The RBI's monetary policy on digital payments

May 2021

Foreword

Dear readers,

It is my pleasure to bring to you the latest edition of PwC's Payments newsletter. In this edition, we have explored the Reserve Bank of India's (RBI) monetary policy announcements pertaining to digital payments.

We have discussed the announcements in detail, their possible impact on various ecosystem players and how the changes will influence the growth of the digital payments ecosystem, and the various players who are a part of it.

I hope you will find this to be a good and insightful read.

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Table of contents

1. Key monetary policy announcements for digital payments 4

2. Impact of the announcements 5

3. Way forward 6

1

Key monetary policy announcements for digital payments

The RBI made a few key announcements in its Statement on Developmental and Regulatory Policies in April 2021.[1] These measures would impact the operations of payments banks, prepaid instruments (PPIs) and membership to the Centralised Payment Systems (CPSs). The proposals come in the wake of the COVID-19 pandemic and aim to encourage digital payments and boost the economy. Additionally, the RBI issued certain amendments[2] in the Know Your Customer (KYC) guidelines, with a view to further leverage the Video based Customer Identification Process (V-CIP) and simplify and rationalise the process of periodic updation of KYC.

1 https://rbi.org.in/Scripts/BS_PressReleaseDisplay.aspx?prid=51380#:~:text=With%20a%20view%20to%20furthering,2%20lakh%20with%20immediate%20effect.

2 https://www.rbi.org.in/Scripts/NotificationUser.aspx?Id=11783&Mode=0

Enhancement of limit of maximum balance for payments banks

The RBI issued guidelines in 2014 to set up payments banks to widen and deepen the digital payments ecosystem, and boost financial inclusion.[3] These banks would differ from traditional banks on several parameters – a deposit cap of INR 1 lakh, inability to issue credit products and stricter regulations, among others. The central bank had issued several licences for setting up payments banks. However, such banks have faced challenges due to limited revenue streams, a challenging business model and miniscule margins. Therefore, the RBI has decided to increase the deposit limit from INR 1 lakh to INR 2 lakh.

RTGS and NEFT – membership for non-bank entities

The CPSs currently include Real Time Gross Settlement (RTGS) and National Electronic Fund Transfer (NEFT). Traditionally, only banks and a few other players were allowed as direct members of the CPSs. However, the central bank has now extended these facilities to non-bank payments system operators such as PPI issuers, card networks, white-label ATM (WLA) operators and Trade Receivables Discounting System (TReDS) platforms regulated by the RBI, and allows them to avail direct membership in the CPSs.

Prepaid instruments – interoperability, increase in account limit and cash withdrawal for non-bank full-KYC PPIs

The RBI issued a circular in 2018 on the adoption of interoperability[4] for all KYC-compliant PPIs on a voluntary basis. The central bank proposed a three-pronged approach to achieve this objective. The RBI's planned process included enabling wallet interoperability through the Unified Payments Interface (UPI), allowing interoperability between wallets and banks, and incorporating interoperability for cards through card networks. The RBI announced in April 2021 that interoperability would now be mandatory for full-KYC PPIs through approved card networks (for cards) and UPI (for wallets). This would be compulsory for the acceptance side as well and should be implemented by 31 March 2022 in entirety.[5] However, gift PPI issuers would have the option to enable interoperability, while mass transit system (MTS) PPIs would be exempted from it. In order to motivate this migration, the RBI has also proposed to increase the current limit on outstanding balance in such PPIs from INR 1 lakh to INR 2 lakh. Furthermore, the RBI has also allowed full-KYC non-bank issued PPIs to avail cash-withdrawal facilities, to be authenticated by an additional factor of authentication (AFA) or a personal identification number (PIN). The issuer PPI would also have to set up a complaint-redressal system for customers and grievances in this regard shall fall under the ambit of the respective ombudsmen schemes and instructions on limiting the liability of customers.

The withdrawal limit for such transactions would be capped at INR 2,000 per transaction and INR 10,000 per month, per PPI. Similar limits would be applicable across all locations (tier 1–6 centres) in the case of withdrawal from a point of sales (PoS) system using a debit card or open-system prepaid cards.

3 https://rbi.org.in/scripts/bs_viewcontent.aspx%3FId%3D2900#:~:text=The%20payments%20bank%20shall%20be,7.5%20per%20cent%20of%20RWAs.

