© February 2019 | IJIRT | Volume 5 Issue 9 | ISSN: 2349-6002

Role of Payments Banks in India

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A new model is emerging in India. Payments banks, which will soon be offering basic banking and payments services for the country's unbanked and underserved, will leverage technology to digitise payments and promote widespread access to banking. Payments banks are unique because they take a market-driven approach to deliver on financial inclusion goals.

The Payments Bank regulatory regime is unprecedented and presents a renewed opportunity for non-bank mobile money providers in India. However, early analysis indicates that payments banks will require high levels of investment and a long growth trajectory to become a profitable and viable business.

What Are Payment Banks?

Payment banks are specialized financial institutions designed to provide basic banking services to the under banked and unbanked population. They offer a limited range of products and services, focusing on facilitating financial transactions and promoting financial inclusion.
Unlike traditional banks, payment banks cannot issue loans or credit cards. Their primary function is to provide safe and convenient access to banking services, such as deposits, withdrawals, remittances, and payments, primarily through digital channels.
A payment Bank is created by the Reserve Bank of India. Payments bank seeks to o provide financial and payment services to small businesses, low-income households, and migratory workers in a safe, technology-driven environment. They function as regular banks but cannot provide credit or loan facilities.

History of Payment Banks

The concept of payment banks first gained prominence in Kenya with Safaricom’s 2007 launch of M-Pesa. This mobile money storage and transfer service allowed users to store and transfer money. Following Kenya’s lead, several countries, including Bangladesh, Nigeria, Brazil, and Indonesia, have embraced the concept.

Development of Payment Banks in India:

- India introduced payment banks as part of its efforts to promote financial inclusion.
- In 2014, the Nachiket Mor committee proposed two types of differentiated banks, namely payment banks and small finance banks.
- The RBI published guidelines for licensing of payment banks in 2014 and approved 11 entities, out of which six started operations.
- These six banks are Airtel Payments Bank, Paytm Payments Bank, India Post Payments Bank, Fino Payments Bank, Jio Payments Bank, and NSDL Payments Bank.

Features of Payment Banks in India

- A payment bank is a special sort of bank that solely performs the limited banking tasks that the Banking Regulation Act of 1949 allows.
- Some activities include deposit acceptance, payments and remittance services, internet banking, and acting as a business correspondent for other banks.
- They can take deposits of up to Rs 1 lakh per person at first.
- They can assist with money transfers and insurance, and mutual fund sales.
- They can also only issue ATM/debit cards and not credit cards.
- They are prohibited from forming subsidiaries to provide non-banking financial services.
- They are not permitted to engage in any lending activity.
- Payment Banks are not allowed to issue Loans and cannot accept NRI Deposits.
- A person with a payment bank account might deposit and take money from any ATM or other service provider.
- Licensing would be granted to mobile companies, grocery chains, and others to cater to individuals and small enterprises.

- They are only allowed to invest money from customers' deposits into government securities.
- The minimum capital for payment bank is of Rs. 100,00,00,000.

Scope of Activities of Payment Banks

- Payment Banks accept demand deposits.
- They are responsible for issuing ATM/debit cards but cannot issue credit cards.
- Another scope of activity is payments and remittance services through various channels.
- NRI deposits are not accepted in payment banks.
- Only that amount they obtained from the customer's deposit may be invested in government securities.

Eligible Promoters of Payment Banks

- Non-bank financial institutions that already exist Other entities such as individuals/professionals; Non-Banking Finance Companies (NBFCs), Corporate Business Correspondents (CBCs), mobile telephone companies, supermarket chains, companies, real sector cooperatives; and Public sector entities that are owned and controlled by residents may apply to set up payments banks.
- To establish a payments bank, a promoter/promoter group can form a joint venture with an existing scheduled commercial bank.
- To the extent permissible by the Banking Regulation Act of 1949, scheduled commercial banks can take an equity position in a payments bank.

