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Payment Banks: Bare Essential Banking for Most Essential Goal of Banking Inclusion

KEYWORDS: Payment Banks, Differentiated banks, Niche Banks, Financial Inclusion, Underbanked households/areas/people, Digital Wallets

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ABSTRACT *There has been a long series of attempts for taking banks to the unbanked and some new experiments are being made now. In the past, the Government of India and the Reserve Bank of India have made concerted efforts to promote financial inclusion of the unbanked and underbanked regions, sectors and societal segments. However, change is a perennial requirement and innovative reforms have to conceptualized in view of the experience gained, emerging needs and lacunae observed in the existing setup. The need to review and revolutionize the present banking/finance institutional set up has also been felt for some time now. '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. Payment Banks, to whom licences have recently been issued by the RBI, are a step in this direction. These new kind of banks are designated to reach people outside the span of formal banking services.*

INTRODUCTION

There has been a long series of attempts for taking banks to the unbanked and some new experiments are being made now. For the first time in India's banking sector, the RBI has given out differentiated banking licences in August-September 2015. By RBI's own admission, the go-ahead given to 11 'Payment Banks' is an 'experiment' towards greater financial and banking inclusion by taking the banks to the unbanked.

The first big push towards financial inclusion had started with the nationalization of 14 commercial banks in 1969, followed by another phase in respect of 6 more commercial banks in 1980. Starting the regional rural banks in 1975 had the objective of bringing the rural areas into the banking mainstream. However, even many decades after these initiatives, the goal of financial inclusion has remained a distant dream because the banking coverage remains abysmally low. Even today, only one out of 15 villages can boast of a branch of a commercial or rural bank in India. There is now a realization that banking inclusion, as a precursor for financial inclusion, must become the essence of banking sector and not merely one of the objectives.

The need to review and revolutionize the present banking/finance institutional set up has also been felt for some time now. In the current phase of **diversification and expansion of the banking system,** since April 2014, the Reserve Bank of India (RBI) has granted 23 banking licences to new players - two were given universal banking licences (April 2, 2014), 11 were issued payment banks licences (August 19, 2015) and 10 were given licences for small finance banks (September 16, 2015). The niche banks or differentiated banks - small finance banks and payments banks - have been set up to further the regulator's objective of deepening financial inclusion. Both payments banks and small finance banks were key recommendations of the committee on financial inclusion chaired by Nachiket Mor and reflect the need to address the huge problem of delivery of meaningful products and services to a new class of consumers through the creation of new organisational structures and business models. Unlike the small finance banks, which are essentially scaled down versions of commercial banks, with both deposit-taking and loan-making functions, the payments banks are stripped down banks in so far as they can take deposits but cannot provide credit except to the government.

Payment Banks, to whom licences have been issued by the RBI, are a step in the direction of banking/financial inclusion. They are not only likely to reach out to unbanked people and rural areas but will also ensure more money coming into the banking system and will introduce more competition among banks. It could be uneconomical for traditional banks to open branches in every village but the mobile phones coverage is a promising low-cost platform for quickly taking basic banking services to every rural citizen. This is the USP of payment banks. The innovation is also expected to accelerate India's journey into a cashless economy. India's domestic remittance market is estimated to be about Rs. 800-900 billion and growing. With money transfers made possible through mobile phones, a big chunk of it, especially that of the migrant labour, could shift to this new platform. Payment banks can also play a crucial role in implementing the government's direct benefit transfer scheme, where subsidies on healthcare, education and gas are paid directly to beneficiaries' accounts. Payment banks cannot lend except to the government. This means payment banks will theoretically be the safest of banks since they have only the government as borrower – and governments don't default. In future, payment bank licences may be available on tap i.e. without any application cut-off date and we could see even 50-100 such banks being set up. If all goes well with the payment banks experience, India may be fully banked over the next decade.

