G Padmanabhan: Alternate payment channels – prepaid cards: issues and challenges

Address by Mr G Padmanabhan, Executive Director of the Reserve Bank of India, at the 5th Financial Inclusion and Digital Payments Conference, Mumbai, 12 September 2012.

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Distinguished ladies and gentlemen,

I am happy to be in your midst today and share some thoughts with you on the future roadmap of the Indian payments system. I have had the pleasure of interacting with the industry participants in similar conferences organised by IAMAI twice in the past. Since then, several developments have taken place which I firmly believe will result in a greater role to the assembled stakeholders in the Indian payments industry.

The enactment of the Payment and Settlement Systems Act, 2007 was a watershed in the sense that it permitted non-bank entities a formal entry into payment systems after being duly authorised by the Reserve Bank of India. Several if not most of you assembled here are now offering payment services albeit mostly in the pre-paid payment instrument category. Nascent as your efforts are it is viewed by us in the Reserve Bank as a welcome and positive beginning in our long haul towards a less-cash society. Given this profile of the audience, I shall confine my comments to issues that are of more direct relevance to this group.

In our efforts to move towards a less-cash society, we have recently unveiled our draft Payment Systems Vision Document, and placed it in the public domain for comments. I am happy to share with you, that we received responses from several of you. We are in the process of finalising the Vision Document taking into your comments and observations.

What are the issues that we have flagged in our Vision Document and what are the challenges before the industry in fulfilling these goals? Our vision is to "proactively encourage electronic payment systems for ushering in a less-cash society in India" and to ensure that the "payment and settlement systems in the country are safe, efficient, interoperable, authorised, accessible, inclusive and compliant with international standards" One amongst the key additions which is relevant on this occasion is the term "inclusive" and the emphasis on "less-cash" – please note we are not talking about cashless but less cash which we consider more realistic. Besides, now that India is a member of Committee on Payment and Settlement Systems, we have to be compliant with international standards.

What are the challenges in our achieving the stated goals? Recently, I happened to read an interesting book entitled, "Jugaad" (NaviRadjou, JaideepPrabhu and Simone Ahuja). First, what is jugaad? According to authors, jugaad is a colloquial Hindi word that means something like, an innovative fix, an improvised solution born out of ingenuity and cleverness. The authors point out that the biggest Indian jugaad to communication is the "missed call" on the mobile phones. India perhaps leads the world in this! Negative connotation to this jugaad notwithstanding, we need to think positively and appreciate that innovation or jugaad- in a positive way- is going to be critical for India- not only for competitive advantage, but also to ensure that our future development is sustainable and inclusive. The authors flag six principles of jugaad in emerging countries which is worth recounting to an audience like this:

1. Seek opportunity in adversity
2. Do more with less
3. Think and act flexibly

4. Keep it simple
5. Include margin
6. Follow your heart

These six principles when viewed in the context of this conference can be interpreted to pose some fundamental issues.

First, can the prepaid industry today proclaim that they have done all what could have been done? I am of the view that although the regulator has authorized the non banks to enter the payments sphere and the non-banks have largely chosen PPI, the results are not very heartening and encouraging. Available data indicates that the growth of the issuance of PPIs in India has and continues to be sluggish. The average issuance of PPIs during the year averaged 48.96 million, with a peak issuance of 57.46 million in July 2011. And even amongst these numbers, it has come to our notice that a particular PPI issuer has issued PPIs of Re 1/– each in large numbers! Reflecting this growth pattern, the volume of transactions (2.3 percent) and value transacted (2.5 percent) with PPIs as a percentage of total card transactions is also very marginal. Second, has the regulator done what could be done? Let me try and defend myself. RBI has always been in the forefront of building an enabling environment for the players of the payment industry. Since the inception of the PSS Act and issuance of guidelines in April 2009, 21 non-bank entities have been authorized for PPI issuance exclusively of which 18 are issuing PPIs, while the other 3 non-bank entities are in the process of doing so. Apart from authorization, RBI has also proactively undertaken policy measures in consultations with stakeholders to encourage the growth of the industry. While doing so, we have always kept the management of risks and addressing AML concerns as a cornerstone of our policy. Based on this approach, we have ushered in several rationalisation measures. But as we all know, while the regulator can act as a catalyst, it is the issuers who have to hit the ground running. Third, have the industry associations done what could have been done? Are we focusing too much on so called stumbling blocks and regulations instead of channelising our energies in achieving the required scale of operations? Let me not pre-judge. But, may be it is time for more introspection.