FINANCIAL SERVICES OF PAYMENT BANKS

Payment banks offer a range of basic financial services to the under banked and unbanked population. Key features include:
Deposit Accounts
Customers can open savings and current accounts with a maximum balance limit of Rs.200,000.
Debit Cards
Payment banks issue debit cards for ATM withdrawals and POS transactions.
Money Transfers
Facilitate domestic and international bank transfers of funds through various modes, such as NEFT (national electronic fund transfer), IMPS (immediate payment service), UPI (unified payments interface), and AEPS (Aadhaar-enabled payment systems).
Mobile Banking
Offering convenient banking services through mobile apps, including balance inquiries, fund transfers, and bill payments.
Agent banking
Expanding reach through a network of business correspondents in rural and semi-urban areas.
Basic Financial Services
Providing essential services like utility bill payments, mobile recharges, and insurance products.
Investment Restrictions
Funds are primarily invested in government securities with a maturity period of up to one year.
Leverage of Technology
Employing biometric authentication, QR codes, and NFC technology to enhance security and convenience for customers.

Partnerships and Collaborations

Payment banks collaborate with financial institutions and service providers to offer a wider range of financial products, such as insurance, mutual funds, and pensions, enhancing their service offerings.

What are the Permissible Activities of Payment Banks?

Payment banks are designed to provide essential banking services to underserved populations. Here are the key permissible activities they can engage in:
Accepting Deposits
Payment banks can accept deposits from individuals, small businesses, and other entities, with a maximum limit of Rs. 2 lakh per customer.
Facilitating Money Transfers
They enable quick and secure money transfers, both domestically and internationally, providing a vital service for migrant workers and others who need to send money across borders.
Issuing Prepaid Instruments
Payment banks can issue prepaid instruments, such as debit cards and mobile wallets, allowing customers to make cashless transactions conveniently.
Offering Basic Financial Services
Customers can open savings accounts, current accounts, fixed deposits, and recurring deposits with payment banks, enjoying attractive interest rates and minimal charges.

Distributing Third-Party Products

Payment banks can distribute third-party financial products, including insurance, mutual funds, pensions, and government schemes, expanding their service offerings to meet customers' diverse needs.

Acting as Business Correspondents

In remote areas, payment banks can serve as business correspondents for other banks, providing essential banking services where traditional banks may not be present.

Benefits for Customers in Remote Areas

- Secure Deposits: Customers can deposit funds securely and earn interest on their savings, even in areas where traditional banks are scarce.
- Convenient Money Transfers: The ability to transfer money quickly and at low cost is crucial for those supporting family members or conducting business across distances.
- Access to Cash and Payments: With net banking, mobile banking, or debit cards, customers can access cash and make payments anytime, anywhere, without the need for intermediaries.
- Comprehensive Financial Solutions: Payment banks offer a range of products and services, from savings accounts to insurance, catering to the financial needs of customers.
- Financial Literacy Programs: Payment banks, often in collaboration with their partners, conduct financial literacy and awareness programs, helping customers make informed financial decisions.

Role of Differentiated Banks in India

- Financial Inclusion: By targeting specific customer bases and regions, these banks play a crucial role in bringing a large chunk of the population into the formal banking system.
- Economic Growth: By providing credit facilities to MSEs, these banks fuel economic growth at the grassroots level, supporting employment and wealth creation in rural and semi-urban areas.
- Promoting Banking Habits: Increased access to deposits and basic financial products fosters a culture of saving and investment.
- Financial Innovation: These banks have introduced innovative banking and financial solutions especially designed to the needs of their customers. For example, payment banks have leveraged mobile technology to facilitate easy and secure transactions, helping to spread digital banking across India.
- Healthy Competition: The presence of differentiated banks fosters competition in the banking sector, ultimately benefiting all customers with better rates and services.

OPERATING GUIDELINES FOR PAYMENTS BANKS

1. Prudential regulation

The prudential regulatory framework for payments banks (PBs) will largely be drawn from the Basel standards. However, given the financial inclusion focus of these banks, it will be suitably calibrated.

