 million seasonal migrants in India who contribute as much as 10% to the national Gross Domestic Product (GDP). Migrants are also largely from vulnerable sections of society like SC (Scheduled Caste) and ST (Scheduled Tribe) populations. 58% of internal migrants are estimated to remit money home and other micro-studies have estimated that these remittances make up 30 -80% of the cash income of poor households in some regions[10].

The market for domestic remittances has traditionally been dominated by India Post and a multitude of informal service providers. Informal remittance channels are pervasive, and surveys have shown that between 50%-90% of all remittances were channelled through informal means[11]. Even in urban areas where banking services are generally available, most migrants do not have a bank account. Banks are positively perceived as the cheapest, quickest and most secure way to send money, but the role of banks in channelling domestic remittances have been constrained by the low penetration of bank branches and distribution infrastructure. Additionally, there is also a section of population that does not have bank account on either ends of the transaction – for such migrants and their families, their remittance options narrow down to the post office at best, and various informal and highly risky *hawala* mechanisms, at worst.

On the international front, India is the largest recipient of international remittances in the world, with over USD 70 billion[12] received in 2013 alone from 25 million non-resident Indians across the globe. This may be contrasted with the USD 28 billion in FDI (Foreign Direct Investment) inflows[13] in the same period. Remittances accounted for over 4% of GDP and form an important source of 'external development finance' to households in India. A Reserve Bank of India study has found that 27% of these remittances are from Western Asia, 38% from North America and another 18% were from Europe. The same study also revealed that over 40% of remittances were

[7] *Social inclusion of internal migrants in India*, 2013, UNESCO
[8] *Internal migrants make up 1/3rd of India's population,* October 2013, Times of India; retrieved from <http://timesofindia.indiatimes.com/india/Internal-migrants-make-up-1/3rd-of-Indias-population/articleshow/24313033.cms>
9 Deshingkar et al. (2010)
10 "Remittance Needs and Opportunities in India" - NABARD, GIZ
11 "Remittance Needs and Opportunities in India" - NABARD, GIZ
12 World Bank
13 UNCTAD

used for household expenditure, highlighting the importance of remittances to households and local economics in migrants' areas of origin[14].

c. Savings

Over 81% of households save in India, and total household savings were estimated to amount to close to INR 23 trillion[15] in 2012. the total amount of deposits held in banks by contrast, amounted to INR 81,000 billion[16]. Close to half of the population does not have access to banking channels, and more than 65%[17] of the population does not access formal financial channels. Clearly, a vast portion of the population continues to be heavily reliant on a myriad of informal financial mechanisms to store their low-value savings. These customers tend to resort to high risk, unreliable methods of savings such as cash, investing in livestock or jewellery or saving through informal saving collectors or clubs. Not surprisingly, households often report that having access to a savings account as their greatest financial need.

Although efforts have been undertaken to provide each household with a specialised bank account (be it Basic Savings Bank Deposit Accounts (BSBDA) or BSBDA-small), most of these accounts are reportedly used to receive welfare benefits and remain dormant otherwise. A large part of this dormancy can be attributed to the fact that a typical banking deposit is not designed for low income households which are prone to unpredictable cash flows and do not have much by the way of assets; these households are likely to want to deposit small amounts (sometimes as small as INR 20-50)[18] at varying frequencies. Such unpredictable patterns of savings cannot be leveraged by banks, and lead to higher costs of servicing these customers. On their part, households would want to maximise their savings by depositing these amounts in schemes that provide them with enough flexibility, are reasonably priced and offer attractive incentives that would instil a disciplined habit of savings. This mismatch between low income household demands and current market offerings has allowed informal and unreliable institutions to flourish, often leading to loss of wealth that has proven expensive for these households. In the absence of any formal institution/mechanism that meets their demands for low value savings in a cost efficient manner, such households end up storing their hard earned monies in risky, informal institutions such as chit funds, which more often than not, creates issues in accessing their temporary savings. Their ability to earn interest on these savings is also constrained on account of lack of formal institutions in some areas, and the monopoly like dominance of informal institutions in others.

Fittingly enough, it is also interesting to note that such households in fact form the core customer base for a number of PPI companies operating in the country. Given that the household savings rate is predicted to grow over the course of this decade, it therefore becomes imperative that alternative, innovative formal institutions be set up to provide easy, cost efficient and reliably bring the poor into the formal financial system.

2.2. Aligning Regulations to Risk

The current guidelines have provided strong groundwork for the evolution and growth of PPI industry. Based on the above analysis, it would appear fair to recommend a move from the wide definition of 'settlement' and limit based regulation to a risk based approach that will foster innovation and differentiation going forward.

The proposed framework will be guided by the risks presented in each product category, and seek to instil adequate safeguards to minimise any systemic fallout. The overarching objective is to bring more people within the formal

[14] *Remittances from overseas Indians: Modes of transfer, transaction cost and time taken,* April 2010, RBI
[15] *Report of the Working Group on Savings during the Twelfth Five Year Plan (2012-13 to 2016-17),* June 2012, RBI
[16] RBI, Profile of banks
[17] FINDEX
[18] P*ortfolios of the Poor: How the World's Poor Live on USD 2 a day*, 2009, Collins et al.

financial system and at the same time create popular convenience products for everyone to replace cash on a daily basis. The table below captures the level of risk evident across key parameters, in each of the three product categories.

PRODUCT USE CASE ↓	LEVEL OF RISK			
	AML	*Systemic/Contagion risk*	*Settlement*	*Technology*
TRANSACTIONS	Low	Low	Low	High
REMITTANCES	Medium	Medium	Low	High
SAVINGS	High	Medium	Medium	Medium

Chapters 3, 4 and 5 will identify associated risks and accordingly identify potential changes to the framework to facilitate growth as well as to safeguard against potential risks. It is understood that many suppliers of PPI services will want to offer comprehensive suite of products and therefore will need to follow an additive framework of regulation, leading to them being classified in the highest regulated category. However, many small innovators will be able to come up with targeted solutions without having to deal with a regulatory and supervisory architecture that takes up their bandwidth and takes away from the core of their business focus. The final chapter (i.e. chapter 6) will sum up key aspects of this proposed regulatory framework, and identify parameters that need to be built into regulatory guidelines to ensure that adequate flexibility is provided to enable movement between these three regulatory categories.

3. Transactions

3.1. Introduction and user case

As outlined in the previous chapter, the emergence of e commerce, proliferation of internet and smartphones as well as changing buyer behaviour will drive the growth in electronic payments. Low banking penetration and ability to lend itself to easy partnerships and captive models of operation with e commerce, PPIs are well poised to take advantage of these trends and grow their market share.

As customers have become increasingly sophisticated in using digital channels for various needs, the demand for specific use-case driven PPI is starting to emerge. Going forward, young consumers will drive the demand for easy & efficient e-wallets/app-based PPIs – be it for car parking, transportation payments, online shopping, or digital downloads. In response to this demand, suppliers of PPIs will need to be nimble and innovate around the customer experience, while ensuring adequate security to prevent fraud and build trust. This will presuppose high degree of technical skills and understanding of consumer behaviour.