4 https://www.rbi.org.in/scripts/FS_Notification.aspx?Id=11393&fn=9&Mode=0

5 https://www.rbi.org.in/Scripts/NotificationUser.aspx?Id=12094&Mode=0

Rationalisation of compliance with KYC requirements

The RBI issued a notification amending certain provisions (primarily pertaining to V CIP) of the KYC Master Direction.[6] The key amendments are discussed below:

- In order to enhance customer convenience, the RBI has decided to rationalise certain components of the KYC norms. These measures include:
    - extending the scope of V CIP for new categories of customers such as proprietorship firms, authorised signatories and beneficial owners of legal entities, as well as for periodic updation of KYC
    - converting limited KYC accounts opened on the basis of Aadhaar e KYC authentication in non face to face mode to fully KYC compliant accounts using V CIP
    - continuing the operation of OTP based e KYC accounts beyond one year by undertaking V CIP
    - enabling the use of the Centralised KYC Registry (CKYCR) and electronic documents (including identity documents issued through DigiLocker) for seeking information as a part of the V CIP process
    - introducing more customer friendly options, including the use of digital channels for the purpose of periodic updation of KYC details of customers.
- In the wake of the pandemic related restrictions, the RBI has decided that no penalty should be imposed on customer accounts in which KYC updation is due/pending, till 31 December 2021, unless warranted due to any other reason or under instructions from any regulator/enforcement agency/court of law, etc.[7] This decision has provided account holders with a longer window to update their KYC details.

6 https://rbi.org.in/Scripts/BS_PressReleaseDisplay.aspx?prid 51526
7 https://www.rbi.org.in/Scripts/NotificationUser.aspx?Id 12083&Mode 0

2

Impact of the announcements

Enhancement of the limit of maximum balance for payments banks

Key benefits

- An increased limit will help payments banks cater to a wider set of use cases (like larger instalments, property taxes, insurance payments and salary accounts) that were earlier out of their reach due to the lower limit on deposits. This will, in turn, increase digital transactions and customer stickiness as users would be able to better utilise with their payments bank accounts.
- Increased balances will also renew the popularity of payments banks among new customers and the target audience. Small and medium enterprises, traders, etc., may now be interested in dealing with payments banks.
- Increased balances will lead to higher interest income, provided the spread between interest paid on deposits and earned on Government securities and bank deposits does not decrease.

Potential pitfalls

- The increase in account limit may be too little, too late, given the thin margins and limited revenue streams for payments banks.
- Further, with the change in PPI regulations – increase in limits, mandatory interoperability, cash withdrawal for full-KYC PPIs – the gap between payments banks and PPIs has been significantly bridged.

CPS – membership for entities other than banks

Key benefits

- By becoming direct members of the CPSs, non-bank payment service operators (PSOs) will help reduce settlement risk and dependency on traditional banks. As non-bank PSOs may need to maintain settlement accounts with the RBI, universal banks will need less liquidity to be kept with the RBI, thereby freeing up cash resources to be deployed/invested in businesses.
- Since non-bank PSOs will not be able to access the RBI's intra-day liquidity (IDL) facility, they may need to avail the assistance of banks for the same.
- Allowing non-bank PSOs to participate in RTGS and NEFT will help in distributing transactions across different payment players and ensure that the CPSs are not overly dependent on a limited set of players.

Potential pitfalls

- Participation in RTGS and NEFT (which were earlier the sole domain of banks) will lead to decreased customer stickiness for banks as users will have new avenues to execute the transactions. Banks will need to counter this by developing intuitive interfaces.
- Traditional banks will lose an additional revenue stream of float income, especially what they would have received through the non-bank PSO transactions of CPSs on the bank's platform.
- Even with the enhanced limit of INR 2 lakh in full-KYC PPIs, it needs to be seen if a use case is at all possible for PPIs when it comes to RTGS (which is only allowed for transactions of INR 2 lakh and above).

PPIs – interoperability, increase in account limit and cash withdrawal for full-KYC PPIs

Key benefits

Interoperability

- Interoperability of PPIs will narrow the gap to a significant extent between non-bank PPIs and bank-issued debit/prepaid cards as customers can now use their PPI balance across multiple merchants and send money directly to anyone's wallet or bank account.
- The RBI has enabled PPIs to compete with traditional banks for micro savings in rural India by mandating universal acceptance and interoperability.
- Enabling interoperability will greatly benefit those who are concerned about payment security. Not exposing bank accounts for transactions and using PPIs for payments limit risks and bring down the exposure of bank savings in case of fraud. Interoperability enabled through UPI (for wallets) and approved card networks (for cards) for full-KYC PPIs may lead to less maintenance and more innovation in creating a financial ecosystem with a common backbone supporting various players and processes.
- Increased interoperability will lead to rising incomes for PPI issuers owing to the interchange earned on transactions. This income will, however, be countered by the expense for cash withdrawal transactions where the interchange must be paid by the issuer. We may see a capping of free cash withdrawals.
- Interoperability will boost wallet companies by promoting optimal utilisation of payments instruments. It will aid financial inclusion by incentivising migration to full-KYC PPIs and adoption of digital payments instruments across the country. It shall also provide easy access to payments instruments such as UPI and cards to the unbanked and underbanked population.