1.1. Capital adequacy framework

Minimum Capital Requirement	15%
Common Equity Tier 1	6%
Additional Tier I	1.5%
Minimum Tier I capital	7.5%
Tier 2 capital	7.5%
Capital Conservation Buffer	Not Applicable
Counter-cyclical capital buffer	Not applicable
Pre-specified Trigger for conversion of AT1	CET1 at 6% up to March 31, 2019, and 7% thereafter

1.2 Large exposures limits (for investments in deposits of scheduled commercial banks)

The exposure in this regard to an individual scheduled commercial bank shall not be more than five per cent of the total outside liabilities of the PB.

1.3 Capital measurement approaches

Credit Risk	Basel II Standardized Approach for credit risk

1.4 Inter-bank borrowings

PBs will be permitted to participate in the call money and CBLO market as both borrowers and lenders. These borrowings would, however, be subject to the limit on call money borrowings as applicable to scheduled commercial banks.

1.5 Investment classification and valuation norms
PBs shall, on any given day, maintain a minimum investment to the extent of not less than 75 per cent of 'demand deposit balances' - DDB (including the earnest money deposits of BCs) as on three working days prior to that day, in Government securities/Treasury Bills with maturity up to one year that are recognized by RBI as eligible securities for maintenance of Statutory Liquidity Ratio (SLR). Further, PBs shall, on any given day, maintain balances in demand and time deposits with other scheduled commercial banks, which shall not be more than 25 per cent of its DDB (including the earnest money deposits of BCs) as on three working days prior to that day.
The investments and deposits made according to (i) and (ii) above, together shall not be less than 100 per cent of the DDB (including the earnest money deposits of BCs) of the PB unless it is less to the extent of balances kept with RBI.
1.6 Restrictions on loans and advances (including lending to NBFCs) including regulatory limits
PBs will not be permitted to lend to any person including their directors. However, PBs may lend to their own employees out of the bank's own funds, as per a Board approved policy outlining the caps on such loans.
1.7 Para-banking activities
PBs will not be permitted to undertake any para-banking activity except those allowed as per the Licensing Guidelines and the related FAQs issued.

1.8 Product approval
At the time of submitting application for licence, the PBs should submit to RBI a list of financial products they intend to offer with a clear description. Any new products proposed to be introduced thereafter should be intimated to RBI for information. If required, RBI may place suitable restrictions on the design, functioning, or other features of the product including discontinuing the product.
2. Risk management

2.1 Credit risk management including credit concentration risk
Not applicable, except as indicated in para. 1.3.
2.2 Market risk management
The provisions regarding market risk management for PBs will be as applicable to commercial banks. PBs will be permitted to use derivatives only for the purpose of hedging their foreign currency positions arising out of the activities conducted under the AD Category II authorization.

2.3 Operational risk management
Payment Banks should implement the operational risk management requirements, issued by RBI for scheduled commercial banks for operational risk, including collection of operational loss data.

2.4 Liquidity risk management
The provisions regarding liquidity risk management shall be as applicable to scheduled commercial banks, with suitable enhancements to take into account the liquidity risk profile of PBs.

2.5 Strategic and reputational risk management
The provisions regarding strategic and reputational risk management shall be as applicable to scheduled commercial banks, with suitable enhancements to take care of the reputational risk arising from use of agents.

2.6 Internal controls, audit and compliance
The provisions regarding internal controls, audit and compliance by the PBs shall be as applicable to scheduled commercial banks, with suitable enhancements to take care of the ICT related aspects and operations through agents.

3. CRR, SLR, disclosures and statutory/regulatory reports

For PBs, the CRR and SLR requirements and the various disclosures and statutory/regulatory reports will be as applicable to commercial banks (see the Master Circular RBI/2015-16/98 DBR.No.Ret.BC.24/12.01.001/2015-16 dated July 1, 2015 and the circulars issued thereafter).

