# Understanding the new digital payments guidelines

**January 2020**

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# Foreword

Dear readers,

It is our pleasure to bring to you the latest edition of our payments newsletter.

In this edition, we have focused on the new initiatives taken by the Government of India (GoI) towards strengthening cashless economy. We look at emerging opportunities for banks/financial institutions (FIs) in corporate/business-to-business (B2B) payments, especially in the light of the new regulations mandating all merchants/businesses with a turnover of more than INR 50 crore to accept via the following payment instruments: RuPay debit card UPI (also BHIM-UPI) and QR code (BHIM-UPI QR code).

We examine the impact and implications of these new initiatives. We hope you will find this to be an insightful read.

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# In this issue

# Introduction

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India's digital economy has witnessed a significant change in the past few years. Various initiatives taken by the Government of India (GoI) to digitalise the economy have contributed towards its transformation. From demonetisation to reduction in fees for transactions done using cards, various initiatives have boosted the rapid adoption of digital payment instruments.

As per the Reserve Bank of India's (RBI) Benchmarking India's Payments Systems report, RuPay has a more than 50% share in the country's debit card issuance market.[1] The report also highlights that the point of sale (PoS) penetration in India is low and was at 427 persons per PoS terminal at the end of 2017, which is low in comparison to that in developed nations and other BRICS (Brazil, Russia, India, China and South Africa) countries.

On the positive side, due to the rapid growth in 3G and 4G network penetration, digital infrastructure has improved rapidly even in remote areas.

Post demonetisation, digital payments became as an integral part of a customer's payment journey. The Ministry of Electronics and Information Technology (MeitY) bore the full amount of merchant discount rate (MDR) for transactions less than INR 2000, applicable on transactions made through debit cards, UPI and Aadhar Enabled Payment System (AEPS) for a period of two years till December 2019. The RBI introduced caps on debit card MDR and the National Payments Corporation of India (NPCI) further reduced the RuPay MDR from 0.9% to 0.6% for digital transactions less than INR 2,000.

1. https://economictimes.indiatimes.com/news/economy/finance/rupay-how-a-six-year-old-card-gave-the-scare-to-global-biggies-such-as-visa-and-mastercard/articleshow/66591913.cms?from=mdr
2. https://www.incometaxindia.gov.in/

## Recent initiatives by the GoI to increase digital payments

The GoI, the Ministry of Finance, the Department of Revenue and the Central Board of Direct Taxes (CBDT) jointly declared policy initiatives in October 2019 to increase the scope of digital payments.[2] A principal feature of this set of new policies is that shops, business firms or companies having an annual turnover of more than INR 50 crore are required to provide electronic payment acceptance facility to customers.

# Introduction

## Key takeaways from the recent initiatives

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| Businesses, shops and organisations having an annual turnover of more than INR 50 crore shall mandatorily provide facilities for accepting payments through prescribed digital modes (Income-tax Act, 1961, Section 269U). | The business or organisation can also accept payment through digital modes such as UPI, quick response (QR) code, card payment, wallet payment, National Electronics Funds Transfer (NEFT) and real-time gross settlement (RTGS). | The bank or the payment systems provider shall not impose any charges on either the payer making the payment or the beneficiary receiving the payment (Payments and Settlement System Act, 2007, Section 10A). | The above provisions came into force effective from 1 November 2019. The MDR charges for businesses with over INR 50 crore in annual revenue were waived from 1 January 2020. | A penalty of INR 5,000 per day will be imposed on businesses which fail to operationalise their digital payment systems before 1 February 2020.[3] |

It is critical to understand the purpose of these initiatives from the business, legal, regulatory, technology and economic points of view. This initiative will have a major impact on the small and medium enterprise (SME) and the micro, small and medium enterprise (MSME) segments and provide new B2B use cases to cater to these segments.

From a business perspective, these initiatives will encourage both large- and mid-sized merchants to adopt and offer digital payments systems and will boost the existing revenue stream of merchants. Acquiring banks need to re-align the existing operating model, assuming they absorb the PoS rental fees, fixed and variable costs, etc.

Banks and FIs need to provide technology and operations support to these merchants in terms of setting up new connections and installing devices, as well as opening and maintaining accounts.

From an economic standpoint, the move will bring more transparency in the tax collections as well as provide the government with enough revenue to incentivise merchants and customers.

