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CUTS INTERNATIONAL

Comments on the RBI Draft Guidelines for Licensing of Payment Banks

Background

The Reserve Bank of India (RBI) has released draft guidelines for licensing of payment banks (Guidelines), for public comments. Set out below are comments from CUTS International (CUTS) on the Guidelines:

1. Objective

Setting out clear and precise objectives for a regulatory action is of paramount importance. It helps in conferring adequate powers to the regulator and review of regulatory performance, thereby ensuring accountability. The Guidelines provide that their objective is to further financial inclusion. Financial inclusion means enabling affordable access to formal financial services such as deposit, credit, payment, remittance etc.

Payment banks, as envisaged by the Guidelines, enable access to formal savings and payment services but not credit. Access to credit is an essential feature of financial inclusion, and without it inclusion cannot be complete.

Suggestion: Consequently, it is suggested that the Guidelines be specific with respect to their objectives of providing access to formal deposit, payment, remittance services, and do not provide any additional objective.

2. Eligibility criteria

The guidelines provide that certain classes of existing market players (such as existing non-bank PPI issuers, NBFCs, mobile telephone companies, super market chains etc) will be eligible to apply for license of payment banks, subject to such entities, their promoters and promoter groups as defined in SEBI (Issue of Capital and Disclosure Requirements) Regulations, 2009 (ICDR Regulations) being ‘fit and proper’ persons. The fit and proper status of the applicants will be adjudged on the basis of past record, financial soundness and successful track record of at least 5 years.

Past experience*:* Consequently, new entities, and entities having a track record of less than 5 years, will not be eligible to apply for license of payment banks, even if they otherwise comply with other conditions (such as minimum capital requirement etc.) for payment banks. The objective of creating such entry barriers seems to be prevention of entry of unscrupulous entities in the market, but might end up preventing entry of new/ inexperienced, but innovative and technologically sound genuine entities. This would thwart the objective of enabling high class low cost/affordable saving and payment services and thus limiting competition in the market. It seems that the regulator, with intention of reducing its work-load of maintaining strict supervision and monitoring of the market for preventing and addressing fraudulent actions, might end up preventing entry of new entities, thus hurting consumer interests.

Promoter group: Further, the term 'promoter group' has a very wide expanse under the ICDR Regulations. It even includes entities in which immediate relatives of promoters hold 10 percent of equity share capital, and body corporates in which a group of individuals or companies or combinations thereof hold at least 20 percent equity share capital, and such group also holds at least 20 percent in the applicant. Identifying such entities has been very difficult exercise in the past. Moreover, there might not be a connection between the applicant and the promoter group entities.

While requesting information about promoter group from the applicant might be understandable, one fails to understand the logic of subjecting such promoter group entities to the stringent 'fit and proper criteria'. In addition, while the Guidelines provide an indication of the constituents of fit and proper test for the applicants, it provides no such indication about the promoter group.

Suggestions: The objective of eligibility criteria must be to enable entry of genuine entities in the market. Enabling includes facilitating legitimate entities and preventing unscrupulous entities. It must not result in preventing entry of legitimate entities. Consequently, it is suggested that the stipulation of 5 year track record be dispensed with. Further, while promoter group might be subject to some scrutiny, they must not be subject to the stringent 'fit and proper test'. However, in addition to relaxing these conditions, the RBI must improve its supervisory and monitoring capabilities.

3. Scope of activities

It has been envisaged that payment banks would be able to offer payments and remittance services through various channels including branches, business correspondents, point-of-sale terminal locations etc. Cash-out possibility is expected to proliferate the amount deposited with such entities, which will increase the risk and possibility of fraud.

Suggestions: Consequently, the Guidelines must provide for strict consumer protection principles when payment banks offer services through third parties. In addition, direct accountability of payment banks must be fixed in case of mismanagement of funds by their agents.

Further, the Guidelines allow payment banks to function as business correspondents of another bank for credit and other services which it cannot offer. It also provides that other financial activities of the promoters should be kept ring fenced with the business of payment banks. Consequently, while a payment banks cannot provide credit services on their account, such services could be provided through the account opened on behalf of the principal bank, which might also be its promoter.

Suggestions: While providing this facility to consumers is praiseworthy, it also raises concerns of consumer protection with respect to intermingling of payment banks account and account opened on behalf of promoter banks. RBI must ensure adequate reporting and supervision provisions to ensure that the payment banks are adequately ring-fenced from the activities they perform on behalf of their promoters.

4. Deployment of funds

The Guidelines provide that payment banks will be required to invest balance funds in government securities/treasury bills with maturity up to one year that are recognised by RBI as eligible securities for maintenance of statutory liquidity ratio.

Suggestions: Payment banks must be allowed to deploy funds in corporate bonds of reputed companies (short term AAA rated corporate bonds), in addition to government securities. This would help them to earn reasonable interest, thus making the business model viable. The Nachiket Mor committee made recommendations on similar lines.