As transaction channels continue to be diverse (e.g. internet moving into phones and smartcard and POS machines co-existing with ' tap and pay' apps), it will not always be possible for these providers to fit within the neat categories of payment intermediary or e wallets, but often have the flexibility of both. In addition, they will necessarily need to work with multiple partners such as commerce establishments, aggregators or banks/acquirers. With more specialized players, there may often be multiple players in a partnership; on the other hand, there could be large groups that would provide end to end services for commerce, electronic or physical.

Regulatory guidelines would therefore need to be appropriately aligned to suit this segment' s needs and to facilitate this growth of the segment by reducing barriers to entry and operations, thereby ensuring that any demand-supply mismatches are minimised. As this segment poses minimal risks, and primarily aims to substitute cash for purchase of goods and services, regulations can be basic and light touch, primarily with the aim of preventing the entry of fly by night operators.

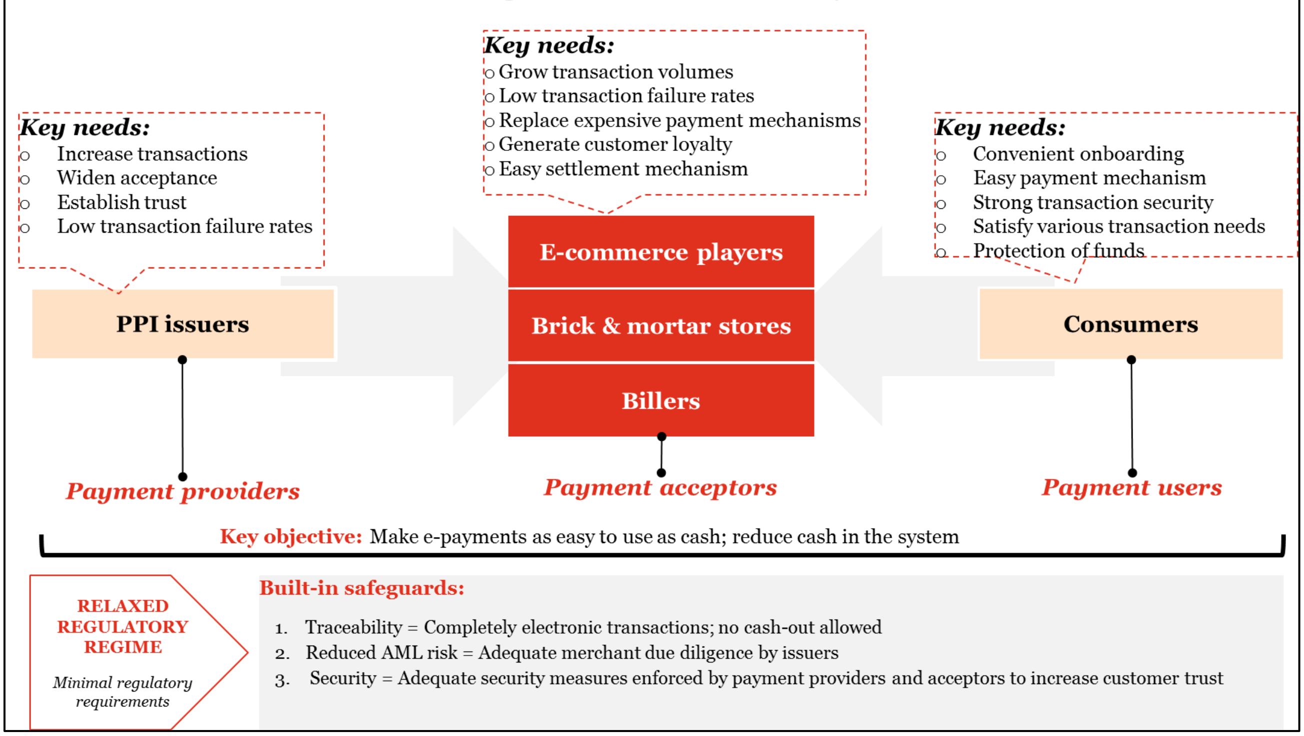
The user of these services will demand certainty and security of transaction beyond everything else. Any instances of operators collecting money to make payments to service providers and not making such payments will dent the trust required for high adoption. One of the reasons for the popularity of COD is the element of delivery vs payment. On the other hand, the COD increases the cost for the seller as well as increases the operational risks. Therefore, sellers will eventually drive the demand for easy electronic payments solutions and replicate the customer experience of delivery vs payment to drive consumers away from COD. Some of this is already evident in the returns policies of e commerce websites.

In the physical commerce ecosystem, altering consumer preference for cash is a more complicated matter, requiring proactive policy intervention on taxation of small businesses, better information dissemination about tax policies as well as the cost of cash, both for consumers and businesses. To grow their market share, PPI providers will need to be a part of such efforts at information dissemination and changing preferences for buyers and sellers.

While security, settlement surety and information dissemination are necessary for rapid proliferation of electronic transaction in physical and electronic commerce space, it is by no means the sufficient condition. That has to be a differentiated consumer experience. The shopper likes to focus on shopping and filling out KYC forms destroys his shopping experience. How many times have we been approached by a sales person to fill up forms for a third party pre-paid cards while shopping and declined rudely because that was the last thing we wanted to do while selecting the colour of the carpet? On the other hand, the cashier asking for a cellphone number and signature with five discount coupons and a small discount on the immediate purchase gets a much better response to enrol the shopper for a rewards program. There is natural synergy here between the closed loop and the semi closed loop as the semi closed obviates the need for carrying multiple reward cards; but the need for different KYC and cost structure today makes the user experience almost jarring.

Similarly, electronic commerce websites must provide as seamless an experience of payment as just checking the option of COD and having some cash at home. Globally, the success of e commerce is tied to payment mechanisms and best practices already exist in technology, product innovation, fraud risk management and transaction monitoring. E commerce is also an useful ally for payment companies because they provide a layer of due diligence on payment providers; taking risks with their payment partners will hurt their business and brand as much as it will hurt the individual buyer (*See figure 3*).

Figure 3: Transaction ecosystem



3.2. Risk Assessment

	RISK LEVELS			
PRODUCT USE CASE	*AML*	*Systemic/Contagion risk*	*Settlement*	*Technology*
TRANSACTIONS	Low	Low	Low	High

Regardless of the actual mechanism adopted, the intent of suppliers of transaction services is to provide a mechanism that replaces cash for payment for goods and services. As the primary use-case is to help make payments for goods and services, cash-out is not the goal of the pure transaction service provider. Transactions are largely electronic in nature, ensuring transparency and 'traceability'. Technology risks in this segment are high as transaction failure is detrimental to consumer, merchant and service provider. Money laundering risks are contained due to traceability of transactions and the end use being exchange for goods and services.

One of the reasons for the popularity of PPI over debit and credit cards is the flexibility to move transaction related cash into the PPI, thus exposing consumer to limited risks. For example, payment through a credit card or net banking exposes the customer to fraud risk of upto the credit limit or the bank balance. On the other hand and on-time transfer to a PPI to make payment only exposes her to fraud risk up to that amount. In the context of India of course, the PPI is also a substitute for the non-existent banking channel for transactions, and therefore an important vehicle for replacing cash.

