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The Payments Banks in India: A Great Initiative but Challenges Remain

The Reserve Bank of India issued in-principle licences to 11 different entities to establish payments banks in India in August 2015. This initiative is a historical step – there is no such banking structure in operation in any other part of the world. Fully based on modern technology, these payments banks are expected to bring the huge unbanked population of India under the formal banking system. This paper analyses how the payments banks were established, and the opportunities they offer and challenges faced by them.

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The payment system in India has gone through significant changes since early 1980s. The Indian banking system has always been a front-runner in adopting modern and latest technology. The Reserve Bank of India (RBI) adopted computerised settlement facilities at all its clearing houses as early as 1988. This was followed by the installation of a core banking software in 2000 and the introduction of internet banking in 2001. In 2007, the Indian Parliament passed the Payment and Settlement Systems Act. Since the inception of this act, the Indian government has continued focusing on creating a cashless economy. Initiatives taken by the government have created a catalytic environment for the greater

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proliferation and growth of digital payments. The establishment of the National Payments Corporation of India, and introducing Real Time Gross Settlement, the National Electronic Funds Transfer and the Immediate Payment Service are some examples of the Indian government's initiatives in this regard. In 2014, the RBI also adopted a new and unique format of banking in the Indian banking system. This was the payments bank.

The RBI issued in-principle licences to 11 different entities to establish payments banks in India. One of the prime motives behind the establishment of these banks was to provide universal access to savings. Payments banks operate like any other bank, but on a smaller scale. These banks are expected to reach the customers mainly through their mobile phones rather than through traditional banking branches. This is a unique format of banking, which has not been witnessed anywhere in the world before.

With the aim of re-structuring the Indian banking system, the RBI released a discussion paper on *Banking Structure in India – The Way Forward* in August 2013. The paper stressed the importance of empowering the Indian banking sector to cater to the needs of a growing and globalising economy as well as furthering financial inclusion. The paper also took note that, even with the 157 banks operating in India then, only 40 per cent of adult Indians were included in the formal banking system in 2013. The Census 2011 estimated that, out of 24.67 crore (246.7 million) households in the country, only 14.48 crore (144.8 million) [58.7 per cent] had access to banking services. The discussion paper argued for the need to adopt innovative approaches in the banking system and to provide access to the formal banking system to low-income households. Subsequent to the release of the paper, on 23 September 2013, the RBI formed an expert committee under the chairmanship of Dr Nachiket Mor² to frame a clear and detailed vision for financial inclusion and financial deepening in India, in addition to several other objectives. The committee submitted its report to the RBI on 7 January 2014, which strongly suggested the licensing of payments banks to offer financial services to the hitherto excluded segments of the population. Later, in the same year, in the Union Budget 2014-2015 presented on 10 July 2014, Finance Minister Arun Jaitley announced that, “After making suitable changes to current framework, a structure will be put

² Dr Nachiket Mor, an Indian economist and a Yale World Fellow, was a member of Board of Directors of ICICI from 2001 to 2007. During the period from 2013 to 2017, he was a member of the Boards of the RBI, the National Bank for Agriculture and Rural Development and the Micro Units Development & Refinance Agency Ltd. He continues to be a member of the RBI Board. He is also currently a member of the CRISIL Board.

in place for [the] continuous authorisation of universal banks in the private sector in the current financial year. [The] RBI will create a framework for licensing small banks and other differentiated banks. Differentiated banks serving niche interests, local area banks, payments banks, etc., are contemplated to meet credit and remittance needs of small businesses, unorganised sector, low income households, farmers and migrant work force.”³

After incorporating the comments and suggestions given on the draft guidelines, the final guidelines were issued by the RBI in November 2014 to license payments banks. Out of 41 applications, the RBI issued in-principle licences to 11 applicants to undertake banking business under Section 22(1) of the Banking Regulation Act, 1949. This marked the start of the payments banks in India. While these banks have similarities, in terms of functions, with the traditional banks, there were several differences as well. Some of the major differences are presented in Table 1.

Table 1: Differences between a Payments Bank and Traditional Bank

Payments Bank	Traditional Bank
They can raise deposits of up to ₹1 lakh (S\$2,000)	There is no limit.
They cannot offer loans	They can offer loans.
They cannot issue credit cards.	They can issue credit cards.
It is mandatory for them to be highly technology driven from the beginning	It is not mandatory for them to be highly technology driven.
They cannot set up subsidiaries to undertake non-banking financial services activities.	They are allowed to set up subsidiaries.

