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"Payment Banks" – A Newer Form of Banks to Foster Financial Inclusion in India

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ABSTRACT

Innovation and enterprise form the essence of opportunities and find reflection in every facet of our functions. With ethos of innovation the bankers have constantly endeavoured to develop new products which are suitable for their clients/ prospective clients' base and conditions. The evolving economic landscape and aspirations of the people have driven the Govt to plan seamlessly for inclusive banking for realising the opportunities that lie within. Considering the long outstanding need for reaching out to the far flung non-banked areas of the country, the Reserve Bank of India has done well to introduce more competition among banks by authorising, in principle, a new kind of bank. On 19th Aug 2015, the RBI announced eleven approvals for Payment Banks, a stripped down version of a full service bank which is designed to reach people outside the span of formal banking services. In the present highly competitive banking; which demands evolving strategies to promote interest of all stakeholders, the need to cut costs in its product & services; opening of more new full-service bank's structure in far flung off areas have proved unviable. The solution therefore has been to operate banks through diverse set of players--- such as Postal Department, Telecom Companies, which promise to reach people more effectively through technological advancements. This paper focuses on the likely banking revolution in the country as a result of clearance for establishment of 11 Payment Banks in India.

Key words : Payment banks, Economic landscape, Evolving strategies, Stakeholders, Technological- advancements.

Biographical notes:

Dr. J.C. Pande is presently a Visiting Faculty with Birla Institute of Technology, Noida. He has also been a Visiting and Guest Faculty to various Management Institutes. Earlier he had served as Chief Manager with Allahabad Bank; one of the premier nationalised banks in India; for over 30 years. He has completed PGDPM from FMS, Delhi University, is an MBA and PhD in Management.

Introduction:

Payments banks are niche banks set up by the Reserve Bank of India to further the agenda of financial inclusion. These banks will provide small savings accounts and payments /remittance services mainly to migrant labour workforce, low-income households, small businesses, etc. by enabling high volume-low value transactions in deposits and payments / remittance services in a secured technology-driven environment. They can accept demand deposits — current deposits and savings bank deposits — from individuals, small businesses and other entities, but there is an upper limit of Rs 1 lac per customer. Customers will earn interest on their savings account balance. The payments banks can accept and send remittances. They are also allowed to undertake utility bill payments and can distribute MF, Insurance and Pension products. However, they cannot lend to customers or issue credit cards.

The Payments Bank will be registered as a public limited company under the Companies Act, 2013, and licensed under Section 22 of the Banking Regulation Act, 1949, with specific licensing conditions restricting its activities to acceptance of demand deposits and provision of payments and remittance services. It will be governed by the provisions of the Banking Regulation Act, 1949, Reserve Bank of India Act, 1934, Foreign Exchange Management Act, 1999, Payment and Settlement Systems Act, 2007, other relevant Statutes and Directives, Prudential Regulations and other Guidelines/Instructions issued by RBI and other regulators from time to time, including the regulations of SEBI regarding public issues and other guidelines applicable to listed banking companies.

Background

It may be recalled that in the Union Budget for 2014-15 presented on July 10, 2014, the Hon'ble Finance Minister had announced that:

"After making suitable changes to current framework, a structure will be put in place for continuous authorization of universal banks in private sector in the current financial year. RBI will create a framework for licensing small banks and other differentiated banks. Differentiated banks serving niche interests, local area banks, payment banks etc. are contemplated to meet credit and remittance needs of small businesses, unorganized sector, low income households, farmers and migrant work force".

Setting up of Payments Banks

The Reserve Bank of India accordingly formulated and released for public comments draft-guidelines for licensing of payments banks in the private sector on July 17, 2014. Final guidelines were subsequently issued by the RBI and the process of inviting applications for setting up of Payments Banks and Small Banks was initiated after receiving feedback, comments and suggestions on the draft guidelines.

Both, Payments Banks and Small Banks are 'niche' or 'differentiated' banks, with the common objective of furthering financial inclusion. While small banks will provide a whole suite of basic banking products, such as, deposits and supply of credit, but in a limited area of operation; payments banks will provide a limited range of products, such as, acceptance of demand deposits and remittances of funds, but will have a widespread network of access points particularly to remote areas, either through their own branch network or through Business Correspondents (BCs) or through networks provided by others. They will add value by adapting technological solutions to lower costs.