Due to the existing provision of PPI providers not keeping any cash in their system, but to keep it in the bank's escrow account, the settlement risk has already been contained, or shifted from the non-bank provider to the bank. The fact that commerce partners have their reputation and business at stake if they tie up with fly by night operators also reduces risk by introducing a check and balance system, where marketplaces and payment providers need to do the due diligence on their merchants and merchants need to do the due diligence on the marketplace and payment service provider and the customer is in the position to punish both, if this system puts him at risk.

Overall, on a relative scale, this segment presents minimal risks which can be addressed sufficiently by mandating registration and routing of all funds only through an escrow account. Our suggestions therefore focus on relaxing entry criteria, KYC norms and light touch supervision.

3.3. Recommendations

Entities in this segment are very similar to Payment Intermediaries with the exception that in place of drawing funds from net banking/credit cards/debit cards/PPIs at the time of transaction), they need to actually store customer funds, thus combining part of the PPI product with the intermediary functionality. However, such money as they collect is also kept in an escrow account with a bank, no different from a nodal account in the case of an intermediary.

a. **No licensing**
Given the low level of risk and the control over funds in the escrow account with the bank, no licensing requirement should be prescribed for this category of PPIs. Instead, registration requirements can be prescribed.

b. Entry criteria – Do away with minimum capitalisation requirement:

At present, PPI guidelines prescribe a single minimum capitalisation limit for all non-bank entities, regardless of the scope of proposed business activities. At INR 50 million, this minimum criterion restricts entry and acts as a disincentive for low cost, innovative businesses to enter this space. The impact of this limitation is systemic – in the absence of truly innovative ideas, the industry will be unable to provide a satisfactory customer experience, and in turn, customers will not move away from cash. Also, global experience has shown that regulated entities with large capital base often develop great partnerships with small innovative businesses, in many instances acquiring and integrating them to provide value to both. It is recommended therefore to relax minimum capitalization norms and prescribe positive net worth as the requirements.

c. Entry criteria for foreign entities – Rationalise FDI norms for stored value/ PPI products:

The current FDI policy places card payment products of all types as activity under NBFCs engaged in fund-based financial services activities, irrespective of their underlying activity (funded or unfunded). The guidelines read as follows – *"Credit card business includes issuance, sales, marketing and design of various payment products such as credit cards, charge cards, debit cards, stored value cards, smart cards, value added cards etc."* Given the nature of the activity, it may be noted that some payments products such as stored value cards offer pure payment services and no lending activity is associated.

Foreign companies looking to invest in pure, non-funded card payment products businesses (such as stored value cards) have to therefore bring in large amounts of capital ranging from USD 0.5 million to USD 50 million, depending on the percentage of foreign equity due to misclassification.

While these capitalisation norms may be appropriate for entities offering funded financial services from the perspective of guarding systemic risk, (for example, credit card business is a funded activity and involves lending), they are however far in excess of the capital required for non-bank entities involved in providing prepaid/stored value/internet wallet businesses (these activities are purely payments facilitation and no lending activity is associated. The separate capitalisation norms for foreign entities imposes an entry barrier and forces cost ineffectiveness on those foreign players who are most likely to bring in the best global practices, technology and scale.

Doing away with minimum capitalisation requirements, which apply to all entities, regardless of ownership, will potentially benefit the industry greatly, by rationalising the cost structure and providing a level playing field for foreign and domestic operators. Additionally, this will give a boost to private equity investors in Indian entrepreneurial ventures, where the efficiency of capital is an important consideration for determining investment.

d. Customer acquisition – Simplify KYC requirements

At present, KYC processes are tiered as per the value of the instrument, wherein no KYC is required for PPIs below INR 10,000 in value and full KYC is prescribed for PPIs valued at INR 50,000. The current KYC regime is also largely paper-based and PPI issuers are required to collect various 'officially valid' documents, which results in the process being cumbersome for on boarding customers.

While formulating KYC requirements for entities operating in this segment, it is important to take note of the fact that transactions will be used only for the purposes of commerce, and that cash out will not be permitted. The end-usage of these instruments will be known, as the closed loop merchant network is known to the PPI provider, allowing for traceability and guarding against any potential AML risks.

Interestingly, while tax evasion is not a predicate crime under the Prevention of Money Laundering Act in India (as in many other countries), the overhang of tax on AML regulations in India is a huge barrier to electronification of commercial transactions. Essentially, if the system does not have the ability to launder proceeds of crime (as enumerated under list of predicate crimes), it should be considered low risk from an AML perspective. Given the use of PPI in this space for exchange at known outlets, their usage is no different from the usage of cash today and burdening the system with anything other than basic information (to be collected seamlessly without involving paperwork) will prevent entry of new customers and merchants in the electronic system, reducing the ability of formal financial system to do monitoring and collect consumer data. An additional argument here is the flexibility under PMLA Rule 9 (1)(b) exempting transactions below INR 50,000 from any requirement of identification or verification.

- ✓ Regardless of size of transaction (below INR 50,000), KYC information should be limited to mobile number and email address. The delivery address or the use information may be required to be stored by the PPI provider for certain duration.
- ✓ Issuers may be encouraged to implement digital KYC, wherein a customer' s voter ID number/Aadhaar number/PAN number is used to verify details against the corresponding online databases, and no paper documents need to be obtained.
- ✓ Cross-usage of banks and other financial institutions and telecom KYC records should also be explored

e. Usage - Enable cross-border transactions:

Today, more than 100 million Indians log on to Facebook where they can gain access to information about the latest developments in gadgets, new music & video releases, changing global consumer trends and customer reviews, which in turn shape their preferences. Rising consumer awareness, especially amongst the aspirational middle-class segment of the population has resulted in Indians seeking to gain access to a greater variety of goods and services[19] via cross-border online purchases. However, the ability of this aspirational class to make these purchases has been limited by lack of easily accessible payment channels, on account of regulatory and practical reasons.

Although theoretically three different modes of payments (i.e. International Credit Cards, debit cards & net banking) have been made available for cross-border purchases, they pose certain challenges and have limited usability. Evidently, as consumer habits change across social strata, bank-based electronic channels and payment instruments will not be adequate to address this demand, especially since much of this cross-border demand may be simply for electronic downloads or small value products.

As PPIs are best placed to satisfy this demand, it may be useful to explore the possibility of making alternative non-bank based electronic payment instruments available for enabling such cross-border transactions. The various risks arising from allowing this functionality are also adequately addressed in the current PPI set up:

- ✓ Unlike debit and credit cards that are primarily governed by the standardised agreements made between a few major card network associations and a large number of merchants, PPIs have limited use cases, and the PPI issuers are therefore able to customise their arrangements with merchants that translate to lower risks

[19] A survey by Borderfree, an e-commerce technology service provider, indicates that 36% of online shoppers in India make cross-border purchases on account of lower prices, while 29% find that international websites offer a greater variety of goods and services.