Let me now flag certain important issues which I hope would be discussed over the course of next two days.

Payment system innovation and role of non-banks payment system providers

The increased role of non-bank entities in payment system is linked to their potential to change the payment system landscape as they can leverage on their product offerings with latest technological features to cater to wide segment of the market. Has this taken place in India? As can be seen from statistics, the share of PPIs in the overall retail segment though growing is yet to achieve a significant level. If we analyse the types of PPIs being issued, paper vouchers constitute the major share of pre-paid payment instruments with 73.40 percent. The relative share of others is magstripe cards: 16.59 percent (mostly issued by banks), m-wallets: 9.94 percent and e-wallets: 0.07 percent. What is the innovation that has taken place if paper PPIs are merely acting as a substitute for cash? Similarly, why are micro payments with PPIs not been successful even though regulations are not stringent in this segment? KYC requirements for PPIs issued up to Rs.2000/– as well as utility payment PPIs are quite relaxed. Why then have PPIs not been successful in at least these segments? Do we have any credible answers?

Promoting access and inclusion

In our vision document we have laid emphasis on access and inclusion. We have been receiving a number of suggestions from the PPI industry as to how PPIs could address the present gap in access and inclusion. The questions to consider in this context are, is the current model of PPIs issuers appropriate? Most issuers are geographically restricted. We have not seen scaling up of transactions by several issuers after getting authorization. Therefore, the larger issue is – do the PPI issuers have the wherewithal to be ready for the long haul and provide nationwide effects? What are the plans for increasing the scale and network services? Why cannot the PPI issuers try to build a relationship with banks by acting as a Business Correspondents and load the government disbursements onto the prepaid payment instruments issued by them which in turn would lead to promoting access and inclusion through electronic payments? The access and inclusion concerns though are far greater in semi urban and rural areas. What is the scale and presence of PPI issuers in semi-urban and rural areas to address the access and inclusion gaps in the existing payment systems? In this context, the related question for the regulator is whether there is a need to review the entry norms so that only serious players come in? Or is it too early to take this step?

Standardization and interoperability

In our vision document we have stressed on the need for standardization and interoperability. We have been also receiving a number of suggestions from the PPI industry for permitting interoperability among the PPIs, use at all PoS terminals, inter-operability with other payment system operators as in the case of other payment products. All these are well appreciated by us. For interoperability to happen, standardization is a pre-requisite. It is only through standardization that the interoperability amongst non bank issued PPIs, usage of such PPIs at channels where the bank issued PPIs and other payment modes are accepted can be achieved. Convergence of any payment instrument into the mainstream acceptance infrastructure is the need of the hour. For PPIs issued by non banks to be accepted at the PoS terminals, they need to adhere to the form factor specification and connectivity to their switch. Is the industry geared up for this? On the other hand, PPIs issued by banks have access to acceptance infrastructure as they adhere to industry wide standards. Significant changes will therefore be required in the technology and business model of non-bank PPI issuers. Another important question is, when a majority of the cards are issued in paper mode, is the industry geared up for such changes? Is there a specific plan to go paperless by these service providers?

Interoperability also pre-supposes a central infrastructure for clearing and settlement. We have already permitted transfer of funds from a fully KYC compliant PPI issued by a non-bank authorised entity to a bank account through the sponsor bank route riding over the banks membership with NFS, NPCI. Why is such a fund transfer not picking up?

In our vision document we have discussed about the need for collaboration and co-operation between payment system operators. What is level of co-operation amongst the PPIs issuers? Have there been any efforts to collaborate at least on boarding of merchants? Is there any effort to standardize the merchant code and enable all the PPI issuers once approved under the PSS Act, to have access to all the merchants? Has the industry deliberated how collaboration and co-operation could be achieved in the three party model to increase the scale and volume of transactions?

Arriving at a consensus on these issues will increase the acceptability amongst the customers as they will have a wider choice of PPIs and will help achieve the objective of increasing the cashless transactions.