The entities eligible to set up a Payments Bank include existing non-bank Pre-paid Instrument Issuers (PPIs), Non-Banking Finance Companies (NBFCs), corporate BCs, mobile telephone companies, super-market chains, companies, real sector cooperatives, and public sector entities. The entities eligible to set up a Small Bank include resident individuals with ten years of experience in banking and finance, companies and societies, NBFCs, Micro Finance Institutions and Local Area Banks.

The other conditions are that:

The operations of the bank should be fully networked and technology driven from the beginning, conforming to generally accepted standards and norms.

The bank should have a high powered Customer Grievances Cell to handle customer complaints.

The minimum paid up capital requirement for both Payments Banks and Small Banks has been kept at Rs. 100 crore, of which the promoters' initial minimum contribution will be at least 40 per cent, to be locked in for a period of five years. Shareholding of the promoters should be brought down to 40 per cent within three years, 30 per cent within a period of 10 years, and to 26 per cent within 12 years from the date of commencement of business of the bank.

On 19th Aug 2015, the Reserve Bank of India 'in principle' cleared 11 entities to set-up 'payment banks'. These are:

Aditya Birla Nuvo, ii. Airtel M Commerce Services, iii. Cholamandalam Distribution Services, iv. Department of Posts, v. Fino Pay Tech, vi. National Securities Depository, vii. Reliance Industries, viii. Dilip Shantilal Shanghvi, the Sun Pharma promoter, ix. Vijay Shekhar Sharma, Paytm founder, x. Tech Mahindra, xi. Vodafone M- Pesa.

These Payment Banks have differentiated license with limitations on what they can do. For example, payment banks can accept deposits upto only Rs 1 lac and cannot grant loans. They can only deposit their money in government bonds. They can issue debit cards but not credit cards. Payment banks will largely depend on mobile and ATM infrastructure to provide banking services. Opening an account is expected to be like acquiring a pre-paid mobile number.

The Reliance-SBI payments bank has an ambitious plan to cover 2,50,000 villages and 5,000 towns in three years. While it plans to start with Rs 100-crore capital base, this will be ramped up to Rs 400 crore in three-four years, depending on business volumes. "This partnership brings together the combined strengths of two of India's Fortune 500 corporations committed to making a transformative impact on India's financial inclusion landscape. We see this licence as an opportunity to promote financial inclusion," SBI Chairman Arundhati Bhattacharya has said.

The Department of Posts and Aditya Birla Nuvo, both unsuccessful in race for universal bank licences last year, succeeded this time. Analysts therefore, expect tough competition to drive down charges for fund transfers and other transactions.

These entities, which are required to have an initial capital of Rs 100 crore each, will have to start operations within 18 months. The promoter's minimum initial contribution to equity capital will have to be at least 40 per cent for the first five years. This is for the first time in the history of India's banking sector that differentiated licences are being given out by the central bank for undertaking specific activities.

On 16th Sep 2015, the RBI came out with a second set of such licences - for Small Finance Banks - 10 entities, including Ujjivan Financial Services and Equitas Holdings, have got RBI's approval to set up Small Finance Banks to provide basic banking services to small farmers and micro industries. Other entities to get the Reserve Bank's nod are Au Financiers (Jaipur), Capital Local Area Bank (Jalandhar), Disha Microfin (Ahmedabad), ESAF Microfinance (Chennai), Janalakshmi Financial (Bengaluru), RGVN (North East) Microfinance (Guwahati), Suryoday Micro Finance (Mumbai) and Utkarsh Micro Finance (Varanasi).

The "in-principle" approval will be valid for 18 months to enable these entities comply with the guidelines on Small Finance Banks, RBI said in a statement. These banks can provide basic banking services like accepting deposits and lending to the unbanked sections such as small farmers, micro business enterprises, micro and small industries and unorganised sector entities. Incidentally, the RBI had received 72 applications for setting up Small Finance Banks.

Since the Payments Bank will not be allowed to assume any credit risk, and if its investments are held to maturity, such investments need not be marked to market and there may not be any need for capital for market risk. However, the Payments Bank will be exposed to operational risk. The Payments Bank will also be required to invest heavily in technological infrastructure for its operations. The capital will be utilized for creation of such fixed assets. Therefore, the minimum paid up capital of the Payments Bank shall be Rs. 100 crore.

The foreign shareholding in the bank would be as per the extant FDI policy.