Policy Background for Payment Banks

The Reserve Bank of India (RBI) issues licences to entities to carry on the business of banking and other businesses in which banking companies may engage, as defined and described in Sections 5 (b) and 6 (1) (a) to (o) of the Banking Regulation Act, 1949, respectively. Based on the

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recommendations of the Committee on Banking Sector Reforms (M. Narasimham committee,1998), Committee on Financial Sector Reforms (Raghuram Rajan committee, 2009), there has been a recognition within the Government of India and the Reserve Bank of India (RBI) think tanks about the need for an explicit policy on banking structure in India. Accordingly, in February 2013, RBI came out with a set of guidelines for licensing of new banks in the private sector and announced that it would work on a policy of having various categories of "differentiated" bank licences which will allow a wider pool of entrants into banking by extending banking services to the underserved and unserved sections of the population. Subsequently, in the Union Budget 2014-2015 presented on July 10, 2014, the Hon'ble Finance Minister announced that:

*"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".*

These efforts have culminated in the grant of Payment Bank licences to 11 entities (in August 2015), which include a diverse set of players ranging from the Government's Department of Posts to telecom giants like Airtel and Vodafone (MPesa) and including the digital wallets like PayTM.

Role of Payment Banks:

a) Objectives and role envisaged: The objectives of setting up of payment banks will be to further **financial inclusion** by enabling convenient transactions and savings accounts for the underserved in the population. They also facilitate remittances which have both macro-economic benefits for the region receiving them as well as micro-economic benefits to the recipients. Higher transaction costs of making remittances diminish these benefits. Therefore, the primary objective of setting up of payments banks will be to further financial inclusion by providing

(i) small savings accounts and
(ii) payments / remittance services to migrant labour workforce, low income households, small businesses, other unorganised sector entities and other users, by enabling high volume-low value transactions in deposits and payments/ remittance services in a secured technology-driven environment.

These banks will depend less on branches and more on alternate channels like mobile phones, internet banking and payments, ATMs and point of sales. It is expected that the payments bank shall operate in remote areas mostly through BCs, ATMs and other networks. However, to be effective, the payments banks should ensure widespread network of access points particularly to remote areas, either through their own branch network, ATMs or BCs or through networks provided by others. At least 25 per cent of physical access points (branches) including BCs are required to be in rural centres.

b) Eligible promoters: The existing non-bank Pre-paid Payment Instrument (PPI) issuers authorised under the Payment and Settlement Systems Act, 2007 (PSS Act); and other entities such as individuals/professionals; Non-Banking Finance Companies (NBFCs), corporate BCs, mobile telephone companies, super-market chains, companies, real sector cooperatives; that are owned and controlled by residents; and public sector entities were entitled to apply to set up payments banks.

Existing PPI licence holders could opt for conversion into payments banks. It is not mandatory for an existing PPI issuer to apply for a payments bank licence and it may continue as a PPI issuer as per the guidelines issued by RBI from time to time. It is pertinent in this context that so far these kinds of digital wallet/PPI products were mobile applications dependent on tie ups with banks to make cash withdrawals and interest payments. But now these operators, say M-Pesa or PayTm, will be banks in their own right, albeit without the provision to extend loans to individuals.

c) Scope of activities: The payments bank will be set up as a differentiated bank and shall confine itself to undertake only certain restricted activities permitted to banks under the Banking Regulation Act, 1949, as given below:

i. Acceptance of demand deposits, i.e., current deposits, and savings bank deposits from individuals, small businesses and other entities, as permitted. No NRI deposits should be accepted. Given that their primary role is to provide payments and remittance services and demand deposit products to small businesses and low-income households, payments bank will initially be restricted to holding a maximum balance of Rs. 100,000 per individual customer.
ii. Issuance of ATM / Debit Cards. Payments banks, however, cannot issue credit cards, as they cannot provide loans.
iii. Payments and remittance services by setting up various channels including branches, Automated Teller Machines (ATMs), Business Correspondents (BCs) and mobile banking.
iv. Issuance of PPIs as per instructions issued from time to time under the PSS Act.
v. Internet banking - The payments banks are expected to leverage technology to offer low cost internet banking solutions.
vi. Functioning as Business Correspondent (BC)/agent of another bank – A payments bank may choose to become a BC of another bank, subject to the RBI guidelines on BCs.
vii. Serve as an agent to distribute credit, insurance, pension products and mutual funds on behalf of other financial service providers, i.e. non-risk sharing simple financial services activities, not requiring any commitment of their own funds.
viii. They can offer services such as automatic payments of bills, and purchases in cashless, chequeless transactions through a phone.
ix. They can send or receive remittances (domestic as well as foreign) under a payment mechanism approved by RBI, such as RTGS / NEFT / IMPS.