Increase in account limit

- The increased limit of outstanding balance from INR 1 lakh to INR 2 lakh will enable PPI issuers to gain customer confidence. Due to the availability of a higher limit in the outstanding balance, many customers may use the instrument/wallet of the PPI issuers as their primary mode of payment. This will lead to a growth in transaction value and transaction fees for PPI issuers.

Cash withdrawal for full-KYC PPIs

- Cash withdrawal using full-KYC PPIs of non-bank PPI issuers will give a boost to the acquirers (ATMs and PoS machines) as the income from reverse interchange is expected to increase.
- The business of ancillary services such as KYC providers will also increase due to the compulsory full-KYC mandate for cash withdrawals.
- PPIs will compete with banks for market share in smaller urban and rural areas, given the versatility of PPIs post the RBI announcement.
- The said measure shall also create a level-playing field for bank and non-bank PPI issuers. It will also provide flexibility to non-bank PPI holders since it reduces their need to carry cash. The scope of this change is unrestricted in the acceptance of such a service. Essentially, all PPIs will have to allow full-KYC customers to withdraw cash. This is true for any PPI player and will help in increasing competition by enhancing the acceptability and usage of PPIs.

Potential pitfalls

- Customers using multiple PPIs may also choose to forego some of them. Customer loyalty and experience will be significant factors in this decision. As a result, some companies will lose business and may exit the space or sell themselves out.
- While the RBI has proposed to enable cash withdrawal from full-KYC PPIs of non-bank PPI issuers, it has also set a withdrawal limit of INR 2,000 per transaction and INR 10,000 per month, which may lead to reduced high-value withdrawals.
- The RBI has directed that there should be an appropriate cooling period for cash withdrawal after loading funds into PPIs. However, this cooling period has not been defined yet and a waiting period will increase the reliance on traditional banking PPIs such as debit cards, as compared to non-bank PPIs like wallets.
- Allowing the withdrawal of cash for full-KYC PPIs of non-bank issuers will lead to a reduction in breakage, i.e. the amount these PPIs would have otherwise gained from unused prepaid services or gift cards. This means that effectively, a customer can simply withdraw this unused amount instead of having it lie idle in the PPI.