Since, the Payments Bank will be set up as a differentiated bank and shall confine its activities to further the objectives for which it is set up, this Bank would be permitted to undertake only certain restricted activities permitted to banks under the Banking Regulation Act, 1949, as given below:

Acceptance of demand deposits, i.e., current deposits, and savings bank deposits:- The eligible deposits mobilized by the Payments Bank would be covered under the deposit insurance scheme of the Deposit Insurance and Credit Guarantee Corporation of India (DICGC). Given that their primary role is to provide payments and remittance services and demand deposit products to small businesses and low-income households, Payments Banks will initially be restricted to holding a maximum balance of Rs.1,00,000 per customer. After gauging the performance of the Payments Banks by the RBI, the maximum balance limit may be raised. If the transactions in the accounts conform to the "small accounts" transactions, simplified KYC/ AML/CFT norms will be applicable to such accounts as defined under the Rules framed under the Prevention of Money-laundering Act, 2002.

Payments and remittance services through various channels including branches, BCs and mobile banking:- The payments/ remittance services would include acceptance of funds at one end through various channels including branches and BCs and payments of cash at the other end through branches, BCs, and Automated Teller Machines (ATMs). Cash-out can also be permitted at Point-of-Sale terminal locations as per extant instructions issued under the PSS Act. In the case of walk-in customers, the bank should follow the extant KYC guidelines issued by the RBI.

Internet banking - The RBI is also open to applicants transacting primarily using the Internet. The Payments Bank is expected to leverage technology to offer low cost banking solutions. Such a bank should ensure that it has all enabling systems in place including business partners, third party service providers and risk managements systems & controls to enable offering transactional services on the internet. While offering such services, the Payments Bank will be required to comply with RBI instructions on information security, electronic banking, technology risk management and cyber frauds.

Functioning as Business Correspondent (BC) of other banks – A Payments Bank may choose to become a BC of another bank for credit and other services, which it cannot offer.

The Payments Bank cannot set up subsidiaries to undertake non-banking financial services activities. The other financial and non-financial services activities of the promoters, if any, should be kept distinctly ring-fenced and not co-mingled with the banking and financial services business of the Payments Bank.

The Payments Bank will be required to use the word "Payments" in its name in order to differentiate it from other banks.

For ease of understanding and easy assimilation, features of these prospective banks are given in a tabular form:

	PAYMENT BANKS	SMALL BANKS
Who Can Pro-mote	Prepaid card issuers, Telecom companies, NBFCs, Bussiness Correspondents, Supermarket Chains, Corporates, Realty sector co-ops & PSUs.	Individuals/ professionals with 10 years experience in finance, NBFCs, Microfinance Cos, Local area banks.
What They Must Do	Have a min capital of Rs 100 Cr Maintain 75% of dep in Govt bonds Maintain 25% of dep in other banks Have atleast 26% investment by Indian Get listed if net worth crosses Rs 500 cr Have 25% of brs in unbanked areas Be fully networked and tech driven Have Rs 1 lakh cap for deposits in one a/c.	Have a min capital of Rs 100 Cr Extend 75% of loans to priority sector Have 25% of brs in unbanked areas Maintain reserve requirements Cap loans to individuals and groups at 10% and 15% of net worth Have a business correspondent network.

What They Can Do	Offer internet banking Sell mutual funds, insurance, pensions Offer bill payment service for customers Have ATMs and Business Correspondents(BC Can function as BC of another bank	Sell forex to customers Sell mutual funds, insurance, pensions Can convert into a full-fledged bank Expand across the country
What They Can't Do	Offer credit cards Extend loans Handle cross-border remittances Accept NRI Deposits	Extend large loans Float subsidiaries Cannot deal in sophisticated financial products.

The in-principle approval granted will be valid for a period of 18 months, during which time the applicants have to comply with the requirements under the guidelines and fulfil all other conditions as may be stipulated by RBI. After the selected applicants have complied with all the requisite conditions as laid down by RBI in its 'in-principle' approval, the RBI would grant a banking licence to them.

Conclusion:

The introduction of Payment Banks in India is a major positive disruption to the banking sector and would certainly see the cost associated with transfer of money or settlements reduce dramatically for end users. Payment banks have been restricted in banking operations, as they will not be allowed to carry out normal lending activities. It does raise questions about who will serve credit needs of the unbanked. RBI suggests that Payment Banks will serve as a bridge to allow people to eventually migrate to full-service banks, which is quite likely. When seen in the background of limited access to the formal banking system, however, the need to introduce newer forms of banks is the way to go, in the correct perspective.

Payments banks will face competition from the existing lenders. Besides, profitability will also remain a challenge as they will be working on narrow margins. To this end, due to ever-growing customers' expectations for faster-easier-simpler banking facilities what will drive the bankers is to work with creativity and passion, which contributes to growth of cross sections of our society, and so the challenges.

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