Case Studies of some of the selected Payment banks:

The licences for the payments banks have been given to quite a heterogeneous group comprising telecom companies and prepaid instrument providers among others. It is a good step because payments banks are really in uncharted territory and the greater the variety of organisational legacies that they come from, the better the prospects of finding a successful mode. Let us look at what some of these players bring to the table:

PayTM (Vijay Shekhar Sharma): The PayTM digital wallet is one of the most popular digital wallets in India right

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now. It boasts of more than 10 crore account holders and leverages the rising number of mobile users. It operates a low-cost model of financial inclusion and aims at bringing half a billion Indians to the mainstream of economy, riding on mobile phone penetration. The main strengths of this bank are the large customer base, existing popularity in the transactions segment as a digital wallet and data analytics technology. The main challenge that it faces is its absence of physical presence, unlike some of the other selected payment bank licencees like India Post, Airtel M-Commerce (with Kotak Bank tie-up) and Reliance Industries (with SBI tie-up).

Vodafone M-Pesa: Vodafone has a large mobile-user base and over 90,000 agents canvassing for m-pesa accounts, which it plans to leverage for its banking business. It is already seen as a popular and convenient way to transfer money. This is a globally developed and tested model of mobile money for financial inclusion. Vodafone's M-Pesa model is working successfully in Kenya where payments on this product constituted about 30% of the country's GDP in 2014. M-Pesa is also exploring the options for enabling direct transfer of wages and subsidies from government departments and agencies into the holder's M-Pesa account. The challenge will lie in creating suitable formal banking tie-up for credit extension business and overall business synergy, for which ICICI looks a likely partner as its m-pesa account holders already had accounts with this bank.

Department of Posts: Government departments were also permitted to apply for payment banks after suitable departmental clearances and this public sector biggie is likely to give the private operators a run for their money. Its USP lies in about a lakh and a half post offices that offer it a widespread physical presence as a bank, especially in rural, underserved and remote areas. By all accounts this entity is on the cusp of being a major instrument for digital financial inclusion and e-commerce. However, to realize this potential the post offices will need to be networked fast. It is pertinent to note that the CBS banking is already being offered in many of the branches (i.e. post-offices). India Post's reach, with 140,000 plus post offices, significantly exceeds the number of bank branches at around 44,700 in rural areas. Since payment banks are allowed to take deposits up to Rs.1 lakh, public sector banks could lose out on customers who might open savings accounts with the post office. The arrival of payment banks like India Post is also likely to transform social welfare and subsidy schemes through direct transfers.

Reliance Industries: Reliance is set to launch its Reliance Jio 4G mobile-internet network, which can be used to jointly promote the mobility as well as banking business. It has a huge customer base and a proven capability to launch mega projects. Its partnership with SBI brings together two of India's Fortune-500 companies. This combination for operating a payment bank looks committed to make a huge impact on India's financial inclusion landscape. This bank is looking to provide, through physical network of SBI and Reliance and mobile platform of Reliance Jio, banking and transaction services to underbanked and small businesses.

Tech Mahindra: As an IT service provider, this player has access to cutting edge technology which will enable low cost banking and payment transactions. Further, it already is exposed to digital payment platforms and branchless banking because it has been providing tech solutions in these areas to other entities since long. The technological competence of Tech Mahindra adds another dimension to the diverse bouquet of players who have been chosen to start the niche segment payment banks. However, the fact that it has earlier provided services and solutions to some of those with whom it will now be competing in the payment bank sphere, raises concerns about conflict of interest. The only other major cause of concern for this entity is its lack of distribution network, where it will have to start from a scratch.