- ✓ The usage of these PPIs is primarily for purchasing digital content such as music, books and applications via well-established and trusted merchant websites, which ensures traceability
- ✓ Fund flow arrangement would be conducted via established banking channels (Nostro/Vostro mechanism), which provides adequate assurance of funds being routed in a transparent manner
- ✓ An additional advantage of using PPIs is that it automatically ring-fences the amount of funds that can be used to conduct online transactions. Potential losses therefore if any, are limited to the amount of customer funds stored in the PPI, which ensures that systemic risk is minimal in most cases, if not completely averted.

f. Acceptance – Allow access to interoperable platforms such as Visa/ MasterCard/ RuPay:

Currently, PPI issuers are not allowed to connect to third party networks such as Visa/MasterCard or RuPay and are therefore restricted from creating a widespread acceptability network for customers. This restriction affects the demand side too – customers, on their part, are less inclined to use PPIs for daily transactions, and in most cases, end up using cash to make payments. On the supply end, expecting PPI operators to set up acquiring infrastructure from ground up may not be feasible or a viable option, as it may translate to heavy capital investments without any certainty of return for the investor. Instead, companies operating in this space could be allowed to connect to existing third party networks to enable widespread interoperability; initially connectivity could be extended to include only homegrown payment networks such as RuPay, and eventually could be expanded to include other networks such as Visa and MasterCard. Additionally, as a starting point, interoperability can be allowed within PPI operators, which will enable PPIs to be issuer agnostic and promote usage.

g. Seamless settlement – Remove value limits for merchants to enable PPI usage across the entire transaction chain

The existing value limits for PPIs translate to a maximum value cap of INR 50,000 for all users of PPIs, regardless of the purpose. This regulatory requirement essentially restricts PPI usability to only customers, and necessitates merchant payments to be routed via banking channels to the bank accounts of merchants. Apart from making the fund settlement process cumbersome and costly, it also automatically eliminates smaller merchants that do not access bank accounts, from being able to use PPIs for receiving payments; in this scenario, merchants are therefore required to resort to inefficient modes of payment such as cash that prove to be costly to accept and manage.

PPI companies already have the requisite infrastructure to enable merchants to accept payments on their own PPIs in a cost efficient manner. Enabling such an end-to-end PPI usage would also go a long way in eliminating cash, and create a clear trail of payment for much of the entities operating within the informal sector of the economy and contribute significantly in extending financial inclusion to hitherto un-included segments of society. Currently, existing value limits at INR 50,000 pose a real hurdle in accomplishing this objective; the RBI could consider doing away with these value limits for merchants. The potential benefits accrued through this action far outstrips the risks posed, Further, any risks arising by doing so are adequately countered by robust merchant due diligence and transaction monitoring processes set in place by PPI companies.

h. Billing transactions to be allowed to transaction PPIs

Within the current set up, PPIs have tied up with numerous billers to enable customers to pay their bills and fulfil recharge transactions in a convenient and secure manner. The BBPS draft guidelines suggest that only BBPOUs will be able to channel bill payments. It is requested that this is reviewed, and that PPIs too are able to connect to BBPS directly (without having to convert to a BBPOU and thereby have to meet the INR 100 crore net worth requirements), since transaction based PPIs can contribute greatly to increase electronic bill payments through high customer enrolment and through bilateral arrangements with billers as merchants.

4. Remittances

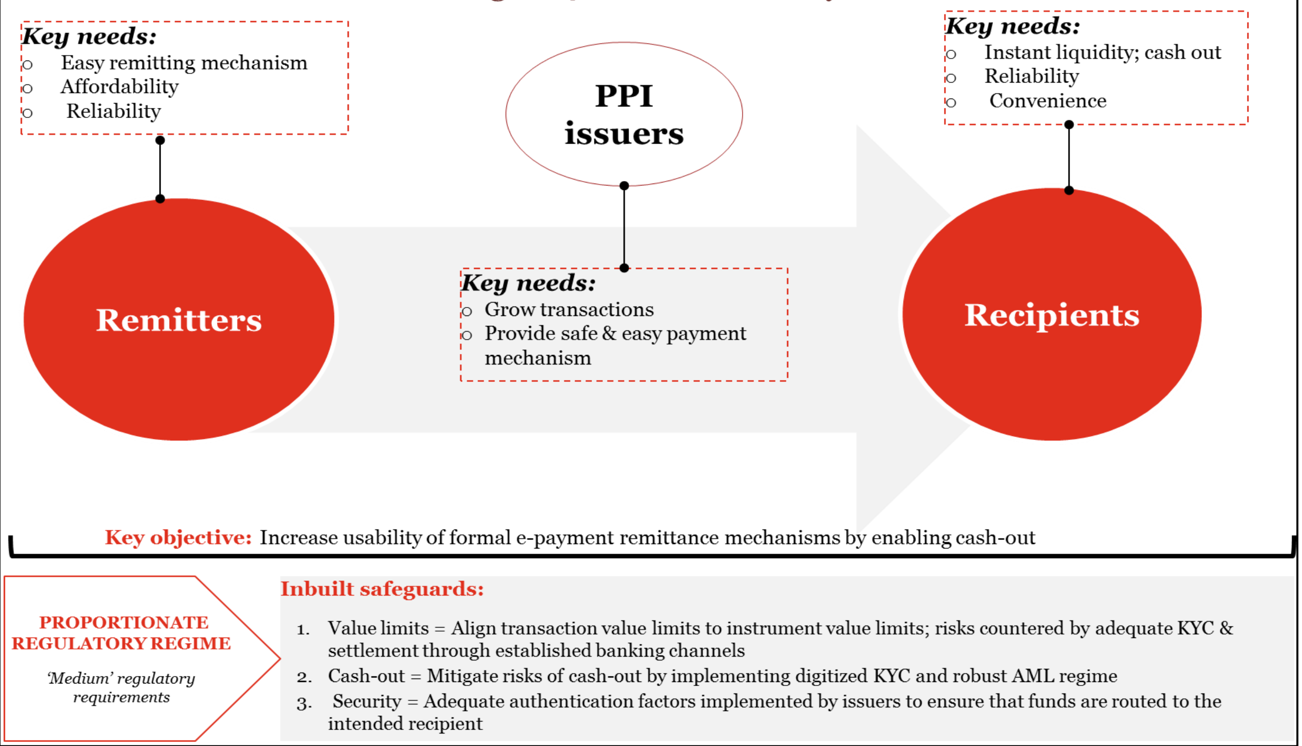
4.1. Introduction and user case

Remittances are an integral, if not the only source of income for many of the beneficiary households. The need for an efficient fund-transmitting and delivery mechanism therefore, goes beyond immediately visible financial need – it is a critical social need, as majority of the remittance senders and recipients do not have access to formal financial channels. Ideally, remitters should be able to send monies back to their families conveniently and in a cost-effective manner, while the beneficiaries should be able to maximise their utility from the money received by using it towards managing household expenses and potentially, savings.