Rationalisation of compliance with KYC requirements

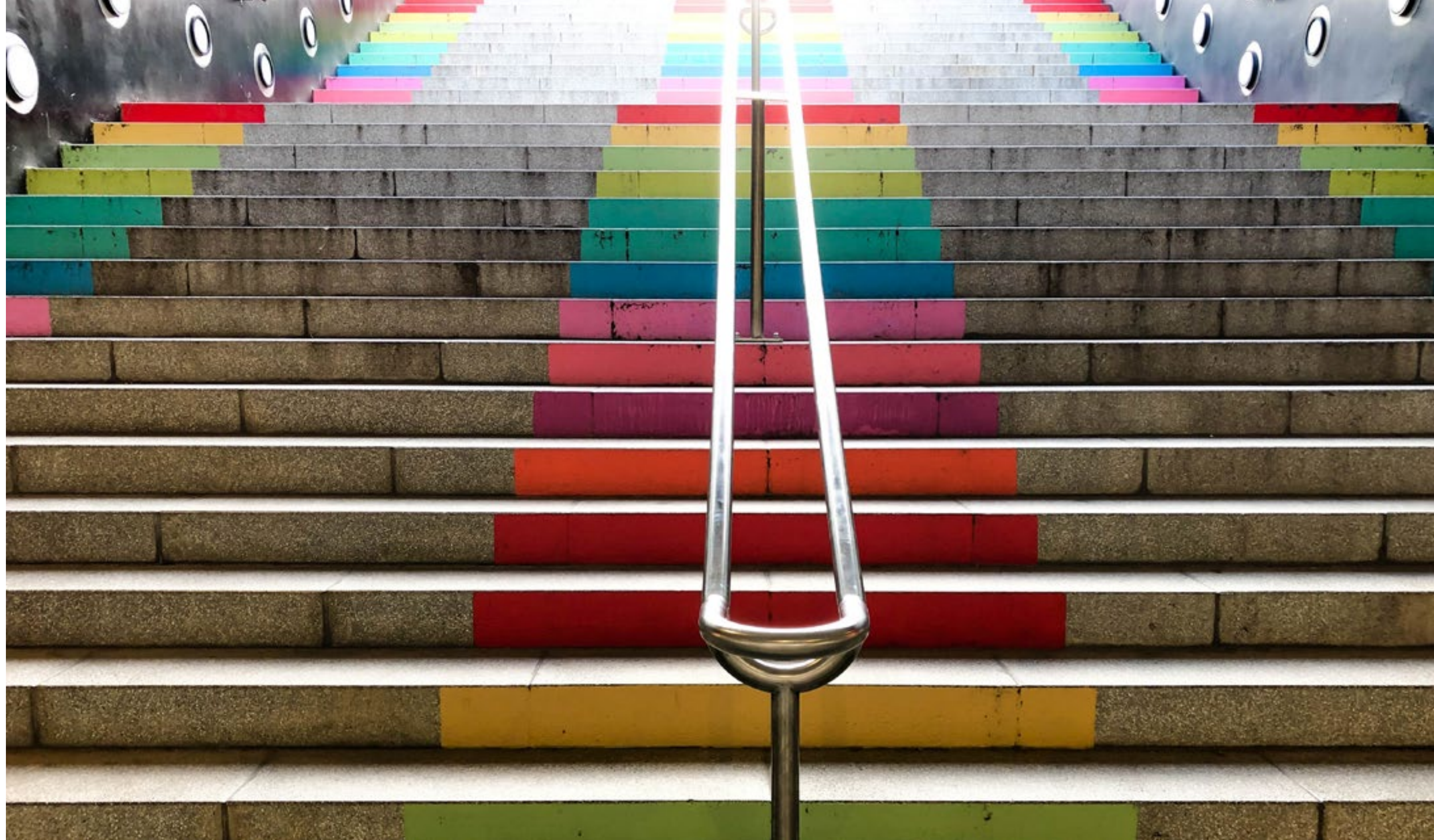
Key benefits

- V-CIP was initially only permitted for individual customers. Entities such as proprietorship firms and beneficial owners in legal entities will get a boost from V-CIP and can conduct complete digital onboarding. Additionally, the entire process will be paperless and shall eliminate the long and cumbersome procedures of submitting and storing physical documents.
- Periodic updation of KYC details through V-CIP was a challenging process and initially not permitted. The relaxations prescribed in the periodic updation of KYC through V-CIP make it a faster and cheaper process. Customers can now simply provide a self-declaration through their registered email address or online/mobile banking, etc., in case there are no changes in the KYC information.
- The amendments in KYC regulations also permit the conversion of limited KYC accounts opened on the basis of Aadhaar e-KYC authentication in non-face-to-face mode to fully KYC-compliant accounts through V-CIP. This measure shall considerably reduce the cost of customer onboarding and acquisition.

Potential pitfalls

- Regulated entities will be mandated to revamp their internal systems and infrastructure, thus making it cumbersome for them and increasing their operational and compliance hurdles. They will be required to comply with the minimum standards prescribed, formulate the required board-approved policies and adhere to other procedural aspects.
- In the past, certain players sought identification information from the CKYCR portal and considered it as completion of the KYC process. The allowability of seeking identification information from the CKYCR portal for undertaking V-CIP indicates that players are expected to verify customer details post gathering information from the CKYCR portal.

3
Way forward



The RBI announcements indicate that the non-bank led payments ecosystem in India, which was in a stabilising phase until now, is geared up for progressing rapidly. The announcements are forward looking and in line with the global practices around the role that non-bank entities can play in the payments ecosystem.

A 360-degree view of all the announcements highlight that they aim at bringing parity to the bank-led payments ecosystem. For example, some of the use cases that can emanate from access to CPSs are expected to be truly worthwhile when interoperability is implemented by non-bank entities. Having said that, announcements like mandatory interoperability may also lead to a decline in revenues or some of the use cases becoming redundant. Implementation of all the RBI announcements by non-bank entities is likely to blur the differentiation between banks and non-banks. It is also likely to involve challenges in ascertaining and executing use cases that are unique and require a realignment of revenue models.

The access of CPSs by non-banks is expected to considerably bring down the pressure on banks in processing daily small-value transactions.

It is also expected to bring the unbanked and underbanked population under the ambit of the digital payments ecosystem. Non-banks are also likely to offer digital transaction processes and enable payment methods validated by CPSs, and these measures are expected to find favour among the country's young population. These are likely to accelerate the Government's digital payments agenda.

The relevance of payments banks is in question once again with full-KYC wallets of non-bank entities, current account saving account (CASA) products of payments banks eligible for cash withdrawal and the provision of maintaining EoD balance of INR 2 lakh.

On the video-KYC front, while certain procedural aspects prescribed by the RBI seem inconsistent with the existing stance taken by some of the FinTech entities, an overall rationalisation of the video-KYC process has definitely brought in some cheer for regulated entities during the crisis faced by them over the last one year.

While a formal notification on access to CPSs is awaited, the approach and the RBI's announcements are likely to provide an impetus to the digital payments ecosystem in India. The RBI has started the new decade on a promising note by implementing payments trends that are followed by global economies. Each stakeholder in the digital payments landscape is expected to contribute positively to the central bank's digital payments plans while ensuring that every Indian is able to access a range of e-payment options that are safe, secure, convenient, quick and affordable.

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