3. https://www.incometaxindia.gov.in/

# Implications of the guidelines

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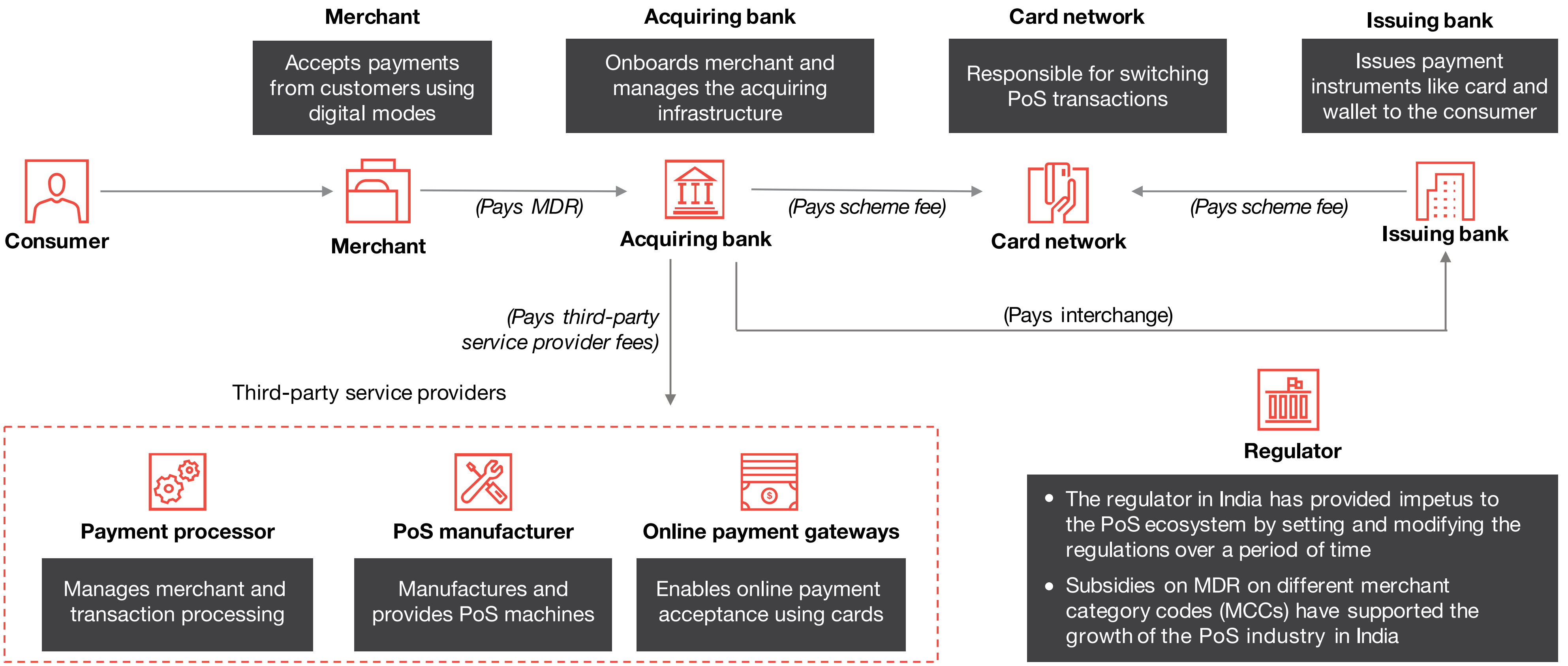
With the emergence of opportunities for banks and FIs, this move will also have positive effects on merchants and consumers. Additionally, such policy initiatives will foster innovation and growth in the merchant acquiring business. The figure below provides a holistic view of how the policies will impact stakeholders within the payments value chain.

## Digital payments value chain




*Source: PwC analysis*

# Implications of the guidelines

## 1. Merchants

- Merchants will see an increase in their turnover once they start accepting multiple digital payment instruments such as RuPay debit card, UPI and payments via QR code.
- By adopting digital modes of payment, merchants can simplify multiple cumbersome tasks like inventory management through real-time updates on inventory data and automated reconciliation.

## 2. Consumers

- The regulation will promote the growth of a less cash economy and ensure enhanced financial inclusion.
- Enabling digital payment acceptance for large merchants will enhance customer experience in terms of faster payments, cashbacks and shorter payment queues.