Source: Author’s own compilation based the guidelines for licencing of Payments Banks, 2014, RBI.

Till now, four payments banks have started operations in India. Airtel Payments Bank was the first such bank to start its commercial operation in India in November 2016 on a pilot basis covering only Rajasthan and extending nationwide later in January 2017. Airtel Payments Bank has a network of 250,000 retail stores which also function as banking points. This bank was followed by India Post Payments Bank (IPPB) which started its branch in Raipur (Chhattisgarh) and Ranchi (Jharkhand) in January 2017, also on a pilot basis.⁴

³ “Payments banks will change the way people think about their money”, Madhulika Chowdhary, *The Asian Banker: Financial Technology*, 13 October 2015. <http://tech.theasianbanker.com/updates/?&docid=00041705450272861341044104>. Accessed on 10 March 2018.

⁴ “All 650 branches of India Post Payments Bank to be launched by April: Manoj Sinha”, PTI, *The Economic Times*, 3 January 2018. <https://economictimes.indiatimes.com/industry/banking/finance/banking/all-650->

However, the IPPB has not been able to add any more branches to-date, although the aim was to have a pan-India presence, with all its post offices acting as banking points. It has said that it plans to open 650 branches by April 2018. It is to be noted that it is the only public sector entity which has been issued a licence to operate a payments bank. Fino Payments Bank, which started its operation in July 2017, claims to have 410 branches and more than 25,000 banking points. The latest addition to this list is PayTM Payments Bank. It started its operation with the inauguration of its first branch on 28 November 2017. PayTM aims to add 500 million customers by 2020.⁵

This is the first time, since its establishment, that the RBI has issued differentiated licences for any banking-specific activity. The RBI initiative is expected to significantly change the banking landscape in India. Indian citizens can experience easier, faster and hassle-free banking. It is hoped that the absence of a minimum balance requirement would induce more citizens to enter the formal banking system. More and more people from the rural areas and the lower economic strata of the society could be brought under the formal banking system.

The Payments banks have access to the latest technology, a large number of existing customers and well-established networks which they can easily leverage in their favour. They also have the opportunity to tap the huge unbanked population of 233 million people. As these banks will be operating through their existing business points, their operation cost will be negligible and this will help them to sustain and earn profit with minimal charges. This innovative banking system will also be boosted by the digital and cashless economy initiative. The increasing internet and mobile penetration in India will definitely be an added advantage to this banking format.

While there are huge potentials, such a banking initiative also has several challenges. The only medium of operation for these banks is the internet. India is struggling with very low internet speeds, which are far lower than the global benchmarks. According to Akamai's State of the Internet report, in the fourth quarter of 2016, the average internet speed in India is

branches-of-india-post-payments-bank-to-be-launched-by-april-manoj-sinha/articleshow/62351904.cms. Accessed on 10 March 2018.

⁵ "PayTM launches "Payment Bank": Aims 500 million customers by 2020", *NYUS*, 23 May 2017. <http://www.nyus.in/paytm-launches-payment-bank-aims-500-million-customers-2020-486>. Accessed on 10 March 2018.

5.6mbps.⁶ India's global rank in this regards is 97, a little behind China and Indonesia out of the 149 qualifying countries. The low internet speed in India may hinder the growth of these banks.⁷ Furthermore, since they are entirely technology-based without any significant physical presence, the payments banks appeal chiefly to the tech-savvy citizens. People from the rural areas and small towns in India will find it difficult to participate in this type of banking facility. Moreover, merely, adding customers or opening accounts is not the end game. The banks need to encourage people to transact regularly. Although India has witnessed a remarkable growth in this type of banking, there is still much ground to cover. Large numbers of Indians are still not covered by the formal banking system.

The introduction of the payments banks is an important initiative. However, although India has a modern and technologically-advanced banking and payment system, there is still much more effort needed in this sector. It is important to bring more of the rural population under the ambit of the formal banking system. After all, this was the key purpose of setting up the payments banks in the first place!

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⁶ "India Sees 36 Percent Increase in Q4 2016 Average Internet Speed to 5.6Mbps: Akamai", *Gadgets 360*, 9 March 2018. <https://gadgets.ndtv.com/internet/news/india-sees-36-percent-increase-in-q4-2016-average-internet-speed-to-5-6mbps-akamai-1667984>. Accessed on 10 March 2018.

⁷ Zahoor Ahmad Shah (2017), "Digital Payment System: Problems and Prospects", *International Journal of Economic and Business Review*, Volume - 5, Issue 8, August 2017.