5. Promoter contribution

The Guidelines provide for mandatory dilution of promoter contribution over a period of time. This is a classic example of multiple objectives of the regulation, having the potential to hamper each other. The objective of the setting up payment banks is to ensure access to select financial services and reduction in promoter contribution is to ensure diversified shareholding of the bank, hence providing the public, benefits of shareholding in successful payment banks. There is a possibility that such condition might stifle growth of payment banks.

Suggestions: This condition has the potential to hamper interest in setting up of payment banks, as the banks are expected to break even and become profitable after a period of time and if the promoters are required to dilute their interest at such point of time, they might not be interested to set up such banks, at first instance. Consequently, it is suggested that such condition might be done away with.

6. Interest on deposits

The Guidelines are silent on the issue of payment of interest on deposits by the payment banks. While this would be additional cost, it would also act as an attractive feature for the customers to convert their idle savings/saving in gold etc. into deposits with payment banks.

Suggestions: Hence, it is suggested that the Guidelines provide that the payment banks will be free to provide interest on deposits, and rate of interest could be subject to market competition.

7. Service charges

The Guidelines are silent on the issue of service charges for access to services like balance enquiry, withdrawal from ATM etc. Experience suggests that there has been a lack of clarity and transparency on the service charges (and hidden service charges) imposed by the financial service providers, including banks.

Suggestions: The RBI must learn from its experience and while the payment banks must be free to charge fee for providing different services, it must be ensured that such charges are disclosed and clarified in unequivocal terms, upfront to the consumers. To ensure this, RBI will have to step up its monitoring and supervision initiatives.

8. Conflict of interest

There is a possibility of conflict of interest and uneven playing field in case telecom companies and existing banks have substantial stake in the payment banks. For instance, a customer could have a mobile connection and payment bank account with different telecom companies. In such case, the payment bank could charge unreasonable fees to route funds through another telecom company, thus disincentivising the customer, or could provide incentives to the customer, to transfer its mobile connection to the promoter telecom company.

Similarly, a customer may have wholesale bank account with a bank but might have a payment bank account with a payment bank in which some other bank has substantial interest, or a payment bank might act as a business correspondent of some other wholesale bank with which the customer does not have an account. In such scenarios, it is possible that such payment bank lures the customer to open account with the bank which has significant interest in it, or of which it is functioning as a banking correspondent.

Suggestions: Such scenarios and anti-competitive practices must be avoided at the RBI must ensure adequate cooperation with the Competition Commission of India to check such practices.

9. Customer sensitisation and education

The Guidelines provide high reliance on technology. This raises concerns with respect to financial education of the vulnerable consumers. Without educating the people of especially the rural areas or weaker sections of the society, a technology driven payment bank plan could be a non-starter.

In addition, customer sensitisation and education is prerequisite for customer empowerment and building trust in the payment bank market. It fosters transparency and accountability of financial service providers in the market.

Suggestions: Consequently, the payment banks could be mandated to sensitise and educate customers about the technology used, customer rights, and grievance redressal mechanism, for a successful execution of payment bank model in the country.

10. Grievance redressal

The Guidelines provide that the payment banks should have a high powered customer grievance cell to handle customer complaints.

Suggestions: It must be ensured that mere perfunctory compliance with this condition does not happen, but the condition must be complied with in letter and spirit. The payment banks could be mandated to resolve customer complaints within a specific period, and the board of payment bank must be mandated to discuss the nature of complaints received, their resolution, and steps taken to prevent such complaints in future. A quarterly report might be submitted to the RBI in this regard.

11. RBI discretion

The Guidelines provide huge discretion to RBI, with powers to restrict payment bank expansion, change in management, imposition of penalties, cancellation of license, et al, without providing any indicator or contours within which such discretion could be exercised. The Guidelines also do not mention if RBI will follow principles of natural justice, such as providing an opportunity of hearing to the payment banks, prior to resorting to such actions.

Suggestions*:* Unbridled discretion results in uncertainty in the market and adds to costs of doing business. Specific procedure and criteria for utilisation of discretion must be therefore laid down.

12. Manner of issue of guidelines

The release of draft Guidelines by the RBI for public comments is indeed a welcome move. However, much more needs to be done. The Guidelines merely provide one set of possible provisions and do not discuss the costs and benefits of such proposals on various stakeholders, such as government, regulators, industry, consumers etc. It does not undertake an assessment of positive and negative impacts of the proposed provisions.

For some time now, there have recommendations to reform the law and regulation making process in the country. Expert committees such as the Financial Sector Legislative Reforms Commission, the Working Group on Business Regulatory Framework, the M. Damodaran Committee etc. have recommended adopting scientific procedure of impact assessment in legislation and regulation making.

In accordance with such procedure, different set of alternatives are provided with assessment of costs and benefits on different stakeholders, in order to ensure rich public debate and discussion. Post receipt of public comments, changes made to the draft regulations are explained and rationale for incorporating or rejecting public comments is provided.

Suggestion: Accordingly, RBI must come out with a document explaining the rationale for revision in draft guidelines and for rejection of other suggestions. At present, CUTS is implementing a project to facilitate adoption of impact assessment in law and regulation making process in India, and would be happy to assist RBI in this regard.

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