KYC related issues

Several requests for liberalisation of KYC requirements have been received from the industry. Several schemes in other countries which are operating in a relaxed and liberalized KYC environment have been cited. We are also aware of the use of PPIs for disbursement of Government benefits in some countries. Before sharing with you what we are reviewing, let me sound a word of caution. How many of you have read Ravi Subramaniam? More specifically, how many of you have read his book “The Incredible Banker”? Can we draw comfort that, what Ravi describes is mere fiction? The underlying message is clear. Competition cannot degenerate into the race to the bottom! Relaxation cannot be confused with abdication. If you are allowed to travel fast on a newly laid road, it does not mean that you have unbridled freedom to close your eyes and drive! Now let me turn to what we are trying to review.

In our vision document, we have committed that the PPI guidelines would be reviewed to provide further impetus to the industry. But it needs to be appreciated that closer the PPI gets to a bank account, the greater the need to apply the same set of KCY/AML regulations which are applicable to the banks. In particular, as the functionalities of PPIs form an ongoing relationship, comparable AML/CFT obligations will have to apply. That is the reason we have been following a risk based approach within the extant AML framework for PPIs. We will continue to evolve our guidelines balancing the demand of the PPI industry and extant AML framework. While doing so there are a few aspects to remember. It must be remembered that the schemes cited in other countries cannot be replicated in India in toto. The risk perception while issuing PPIs up to USD1000 without KYC in USA may not be same as the risk perception associated with PPIs up to Rs.50,000/– in India. The permissible limits, top ups and reloadability will depend not only on the purchasing power but also on systems in place to address the risk in terms of strong enforcement and compliance framework.

One of the reasons cited for replacing cash with PPIs is the trails that PPIs will provide. However, it is essential that PPI issuers are in a position to deliver the requisite trails. In some of the cases we have observed there is no proper system to track the card issuance let alone system for tracing the transaction trails. To put it more directly, in a mobile based prepaid system, this auditability is more straight forward if there has been proper adherence to rules while issuing SIM cards since minimum KYC standards are prescribed now. The national identity scheme needs to be vigorously integrated with the payment systems to create the necessary synergies. The industry may need to examine how quickly the Aadhaar scheme could be used to address the identification and authentication requirements. While this process is ongoing, caution has to be the better part of valour. So, while the demand for relaxation of KYC is well taken, the industry should work on improving the system for providing the necessary trace and transaction trails.

There have been demands for increasing the transaction limits. Increasing transaction limits by compromising on the KYC would be a risky proposition given its susceptibility to money laundering. As you will be aware increase in transaction limits will need proportionate increase in safety and security of transactions as applicable to other card schemes in the form of an additional factor of authentication. The industry needs to deliberate more actively on this issue and we as a regulator would be willing to act as a catalyst in the process.

Creating awareness – is the industry doing enough to increase the use of alternate payment channels?

I am asked why a customer will buy a PPI and block up to Rs.50,000/– without earning interest. It points towards the need for creating awareness about the PPIs. I do appreciate that it is a tightrope walk as bringing cash transactions through the PPI route also needs identification of that segment of population that would be happy to hold cash and use it anywhere. The test lies in convincing them about the advantages of such a product but the acceptance infrastructure and backward linkages have also to be built. We have to find ways to address such issues through awareness campaigns over the mass media.

The need for orderly growth – Is the industry adhering to laid down rules and regulations?

As a part of our oversight responsibility, we had carried out on site inspections of certain operators. This revealed several shortcomings relating to maintenance of escrow accounts, adherence to guidelines on KYC, absence of an efficient system to monitor and report suspicious transactions and in putting in place systems and practices for ensuring customer protection.

The regulatory guidelines for the PPI industry are three years old in the country. Entities are still learning the eco system and the business models are still evolving. Being new, non-bank entities are obviously focusing more on business than the processes. This is not very heartening from a regulatory perspective.

Let me now conclude. I have tried to highlight some of the important issues that the PPI industry should address to make this alternate payment channel scale up and become more vibrant. At the same time, certain concerns relating to non-adherence to regulations and laid down procedures have come to light during the first round of on-site inspections of some of the entities. This needs to be addressed and remedied urgently. In this context, industry organizations like IAMAI can play a useful role if they increasingly assume the role of a SRO rather than a mere lobbying body for its members. I thank you for your attention as I leave you with these thoughts and concerns.

I wish your deliberations all success.