Opportunities and Challenges

Payment banks involve tweaking the entire idea of a bank, in order to reach people. The payment banks are stripped down version of a full service bank and are designed to reach people outside the span of the formal banking services, using digital payment systems, payment wallets, internet banking, mobile banking, ATMs and other payment platforms which are **high on technology and low on operative cost**. In the banking environment of a country like India where more than 60% of people earn less than Rs 4000 pm, costs do matter and the full service bank's structure has proven unwieldy. A stripped down bank can be the **bank for the unbanked**. The licencing condition, with a cap of Rs 100000 on deposits that payment banks can receive, defines the market that they will target – namely the unbanked population. The RBI expects payment banks to target migrant labourers and the self-employed, besides the low income households, offering low-cost savings accounts and convenient remittance services so that those who at present transact only in cash can take their first step into the formal banking system. It is also hoped by the RBI that these payment banks will serve as the bridge to allow people to eventually migrate to full service banks. Thus, this technological solution may also turn out to be a major step towards achieving **a truly cashless economy** if they become successful as the target market's chosen mode of financial transactions.

Being operated by a diverse set of players such as postal department, telecom companies and digital wallets, these banks promise to reach more people effectively. With this experiment, the access to and usage of banking system is likely to go up and that opens up many more opportunities as it **inculcates saving habits and makes credit more accessible**. It is believed by banking experts that led by mobile banking and data analytics technologies; these payment banks will be able to change the face of financial inclusion opportunity in India. These banks seek to leverage the rising number of mobile users for translating those numbers into banked population. The initiative visualises platforms like Vodafone's M-Pesa closer to the version that is working successfully in Kenya where payments on this product alone constituted about 30% of the country's GDP in 2014. **Digital financial inclusion and e-commerce activities** are set to get a major boost because of this initiative. Going by the international experience, this innovation of basically transforming **a citizen's mobile phone into a stripped down bank branch** has a greater chance of success. Thus, the scenario looks bright for inclusive banking outreach and branchless banking in our country.

Though this banking diversification is a welcome development, some caution is advisable in assessing the prospects of the payment banks. It will be difficult for them to obtain deposit accounts because of the fact that the Prime Minister's Jan Dhan Yojana has achieved virtually full penetration of no-frills accounts. Therefore, the payments banks would face the challenge of successfully persuading a large number of potential customers to either make a switch from

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commercial banks or open up a second account. Additionally, these new forms of banks pose new regulatory challenges and the RBI will need to keep pace with the evolving requirements in terms of quality, and not quantity, of regulatory regime for an experimental and innovative banking sector. On the other hand, the big players in the niche bank segment are also likely to hit the smaller of the existing full service banks (both public sector and private) hard. The competition for state-owned banks will intensify as payment banks, which are backed by digital platforms, adequate capital, zero legacy issues, and low-cost innovative and convenient services, will compete heavily for business in rural and semi-urban areas.

CONCLUSION

Considerable optimism surrounds the diversification and expansion of the banking system. These niche banks are likely to take basic banking services, including acceptance of deposits and lending operations (in case of small finance banks), to unserved and underserved sections of the population. Financial experts are going to the extent of calling this initiative as the biggest banking reform since the bank nationalisation of 1969. In fact this bold and experimental move by the RBI also means that ironically the cycle of institutional reform experiments that started with the 1969 round of bank nationalisation has now come full circle. The responsibility for financial inclusion is now almost entirely entrusted to the private sector.

While the road ahead is full of challenges and uncertainties, the fact remains that the RBI approval for setting up payment banks will pave the way for financial inclusion through a combination of branches and digital platforms. Banking costs will come down due to intense competition driven by the expected proliferation of payment banks. Currently, the customers are required to pay heavily for services like ATM transactions beyond a prescribed limit, additional cheque-books, non-maintenance of minimum balances etc. These costs will come down as payment banks start offering zero-balance, barefoot accounts with low-cost services and potentially higher rate of interest on deposits. The customer is finally going to be the king in the banking sector.

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