## 3. Regulators

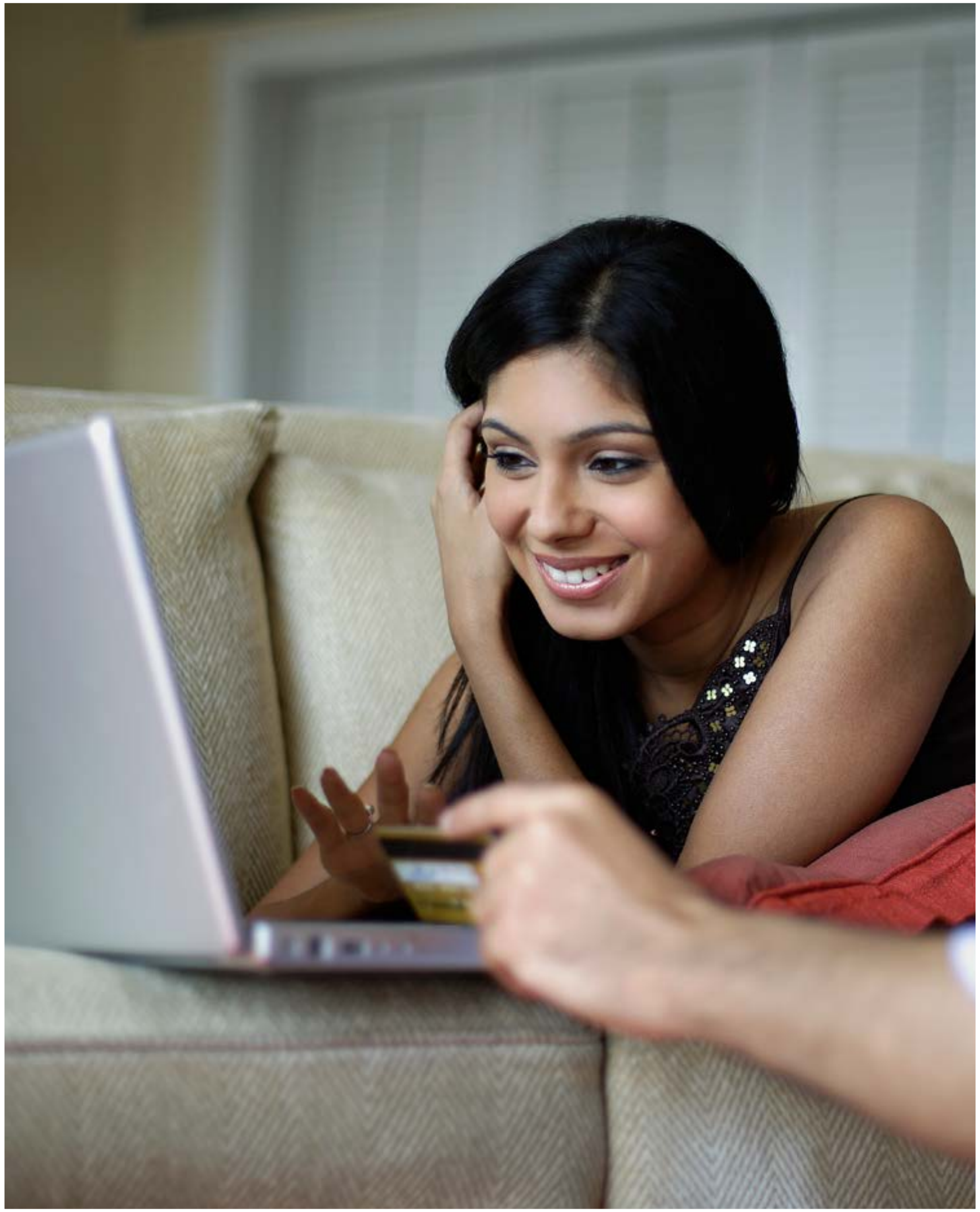
- With increased digitalisation of payments, the issue of tax evasion due to anonymity of transactions will be addressed significantly.
- GST collection will be higher for the government.
- The GoI has been targeting to build an acceptance infrastructure that would be touchpoints for PoS terminals and Bharat QR in proportion to the number of cards issued. This regulation will boost the development of an acceptance infrastructure.

## 4. Banks/FIs

- Adoption of digital payment instruments by merchants will significantly help in reducing the cash-handling costs for banks.
- MeitY aims to enhance the acceptance of digital payments in the country. In order to promote digital acceptance, MeitY has assigned targets to banks for deploying PoS machines. This regulation will leverage as a strength for banks to achieve their targets and enhance acceptance of digital payments in the country. This trend has continued since 2012, when the RBI first capped the MDR.
- There will be also an upward thrust in current account deposits, enabling banks to improve their loan books. This initiative will also boost digital lending since banks and FIs will own the merchant data.

## 5. Payment aggregators

- Payment aggregators can leverage their existing merchant acquiring application programming interfaces (APIs) as well as merchant plugins in order to enable smart routing of on-us transactions. Smart routing of on-us transactions can be an innovative operating model that aggregators can follow. Aggregators try to build up a middleware and extend their APIs to partner with all the major private/public sector banks. Irrespective of the merchant's acquiring bank, the aggregator smartly routes the transaction to the cardholder's issuing bank. This helps the aggregator to save up on the switching fees and additionally ensure a better success rate for the transaction.
- This initiative will encourage aggregators to earn additional revenues in terms of PoS set-up fees, field support services, annual maintenance contracts (AMCs), etc.
- In order to boost their profitability and customer stickiness, payment aggregators can provide value-added services like dynamic currency conversion (DCC), digital lending and loyalty programmes to merchants.



