CUTS International

Submission to the Reserve Bank of India for Managing Concentration Risk and Promoting Competition and Innovation in Retail Payments Sector

1. Background

1.1. The retail payments sector in India is growing at a rapid pace. In 2017-18, the share of electronic transactions in the total volume of retail payments increased to 92.6 per cent, up from 88.9 per cent in the previous year. While many payments banks started to operate (including the recently launched India Post Payments Bank), customer acquisition remained frozen for some for a considerable period. [1]

1.2. On regulatory front, the Reserve Bank of India (RBI) rationalised the Merchant Discount Rate (MDR) framework, issued revised guidelines for Prepaid Payments Instruments (PPIs), and peer to peer lending platform regulations during the last year. In June 2018, the it noted that **it is important that concentration risk in retail payment systems is minimised from a financial stability perspective. RBI plans to encourage more players to participate in and promote pan-India payment platforms to give a fillip to innovation and competition in the sector. It is likely to put a policy paper for public consultation (RBI Policy Paper).**

1.3. More recently, the Inter-Ministerial Committee for Finalisation of Amendments to the Payments and Settlement Systems Act, 2007 released its recommendations. The Draft Payments and Settlement Systems Bill 2018 seeks to foster competition, consumer protection, systemic stability and resilience in payment sector. In addition, recently, the Supreme Court of India upheld the constitutional validity of the Aadhaar (Targeted Delivery of Financial and other Subsidies, Benefits and Services) Act, 2016, albeit with conditions.

1.4. Consumer Unity & Trust Society (CUTS International), an independent non-profit economic policy research and advocacy organisation, has been working to promote consumer welfare in across sectors, including in retail payments. It had undertaken in-depth evidence-based research on regulation and competition in payments banks[2] and digital payments[3] and had also worked closely with the Watal Committee on Digital Payments. In anticipation of the RBI Policy Paper, it organised a brainstorming session with key stakeholders on the issue of managing concentration risk and promoting competition in retail payments. Set out below are our submissions to the RBI which it may consider while designing the Policy Paper.

2. CUTS Submissions to the Reserve Bank of India

2.1. **Create threat of competition** – The National Payments Corporation of India (NPCI), a banks owned non-profit company, is recognised as the sole retail payments organisation in the country. It operates the critical infrastructure (such as IMPS and UPI) to support retail payments. While NPCI's performance has been spectacular, regulatory vacuum exists in relation to eligibility criteria and operating conditions for another interested organisation to offer services like the NPCI. Evidence suggests that threat of competition is an enabler for competition and innovation.

[1] In 17-18, PPIs overtook debit cards in terms of volume and clocked 3,459 million transactions. Also, non-bank entities operating PPIs decreased to 49 from 55. In August 2018, the NPCI launched UPI 2.0.

[2] http://www.cuts-ccier.org/PaymentsBanks/

[3] http://www.cuts-ccier.org/Payments-Infrastructure/

2.2. **Avoid conflict of interest** – Indian retail payments sector has several instances of conflict of interest which may have impeded competition and innovation. For instance, the NPCI operates critical infrastructure as well as payments instruments (such as BHIM and RuPay) etc. It also operates as Bharat Bill Payment Central Unit for the Bharat Bill Payment System. Given its role, it also acts as quasi-regulator in the retail payments sector. It is essential that different roles played by NPCI do not adversely impact growth of the sector. Consequently, NPCI's role as an infrastructure provider needs to be separated from its role as instrument operator, by situating its payment instruments related functions in a separate profit-making entity.

2.3. **Encourage level playing field** – The RBI has taken laudable steps to enable competition in the retail payments sector. Most recently, it has allowed phased interoperability between banks and non-bank PPIs. However, in order to facilitate effective competition, there is a need to encourage level playing field by treating similarly placed entities similarly, and dissimilarly placed entities dissimilarly. For instance, despite the move towards interoperability, only banks are allowed to issue open PPIs. Also, non-bank PPIs are required to maintain their outstanding balance in an escrow account with any bank, i.e. their potential competitors. Similarly, under the peer to peer lending platform regulations, platforms are required to maintain two escrow accounts, mandatorily promoted by banks, and all fund transfers are required to be routed only through banks, excluding non-banks. Also, cross-border outward transactions can be conducted only through PPIs issued by banks. The objective of safekeeping depositors' money can be achieved without compromising competition. There is a need to review the rationale for such regulatory differentiation and ascertain if it restricts competition and innovation in the sector.

2.4. **Ensure proportionate risk-based regulation** – Disproportionate regulation has the potential to impose unreasonable costs on market participants thereby impeding competition and innovation in retail payments. A summary review of regulation in retail payments reveals several instances of such unreasonable regulation that needs to be reformed. For instance, requirement to undertake full KYC even for small amount PPIs, capital adequacy ratio of payments banks higher than universal banks; requirement to quote PAN/ submission of Form 60 for account opening; submission of documents to Central KYC Registry in physical format; requirement of significantly high minimum positive net worth for PPIs; restrictive eligibility criteria for non-banks to operate peer to peer lending platforms; restriction on innovative ways of customer authentication; prohibition on virtual currencies; among others. It is possible to meet objectives of these regulations through economical and more efficient means. There is a need to reform such disproportionate entity-based regulation and move towards proportionate risk-based regulation to promote competition and innovation.

2.5. **Adopt Regulatory Impact Assessment and structured stakeholder consultation –** The RBI has remained cognisant of market developments and innovations and has also been prompt in considering innovative regulatory mechanisms. It has been reported that it is considering formation of regulatory sandbox and data science lab. In addition, it should consider institutionalising regulatory impact assessment framework in regulation making. These can introduce clarity in regulatory objectives and promote use of tools like cost-benefit analysis for selection of regulation. In this regard, it should also consider constituting a Payment Systems Advisory Council to regularly consult with stakeholders in the sector.

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