4. Ownership and control regulations

The extant provisions in this regard as applicable to private sector banks, as covered in the Master Directions on Issue and Pricing of shares by Private Sector Banks DBR.PSBD.No.95/16.13.100/2015-16 dated April 21, 2016 and Master Directions on Ownership in Private Sector Banks DBR.PSBD.No. 97/16.13.100/2015-16 dated May 12, 2016, shall be applicable to PBs as well, except what is provided in the existing regulation contained in the Licensing Guidelines.
5. Corporate governance

5.1 Constitution and functioning of board of directors

The extant provisions as applicable to banking companies shall be applicable to PBs as well. Specifically in the case of converting entities, the terms and conditions of appointment of existing Directors will be grandfathered till completion of their present term.

5.2 Constitution and functioning of committees of the board, management level committees, remuneration policies

The extant provisions in this regard as applicable to private sector banks, shall be applicable to PBs as well.

6. Banking Operations

6.1 Authorization of Access Points

The annual plans for opening of physical access points by the PBs for the initial five years would need prior approval of RBI. The first of such plan shall be submitted to RBI before commencement of business. After the initial stabilisation period of five years, and after a review, RBI may liberalize the requirement of prior approval.

An employee of the PB should be available for sufficient duration, at a fixed location known to the customers at the district level, to attend to customer grievances and support the agent supervision. This fixed location may also be used to conduct the banking business of the PB, and it will be considered as a physical access point for the purposes of assessing the requirement of opening at least 25 per cent physical access points in rural centres.

6.2 Regulation of Business Correspondents

The PBs can engage all permitted entities including the companies owned by their business partners and own group companies on an arm's length basis as "BCs". These companies can have their own branches managed by their employees operating as "access points" or may engage other entities/persons to manage the "access points" which could be managed by the latter's staff. In the above cases, from the regulatory perspective, the bank will be responsible for the business carried out at the 'access points' and the conduct of all the parties in the chain regardless of the organizational structure including any other intermediaries inserted in the chain to manage the BC network.

Inter-operability of the BCs will be allowed except for opening of savings and current accounts. BCs cannot undertake any offline transactions. Consequently, BCs cannot undertake transactions if there is no internet connectivity. The PBs will be exempted from the requirement of having a base branch for a certain number of BCs/access points managed by BCs as currently stipulated in the RBI guidelines to scheduled commercial banks.

Note: It is clarified that in cases where a PB is acting as the BC for a bank, the BC engaged by the PB shall not open deposit accounts for the partner bank for whom the PB acts as the BC or undertake KYC documentation for that bank.

6.3 Bank charges, lockers, nominations, facilities to disabled persons, etc.

The extant provisions in this regard as applicable to scheduled commercial banks, shall be applicable to PBs as well.

7. Bank deposits

(i) As provided in the current RBI directions, PBs can accept only savings and current deposits. The aggregate limit per customer shall not exceed ₹100,000, as provided in the Licensing Guidelines. However, the RBI will have no objection to the PBs making arrangements with any other scheduled commercial bank / SFB, for amounts in excess of the prescribed limits, to be swept into an account opened for the customer at that bank. This arrangement should be activated with the prior written consent of the customer.

(ii) The above limit shall apply to customer deposits and not to any security/earnest money deposit the bank may collect from any of its service providers in the ordinary course of business.

(iii) All RBI and BR Act provisions and RBI directions relating to minimum balance, inoperative accounts, unclaimed deposits including transfer of such deposits to the Depositors Education and Awareness Fund maintained by RBI on regular basis, nominations, cheques/drafts, etc., will be applicable to the PBs.

(iv) Payments Banks: need not issue passbooks for the deposit accounts; may provide statement of account in paper form on request on chargeable basis, or otherwise; may provide account information through multiple user friendly modes such as SMS and/or internet banking; andshould provide electronic confirmation through SMS/e-mail/printed proof for each account transaction.

8. KYC requirements

At their discretion, PBs may (like all other banks) decide not to take the wet signature while opening accounts and instead rely upon the electronic authentication/confirmation of the terms and conditions of the banking relationship/account relationship keeping in view their confidence in the legal validity and authenticity of such authentications/confirmations. However, all the extant regulations concerning KYC including those covering the Central KYC Registry, and any subsequent instructions in this regard, as applicable to commercial banks, would be applicable to PBs.
PBs should ensure that every customer, including customers of mobile companies on-boarded comply with the KYC regulations, which could include simplified account opening procedures. It is clarified here that if the KYC done by a telecom company, which is a promoter / promoter group entity of the PB, is of the same quality as prescribed for a banking company, PBs may obtain the KYC details of the customer from that telecom company, subject to customer consent.