The user case for remittances in India is largely a story of inclusion of migrant workers and their families' subsistence. The senders of remittance are typically workers who cannot afford to stand in lines and miss their day's wages. Obviously, the formal financial system does not make itself available beyond working hours and even when open for business, is often not a comfortable place for this individual. The service provider at the sender end thus, must be available when the customer is free, which is often before and after work hours, they must also make him or her comfortable with the ambience and service provider and as much as possible create the ability for him or her to make repeated small value remittances in an assisted or unassisted way, subject to their preference and ability. Another class of sender in the remittances segment is the government, which is likely to become more proactive and look for efficient means of transferring benefits to the poor. Although current indicators are that the preference will be to use the banking system, given the limitations of the existing banking infrastructure, PPIs are well positioned to support these programs in a cost efficient manner. This will require PPI providers to upscale their infrastructure and partner with state and central governments.

At the recipient end, the challenge is often worse. The geographies are remote or sometimes inaccessible and unbanked. The person receiving the money perhaps has already spent it in advance and needs immediate cash; in any case, he or she needs cash because the ecosystem around them operates only in cash. Even if they have the trust and comfort level to leave the money in the system for a few hours or days, they must have the certainty of being able to get cash at a moment's notice, on their doorsteps or close by *(See figure 4)*.

Figure 4: Remittance ecosystem



An interesting turn to the remittance story however, is that of person to person transfer in the banked and relatively wealthier sections of society, where remitting money to their children or other service providers can be shifted to PPIs, if they are able to provide better customer experience and efficiency. This will provide much needed competition to banks, spurring innovations and better customer service and more importantly, leading to price discovery in an unprotected way.

While the existing regulatory framework for PPIs addresses the needs of the remittance product, it limits the usability significantly because only bank channels are allowed to cash out. Partnerships between banks and PPI providers have not yielded the desired results because of various reasons, including the following:

1. Since remittance products are primarily used by financially excluded, the PPI partner has the responsibility to invest in the distribution infrastructure as well as provide low risk, high efficiency technology platforms. Recovering these costs becomes difficult in a model where partnerships are not germane to the business, but as a result of regulatory constraints.
2. Because of the ' superior' regulatory treatment accorded to banks as well as higher expectations from regulators in terms of systems and accountability, banks want to extend their existing systems on the PPI product. If it has not worked for the bank to grow the market to the excluded segments, it is also not going to work for the PPI
3. Turnaround times for banks and PPI providers are quite different. Because the PPI owns the front end, they need to answer uncomfortable questions. The banks primarily are doing this to fulfil targets and do not have the same sense of urgency or customer orientation towards this customer segment
4. Most importantly, banks' core competency is in handling account based relationships. To this extent, their customer focus is on such customers who are attractive from a cross selling perspective and who maintain good balances in their accounts. Remittances (for that matter, all payment products) target money that is mobile with a high velocity. The revenue model being based on transaction fees, non-bank providers have no

choice but to innovate and be efficient in this space, whereas banks have the choice to target more 'bankable' consumers. This makes the partnerships rather impractical at the vision and mission level itself.

4.2. Risk Assessment

	RISK LEVELS			
PRODUCT USE CASE	*AML*	*Systemic/Contagion risk*	*Settlement*	*Technology*
REMITTANCES	Medium	Medium	Low	High

Failure of technology creating a business continuity issue is the most significant risk in the remittances space, given that at any point of time, consumers are likely to be using the system for very basic needs. The technology, unlike in the case of bank remittance channels is expected to be available on a real time basis, moving money into the system, transferring it to the bank escrow account and making it available on demand to the recipient.

With future growth in transactions and merchant acquiring mechanism in the remote areas, many remittance providers will target the space at the cusp of remittance and transactions, i.e. people transferring money for specific payments or keeping remittances received in the system for usage at the closed loop network. Remittance focussed PPIs are therefore likely to keep some money in the system, but more likely to have money in transit. The success of their product, at least in the near term, until acquiring mechanisms become ubiquitous and habits change to non-cash, will depend on cash out. As explained earlier, PPI providers, especially given their distribution backbone may prove themselves to be better suited to person to person remittances than their bank peers if the ability to cash out is combined with this strength. If cash is therefore allowed to remittance PPI providers in a limited way, the risk profile will change from low to medium, with AML risk being most significant. It will therefore be important for the regulatory framework to focus on AML surveillance for this segment.

4.3. Recommendations

Formal remittance channels should be able to successfully wean people away from having to resort to informal (and often unreliable) channels. On the other hand, savvy urban consumers will demand high end products combining the facility of remittance and transaction, for example, a parent remitting money to child for payment of fees or bills or use at a restaurant. Both will drive the remittance PPI segment and it is recommended that products with greater responsibility for AML monitoring, flexibility of limited cash out be granted. It is also recommended that non-bank PPI providers be continued parallel to payments banks as the focus of such providers is not deposits and treasure management, but remittances and transactions.

a. **Usage – Allow cash-out for beneficiaries, subject to certain value limits**
Remittance recipients often opt for the more risky informal channels on account of its instant liquidity facility – remittance amounts are carried in cash, and delivered in cash to the recipients. Considering that most of the remittance beneficiaries are situated in rural areas, this proves to be a crucial and deciding factor in majority of the remittance senders opting for informal channels. In the current set up, only open system PPIs are allowed to offer cash out facility – given that only banks are allowed to issue this category of PPIs and that most of the customers using remittance

services are unbanked, the ability to leverage on this facility and offer this service to customers becomes severely limited.

PPIs, by themselves (without any partnerships with banks), do present the best case for channeling remittances. PPI issuing entities have a wide distribution network, the technological capability to offer low cost services, and the convenience of being operational beyond normal banking hours. Not allowing cash out therefore, impacts their ability to leverage on their advantages and serve the financially excluded segments of society. Relaxing regulations that will allow PPIs to offer limited cash out facilities will automatically capture a captive customer base and will help greatly in reducing the flow of money through informal means. This can be carried out in a phased manner:

- ✓ Given that currently banks insist on PAN for transactions beyond INR 50,000, the same limit can apply to cash out through non-bank PPI. Providers
- ✓ Remittance PPIs should be able to demonstrate surveillance and STR raising capabilities to be allowed cash out.
- ✓ Those non-bank PPI providers that do not opt for cash out benefits, but want to combine remittance with transactions can continue to operate with minimal KYC requirements, with the current wallet limit of 50000 INR. They should also be required to maintain data regarding remitter and end user transactions.
- ✓ The transaction will be routed through normal banking channels, via the mandated escrow mechanism, reducing the settlement risk.

b. Customer acquisition – Simplify KYC norms and focus on strong AML monitoring

Entities operating the remittance-PPI product will often find that their customer segments are composed of migrants who do not have adequate documents to satisfy the extant KYC requirements. This hurdle has been recognised by the RBI and various measures have been undertaken to ease the process. In place of limit based liberalization, that create the need for providers to have monitoring mechanisms in place and potential threat of breaches, it is requested that a holistic systemic view is taken. Since wallet size is capped to synchronize with tax limit on INR 50000, no further sub limits may be required. Allowing for inter-usability of KYC records across the financial sector, which will considerably reduce duplication effort and costs involved. A uniform mechanism should be instituted whereby existing KYC records with any financial institution can be leveraged by PPI operators while issuing PPIs to customers.