# Way forward

# Way forward

From a cost perspective, banks need to forgo revenue which they used to earn in the form of MDR on RuPay debit card and UPI transactions. Banks have also been asked not to charge any interchange on RuPay- and UPI-based transactions.

Payment aggregators already operate their merchant acquiring business at extremely low margins, resulting in a lot of independent acquirers already running on negative margins. With the recent initiatives taken by the GoI, the margins will erode further and there needs to be an incentive for aggregators to compete and sustain themselves in the acquiring business.

Understanding the implications listed in the previous section, it will be interesting to note whether the capping on MDR will have any commercial benefits for merchants or will increase their costs to accept digital transactions.

Secondly, the initiative is aligned with the RBI's Payment and Settlement Systems in India: Vision 2019 – 2021, which aims to address the supply side issues in the payments value chain. This will accelerate the creation of an acceptance development fund (ADF) that was envisaged to subsidise acquirers for deploying PoS infrastructure in tier 3 to tier 6 centres.

Thirdly, this will spur innovation in both the payments and lending space, especially in the B2B segment. Banks should take this opportunity to provide services to merchants based on improved data and fraud analytics. Banks can optimise the operations costs by providing a better reconciliation and settlement module as well as aim to implement a 'T+0' settlement cycle.

Lastly, the initiative aims to reduce the surcharge or commission fees collected from customers for transacting digitally. Merchants and banks should provide a seamless experience to customers in order to increase the uptake of digital acceptance.

In addition to these points, it is also critical for regulators and respective ministries to take inputs from banks and other key stakeholders in order to understand the impact of these regulations on their existing business models.

# Payments technology updates

# Payments technology updates

## Prescribing of certain electronic modes of payment under section 269SU

*IncometaxIndia*

In furtherance to the declared policy objective of the government to encourage digital economy and move towards a less-cash economy.

**Read more.**

## From Feb 1, businesses will be fined ₹5,000/day if they do not offer digital payment facility

*BusinessLine*

From February 1, businesses with turnover of ₹50 crore or more that failed to operationalise payment system through RuPay debit card or BHIM UPI, will be liable to pay penalty at the rate of ₹5,000 per day.

**Read more.**

## No charges on digital payments to biz with turnover over Rs 50 cr from Nov 1

*The Indian Express*

Central Board of Direct Taxes (CBDT) has called for applications from banks and payment service providers operating an authorized payment system under the Payment and Settlement Systems Act 2007 who are willing that their payment system may be taken into consideration.

**Read more.**

## Zero MDR on RuPay, UPI to kill digital payments industry, says Payments Council of India

*The Economic Times*

Zero MDR on RuPay, UPI to kill digital payments industry, says Payments Council of India.

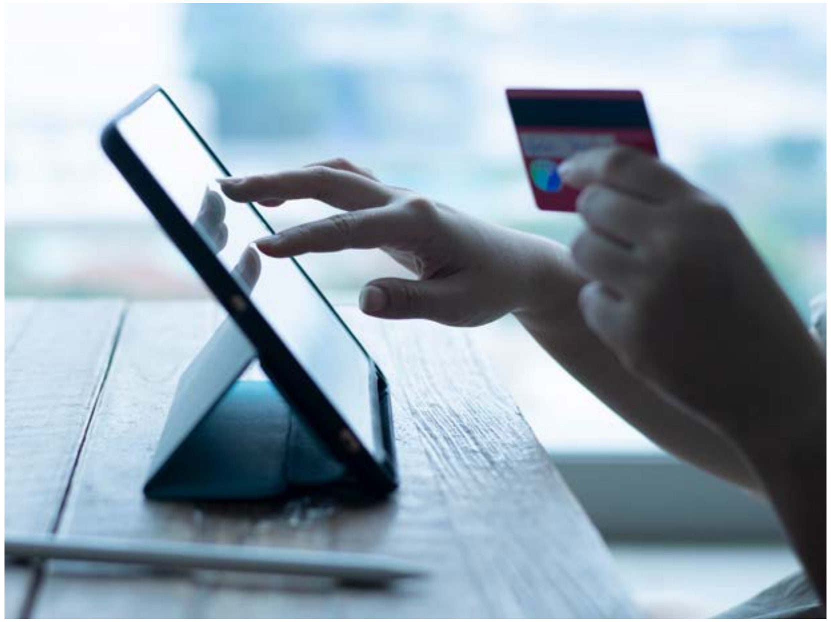
**Read more.**

## India's love for cash hinders move to digital economy

*India Today*

For many citizens living in rural areas, cash still remains the bedrock of daily existence because of a lack of facilities.

**Read more.**



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