9. Foreign exchange business

Payments Banks shall: Comply with all the conditions attached with the AD Cat II licence that will be issued by the FED, CO. Implement the provisions of Foreign Contribution (Regulation) Act, 2010 (As applicable to commercial banks).

10. Other banking services

10.1 Currency distribution (covering detection of forged and counterfeit notes, currency chest facilities, facilities for exchange of notes)
PBs may, at their option, exchange mutilated and defective notes at their branches, subject to compliance with RBI norms.
10.2 Customer education and protection
All customer grievance issues related to a particular access point should be addressed both at the access point and at the district level location. PBs will be covered by the Banking Ombudsman (BO) Scheme. The mechanism put in place by PBs to effectively resolve customer complaints and its communication to customers, and role of different levels (access point, controlling office (centre at the district level), and head office) in grievance redressal should be clearly communicated to RBI along with the application for licence. The customer service policy approved by the boards of the PBs should provide for continuous and intensive monitoring of redressing of customer grievance by the PBs. RBI will closely supervise the grievance redress system of the bank through both onsite and off-site surveillance system.

11. Outsourcing of operations, internet banking and mobile banking

The extant provisions in this regard as applicable to scheduled commercial banks shall be applicable to PBs as well. Loading of PPI balances through other bank credit cards will be permitted.

12. Implementation of Ind AS

Implementation of Ind AS would be applicable to PBs once they become scheduled banks. In view of the same, it is recommended that the PBs start adoption of the same in order to avoid transition costs subsequently.

Advantages of Payment Banks

- Payment banks help unbanked people join the formal banking system while also speeding up financial inclusion.
- The growth of banking will also aid in the financial literacy of the poor and the fight against poverty.
- Payment banks reach out to people in rural areas.
- More money will enter the banking system thanks to payment banks.
- Various banks, including large banks such as SBI, strive to increase their rural reach, and payments banks will assist them.
- The expansion of rural banking and financial inclusion is underway.
- The formal financial system is becoming more developed.
- It is a viable alternative to traditional banks.
- Deals effectively with low-value, high-volume transactions.
- It has access to several different services.

Disadvantages of Payment Banks

- Banks cannot lend money from their deposits and hence can’t charge a high-interest rate on borrowed funds.
- Payment Banks do not offer credit as a product, which puts them at a severe disadvantage compared to commercial banks.
- Unexpected sources of competition, such as the Unified Payments Interface (UPI), are putting pressure on payment banks.

- Due to its smooth interoperability, tight security, and significant cash back from third-party payment apps on the network, UPI swiftly became the star of digital transactions.
- The UPI app (third party) features a simple interface that is not restricted by banking laws, unlike payment banks. It's a one-tap solution that may be used without requiring KYC.
- There needs to be more understanding among the general people as to how to obtain these services.
- There are no incentives for agents to participate in these activities.
- Infrastructure and operational resources need to be increased.

Scope of Activities of Payment Banks

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- They are responsible for issuing ATM/debit cards but cannot issue credit cards.
- Another scope of activity is payments and remittance services through various channels.
- NRI deposits are not accepted in payment banks.
- Only that amount they obtained from the customer's deposit may be invested in government securities.

CONCLUSION

Experts believe that the launch of this payment banks will bring the 'one-size-fits-all' approach in commercial banking to an end. Organisations like SBI, RIL, Paytm, Future Group, Vodafone, Yes Bank etc have applied for launching payment banks in India. All in all, payment banking looks like an attractive option in banking, especially for the groups at the base of the income pyramid. Meanwhile we can hope that this format is as promising as it looks on paper and These banks will cater to the need of the lower income groups by introducing simple policies especially designed to help them and take India a step closer to achieving 100% financial inclusion.

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