- ✓ In any partnership arrangement (telcos and banks, banks and non-banks, non-banks and non-banks), one KYC (preferably digital) should be required and all acceptance of terms and conditions is through an action and not through signatures. No ‘original seen and verified’ to be required.
- ✓ Move away from paper-based KYC to a digitized KYC process, wherein existing databases can be utilised by PPI companies to pull customer information. In this scenario, customers could provide PPI operators with their ID number (PAN, Aadhaar or Voter ID), which can then be plugged into the system by PPI entities to retrieve customer data which will suffice for KYC records. Additional security measures can be mandated to make sure that these databases are not misused in any manner.
- ✓ There may be complete parity between bank BC model and PPI remittance model on KYC since both are in effect conducting the same business and dealing with the same client segment, often leveraging on the same distribution infrastructure.

- ✓ Allow remittance of above 50000 with full, bank like KYC

c. Usage – Allow international remittances to be directly loaded on to domestic PPIs

At present, international remittances are either provided to beneficiaries in the form of cash, loaded on to specific cross-border remittance cards, or directly routed to their bank accounts. International remitting entities are restricted from loading remittance receipts directly onto domestic PPIs issued by non-banks. While the need for cash out is essential and immediate, the longer term (and perhaps, more integral) goal of transitioning to a cash-less society should also be simultaneously pursued. Allowing international remittances to be directly received in the beneficiaries' PPIs/wallets will not only increase customer convenience multifold, but will also lead to an increased comfort with the usage of alternative e-payment systems. This is particularly relevant for remittance beneficiaries based out of urban and semi-urban areas, where the adoption of digital channels might be faster.

d. Entry criteria – Make capitalisation norms ownership neutral for domestic and foreign owned entities

While the PPI issuing entities operating within the remittance segment can be required to bring in INR 5 crore as prescribed in the current RBI PPI guidelines, (in a phased manner), foreign owned entities seeking to provide similar PPI remittance services should also be subject to the same requirement. However, under the current FDI policy, foreign owned companies will be required to bring in capital to the tune of USD 0.5 million to USD 50 million, depending on percentage of foreign equity – this level of capitalisation is likely to be far in excess of what is required for this business and create barriers to entry for foreign players who are likely to bring in innovative practices. Capitalisation norms should therefore be ownership neutral, and apply to both domestic and foreign owned entities equally.

e. Security – Encouraging a multi-pronged authentication approach:

PPI-remittance entities' ability to successfully migrate people to this formal, electronic system of remittance channel is heavily dependent on the convenience and security of the system. Transfer of remittances, be it international or domestic, will need to be as seamless and secure as possible, in order to establish consumer trust.

- ✓ For domestic remittances, where cash out is being proposed, the need for an authentication mechanism to prove that the beneficiary is indeed the intended recipient, is all the more important. Implementing an authentication factor that promises robust security, while not inconveniencing customers, is key to addressing risks. In the domestic remittance case, where the recipient opts for cash out, the usage of Aadhaar-based authentication mechanism may be explored. Alternatively, other security technologies (mPIN, traditional passwords) could also be allowed.
- ✓ For international remittances that are routed directly to a domestic PPI, extending the mPIN applicability (to perhaps create a system where a common, transaction specific mPIN is used by both the remitter and the recipient) could be valuable. Much like transaction-based PPIs, regulatory prescriptions would need to be flexible enough to allow for new, innovative mechanisms to be tested and developed. A basic standard should be set, and companies' authentication systems could be allowed to deviate from the norm, as long as the basic standards are being met.

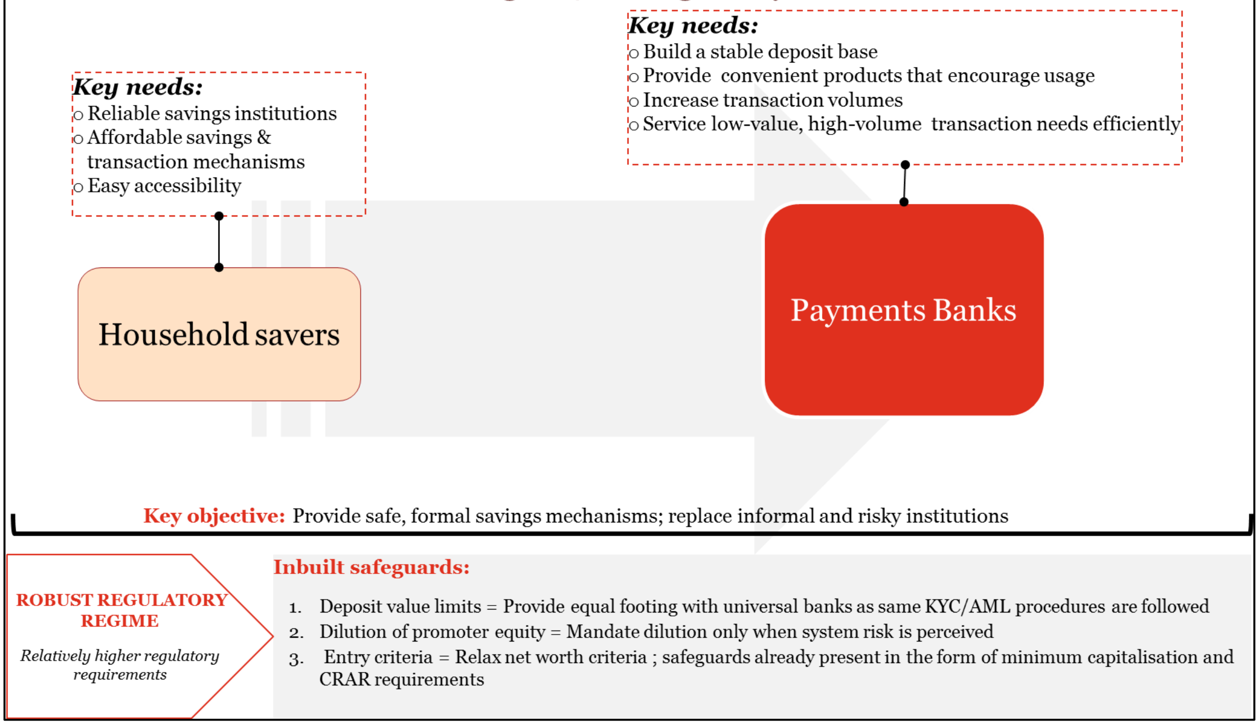
5. Savings

5.1. Introduction and user case

Given the low banking access in India, the fundamental difference between banks and non-banks as payment service providers has come to the fore of policy making process. While banks cater to various customer segments and are engaged in deploying a diverse range of products and services, third party payment companies have a specific business scope that is limited to transactions. The very nature of their business implies that banks gain revenues through high ticket, low volume model. The payment companies, on the other hand, achieve higher revenues through low ticket, high volume business models. As financial access in India is still considerably low and electronic payments are expected to be a major driver of inclusion, increasing participation from non-banks, or rather, specialised entities focussing on payments are likely to yield more flexible solutions and rapid expansion of services.

The Mor Committee Report released earlier this year, and the subsequent release of draft guidelines for Payments Banks by the RBI takes cognisance of this fundamental difference between universal banks and non-banks in catering to low income households' needs for a safe deposit mechanism, and efficient transactional services. Both, the Committee Report as well as the draft guidelines mooted the concept of niche banks catering to specialised needs of specific segments of population in India. The driving rationale behind Payments Banks is that by being relatively small, and by restricting their activities to deposits and transactional services, these niche banks can service low income households far more efficiently than universal banks. These banks have the tall task of replacing the informal saving networks that seem to operate at the base of the economy with tremendous efficiency, but also cause risks to the depositors as well as to the financial system. Being targeted at small businesses, their constituents and households, their business model, technology, distribution touch points and human resources are all expected to differentiate in favour of their niche. In some sense, they may have better ability to match up to the diversity of the real economy in India and therefore achieve what banks have found difficult within their cost structures and business strategies *(See figure 5).*

Figure 5: Savings ecosystem



The guiding principles here are providing comprehensive financial services in small sizes-the financial equivalent of the FMCG sachet, with equal ease and approachability. The operating principles are technology, data, flexibility, presence and collaboration with other financial services providers; all of it coming together to replace various informal mechanisms that provide usurious, high risk but flexible solutions to the unbanked segments in the current scenario. The user case, therefore is far more comprehensive and the licensing of such vehicles within a banking framework will ensure adequate attention, support and oversight to minimise any risks. The challenge here may come from a regulatory and supervisory infrastructure that is not differentiated from the banking infrastructure, thus not allowing these providers to achieve their objective while remaining profitable.

With the right regulatory framework and the play of competitive-collaborative models, these institutions can foster not only the growth of the retail electronic payments industry in the country, but also change the operating landscape at the grassroots level through mopping up savings and brining new customers within the formal financial services who will form the core of banking and economic growth tomorrow.

5.2. Risk Assessment

	RISK LEVELS			
PRODUCT USE CASE	*AML*	*Systemic/Contagion risk*	*Settlement*	*Technology*
SAVINGS	High	Medium	Medium	Medium

Payment banks will have the ability to build comprehensive financial services businesses in small sizes, with the significant exception of credit. This dramatically alters their risk profile and reduces the need for parity with bank regulations. On the other hand, they will be depository institutions and enjoy benefits of deposit insurance and therefore will need to be licensed and regulated.

Recognizing the above, the draft framework has recommended certain licensing and operating framework for these institutions. The industry is in the process of submitting its feedback as the guidelines are finalized. However, from the perspective of PPI providers who may opt to become payments banks, it is important to highlight how this category will differ from the other two and what level of regulations will facilitate growth and inclusion through these banks.

5.3. Recommendations

The draft guidelines provide key provisions for Payments Banks to follow, and lay down certain operating criteria. For Payments Banks to be successful however, enough flexibility should be allowed for promoters to retain control and ownership. Further, the continued adherence to adopting a ' value-limits' approach will pose significant operational hurdles for Payments Banks; it is important to note that Payments Banks will already have slim business margins, and placing further restrictions on products and services offered may just result in the business being unviable. Finally, regulatory guidelines should be such that market forces are allowed to function without interference, thereby letting the most innovative and efficient players thrive and best practices to emerge.

a. **Entry criteria – Do away with minimum net worth requirements**

The current net worth requirement of INR 100 crore may put unwarranted burden on constant capital infusion on these banks. This requirement seems particularly excessive in the light of INR 100 crore capitalisation and 15% CRAR norms prescribed for Payments Banks. Further, as Payments Banks may not be profitable right from the start of business (on account of restricted scope of activities and a fairly ' tough' customer segment to cater to), imposing this net worth requirement may just exacerbate the losses of Payments Banks, and prolong the time period before these entities break even. It is also not justified in view of the low risk on the balance sheet.

b. **Ownership & control – Mandate dilution of promoter stake only when banks become systemically significant**

As a business that is envisioned to be driven by innovation, Payments Banks will heavily depend on the involvement of the promoter. Diluting promoter' s stake in the bank at a pre- determined stage of business may distort the leadership by either creating a business for taking to market or not providing enough direction to the business to ensure its success. While the need for dilution of large shareholders in full service banks to prevent influence on credit decisions which can put the depositor's money at risk is undeniable, such a scenario is not applicable to Payments Banks as they are restricted from taking on any credit risk. Moreover, with the entire depositors' money kept in government securities and the requirement for Payments Banks to maintain 15% of risk weighted assets as CRAR, any risks faced by Payments Banks is further significantly minimized. Instead, dilution can be made mandatory for Payments Banks only when they assume systemic importance or significance, which can be determined as holding a fixed proportion of deposits of the banking system.

c. **Deposit products – Allow Payments Banks to collect deposits without imposing any value limits**

Payments Banks will need to be competitive, and cater to varied customer demands. Restricting deposits to INR 1,00,000 per customer would be counterintuitive to this business model. Since the business of Payments Banks will involve taking deposits and cash management for all its stakeholders, including customers, distributors, agents, billers and merchants; aggregated deposits amounts, especially on the distributor and merchant level may amount to funds far in excess of INR 1,00,000. Restriction on these deposits will require Payments Banks to lose such accounts to full service banks, which will not only impact revenues, but also pose operational hurdles.

This problem is further compounded as Payments Banks are supposed to collect deposits from small businesses and the unorganised sector, where the restriction on maximum limit may prove to be a hindrance to acquiring customers. The draft guidelines have been designed in such a way that Payments Banks will be required to follow every other stipulation applicable to universal banks and will pose significantly lower risks to the system, as their entire customer funds will be held in zero-risk Government Securities of limited tenure. Even while opening accounts for customers Payments Banks will be required to follow full KYC/AML procedures, further securing themselves against any potential risks in the system. Given that Payments Banks will be safer than universal banks, limiting their deposit taking ability will render their business model unviable.

d. **Scope of activities – Allow Payments Banks to offer a wide range of transactional services, and partner with other financial institutions**

Payments Banks are essentially a deposit and transaction driven business and must be encouraged to expand their scope of their activity for maximum impact. Payments Banks must therefore be allowed enough operational flexibility to offer cross border transactional services to their customers to capture the international remittances market which today in estimated to be USD 70 billion. The regulator may also consider allowing Payments Banks to act as BCs to financial institutions other than banks, like NBFCs, MFIs, Insurance companies, Mutual fund companies etc. for distribution of non-credit products. Such expansion of their activities will allow Payments Banks to reach a wide array of banked and unbanked customers.

Additionally, on account of the nature of their businesses, Payments Banks will engage in a number of complementary activities, such as bill aggregation, CBS solutions, bill payment services like mobile recharges and DTH recharges, gift vouchers, closed loop gift cards etc. In the interest of promoting the growth of these specialised banks, and ensuring business viability, regulatory guidelines could allow for Payments Banks to set up subsidiaries to undertake these complementary activities. On the other hand, payments banks should also be allowed to undertake all such activities within the bank, depending upon how they want to structure their capital. If required, initially, Payments Banks could be provided an approval on case-by-case basis for subsidiaries.

e. Pricing – Allow market forces to determine optimal pricing structure

Payments banks are likely to derive a large chunk of their revenues from generating sizeable volumes of transactions. As they are required to invest all their monies in approved Government Securities, and expected to offer interest on deposits, their net interest margins will already be low, further increasing their reliance on fee-based income generated by facilitating transactions. Universal banks today, are required to adhere to prescribed pricing limits while offering certain products and services to customers (MDR for Debit cards, NEFT & RTGS charges etc.), in the interest of making these services affordable for customers and encouraging the adoption of e-payments. However, unlike Payments Banks, Universal Banks' business models are underpinned by asset creation – i.e. revenues of Universal Banks are largely comprised of the interest payments received loans and other credit products. Payments Banks, with a limited mandate, will not be able to similarly leverage their deposits to offer credit products – their transaction-based business model is therefore likely to be impacted if pricing is artificially capped by regulations. Instead, regulatory guidelines should adopt a 'tariff forbearance' view allowing Payments Banks to discover market pricing for services offered – including cash deposits, withdrawals, payments and remittances as is the case with PPI products currently. Further, the interest rate payable on deposits should also be allowed to be determined solely by market forces, with minimal regulatory intervention.

6. Summing up: Building flexibility into the regulatory regime

RBI's goals of a less-cash and inclusive society in India are premised upon fostering innovation, encouraging adoption and pro-actively regulating the e-payments space. In identifying these key tenets, the regulator has also sought to design regulations such that they 'channelise innovation and competition to meet demands consistent with international standards and best practices'[20] which will 'incentivise all segments of society to increasingly adopt non-cash modes of payment in lieu of cash'[21]. While the focus is to 'proactively encourage electronic payment systems'[22] on the whole, the past few years have seen PPIs being increasingly recognised as integral to achieving these objectives. Although PPIs on their part have had some measure of success in creating awareness, and in garnering more than 200 million transactions[23], market growth has been less than optimum on account of a fundamental misalignment between regulatory framework and emerging practices.

As the market is increasingly tending towards differentiation, regulations will continue to foster market growth and safeguard against potential risks. As detailed in the preceding chapters, the PPI segment can be divided into three major use cases – transactions, remittances and savings. Each of these three use cases present their own unique levels and compositions of risks, which need to be taken into account by regulations; risks identified and the commensurate regulatory recommendations are captured in the table below:

PARAMETER	PRODUCT CATEGORIES		
	Transaction	*Remittance*	*Savings*
Capital requirements	• No minimum capitalisation requirements • Ask for entities to maintain positive net worth at all times	• Follow current entry criteria in with a provision to raise minimum capitalisation from INR 2 crore to INR 5 crore within a set time frame	• Retain minimum capitalisation limit but do away with minimum net worth requirements • Mandate dilution of promoter stake when they become systemically significant
Safeguards against money laundering(KYC/ AML/CFT) provisions	• No KYC up to 50,000 • Minimal KYC	• Minimum KYC up to 50K • Provide parity with the existing BC model; allow cash out with limits	• Follow set KYC/AML processes; focus on digitisation of KYC • Follow established escrow mechanism
Enabling billing transactions	• Allow PPIs to connect directly to BBPS	• Allow direct connection to BBPS	• Allowed
Deployment of money collected	• Follow established escrow mechanism	• Follow established escrow mechanism	• Follow established bank settlement channels • Maintain prescribed SLR criteria
Transaction limits and other key features	• Allow cross-border usage for transactions • Move away from a limits based	• Allow limited cash out • Allow cross border remittances to be loaded on to domestic PPIs	• Do away with caps on deposit values • Allow Payments Banks to offer a wide range of transactional services

[20] RBI vision document for Payment and Settlement Systems, 2012-15
[21] RBI vision document for Payment and Settlement Systems, 2012-15
[22] RBI vision document for Payment and Settlement Systems, 2012-15
[23] RBI, DBIE

	regime • Do away with limits for PPIs to be used by merchants		and partnering with other institutions • Allow market forces to determine optimum pricing structure
Technology – fraud prevention and security standards	• Allow PPIs to connect to third party interoperable payment networks	• Encourage multi-pronged authentication approach • Higher emphasis on transaction monitoring to ensure AML compliance	• Follow established security authentication mechanisms & institute high technology standards
Interoperability	Since high usage of PoS and internet transactions will drive volumes, all segments should be allowed to be interoperable	• Since high usage of PoS and internet transactions will drive volumes, all segments should be allowed to be interoperable	---

The passage of PSS Act in 2007 and the issuance of PPI guidelines in 2009 provided a firm footing for PPIs by generating awareness and establishing public trust in alternative electronic payment systems. Since then, internet and smartphone adoption have more than doubled, usage of social networks and other digital platforms have increased rapidly, and a number of policy programs have been instituted to improve technological infrastructure in the country. All of these factors have culminated into a need for market to be able to differentiate, innovate and meet growing customer demands for convenience, affordability and safety. The PPI industry today stands poised at the cusp of a paradigm shift; as we usher in an era of high growth in e-payments, we hope that these recommendations prove to be useful to the regulator. We look forward to receiving regulatory support in our endeavour to grow the industry and working with the regulator in truly transitioning to a financially included and cashless society.

The enclosed note is prepared based on the information given to us by Payments Council of India, Internet and Mobile Association of India (IAMAI) and is accordingly, given specifically for the use by IAMAI. Our conclusions are based on the completeness and accuracy of the above stated facts and assumptions, which if not entirely complete or accurate, should be communicated to us immediately, as the inaccuracy or incompleteness could have a material impact on our conclusions.

The conclusions reached and views expressed in the Note are matters of opinion based on our understanding of the law and regulations prevailing as of the date of this Note and our past experience with the tax, regulatory or other authorities as may be applicable. However, there can be no assurance that the tax authorities or regulators may not take a position contrary to our views.

Legislation and the policies of the authorities as well as their interpretations are also subject to change from time to time, and these may have a bearing on the advice that we have given. Accordingly, any change or amendment in the law or relevant regulations would necessitate a review of our comments and recommendations contained in this Note. Unless specifically requested, we have no responsibility to carry out any review of our comments for changes in laws or regulations occurring after the date of issue of this Note.

Notwithstanding anything to the contrary, this advice was prepared exclusively for IAMAI, and is based on the facts as presented to us as at the date the advice was given. The advice is dependent on specific facts and circumstances and may not be appropriate to another party.

Neither we, nor our Partners / Directors, employees and / or agents, owe or accept any duty of care or any responsibility to any other party, whether in contract or in tort (including without limitation, negligence or breach of statutory duty) however arising, and shall not be liable in respect of any loss, damage or expense of whatever nature which is caused to any other party.