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Payments Banks: A Study on Recent Progress in India

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Banking is the backbone of any financial system in the world. Typically banking business means collecting money from people and lending them whenever required. Banking also helps Individuals, Business groups, small businesses, and even all classes of people like lower-income class groups, Middle-income class groups, and higher income class groups to save money and provide a return on investment. Also, banks provide a lower rate of lending to all groups, strengthening the country's financial system. Normally when we think about banks, the first picture that comes to our mind is of a few persons sitting in a well-furnished place, where one person specifically gives and takes the cash payments. And other is doing separate transaction works. As the population increased, also increased the number of banks and their branches. Approximately 41 million transactions are made on a daily basis on banking channels, as a report by FIS global. This data shows the importance of banking in an economy. But 53 percent of the total population used banking in 2014 in India. RBI in 2013 launched a new bank which we called payments bank, which is a type of small-scale bank. In this research paper, we will deal with the Evolution of Payments banks in India pre or post-demonetization and explain the business model of payments banks in India. Also, in the last part of the research paper, we are dealing future of payments banks in India

Keywords: *banking, demonetization, payments bank, rbi, banking regulation*

INTRODUCTION

Money brings strangers together by allowing us to form and destroy things. Money assists us in achieving our goals. Money is a universal requirement for both individuals and businesses. Some of us have a lot of it, while others have very little. Our relationship with money has changed over the years. The creation of banking and other financial institutions to assist us in managing our money and providing the income on our money in the form of Interest and other things like timely payment, provide funds to start their own business[1]. For us, technology has made money simple. Money is now available in digital form. And our lives have never been more convenient, but everyone feels the same way. Money is not straightforward for millions of individuals all around the world. They are people we see every day in our homes, communities, and villages working in low-wage positions for a sector that is sometimes referred to as the economy's lifeline. Sending remittances back home when living in a distant country. In India, Many people come from the different backgrounds like farmers who live in villages and depend upon agricultural activity for their income in the form of money, and some people who live in hill areas or near about sea spend much of their time lives away from home for earning daily bread and butter, for all these people getting money is very hard, they get their income after several months of their hard work. [2]A lot of problems hinder savings, regular payments, and their ability to borrow and money transfer into another account with ease, including low or different income of ungrouped sector, making recognition in society, differences in education levels, distances their place of living, and many others which affect their income and ability to save them. They earn very low, and their expenses are higher than their income, and they spend only on bread and butter, not on fencing things, because they live simply without any facility. And also, they are far behind in receiving government monetary benefits due to not having access to banking services. Many other reasons were also responsible for the low income of people who are lived in remote areas and especially in tribal areas, such as natural disasters, medical emergencies, economic crises, and

[1] Harri Ramcharran, 'Bank lending to small business in India- Analyzing productivity and efficiency' (2017) 65(c) The Quarterly Review of Economics and Finance, 16-24 <https://ideas.repec.org/a/eee/quaeco/v65y2017icp16-24.html> accessed 12 April 2022

[2] Aditee Dash, 'Payments Banks in India: Can They Promote Social Inclusion?' (*Academic,* 8 September 2021) <https://www.lawctopus.com/academike/payments-banks-in-india/> accessed 12 April 2022

even more. Financial services are one type of aid that could change the future of Indian society and come closer to financial inclusion, which addresses some valuable issues such as poverty and inequality. In India, around one ninety Million adults and individuals do not have access to financial services, and even they do not have bank accounts to operate. Despite having 150 domestic commercial banks and 2700 cooperative sector banks operating in the country, women account for more than half of them. Individuals and enterprises have access to many things like they have a facility to credit and deposits and payments and also receiving government benefits directly into their hands at low cost and without manipulation of things. And, to create an equal world, we must concentrate our efforts on reaching out to those who have been left out.

The working of two eminent departments of the Indian government, the ministry of finance and the Reserve Bank of India, have been working together to promote and inclusion of the rural population of India in the financial inclusion goals as one of the country's major national goals for providing equality[3]. The government of India, in the second phase of development of the financial system doing, nationalization of banks because they have a clear vision of opening a large number of branches in rural areas and aim to provide credit facilities to develop their business and industries established with the help of branch network of scheduled commercial banks, co-operatives, and regional rural banks, the introduction of mandated priority sector lending targets, lead bank scheme, formation of self-help groups. In 2013 RBI panel report suggested that a special category of banks, called payments banks, need to be set up in India. In India, forty-one percent population still does not have access to normal banking services or financial services. So, RBI, with the object of spreading or increasing the payments and deposit services to low-income households and small-scale businesses, launched this payments bank in India.

In India, a larger group of people lived in villages and did agriculture-related work and earned in cash and usually also spent in cash too. They did not have a habit of investing money into any schemes. They trusted their households to save money. They took loans from

[3] Raj Bhala, 'Design and Challenges of Banking and Foreign Exchange Regulation in India' (2015) 16 Asian Business Lawyer, 27-72 <https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2713939> accessed 14 April 2022

untrusted zamindars and their relatives at a high rate of Interest after pledging their land to these zamindars. Reasons for taking a loan to untrusted sources and not putting their money into a bank are many, like not having any nearest branch of the bank and do not have so many documents like pan card, income tax returns, Aadhaar cards, and other land-related documents. They do not want to put themselves into these issues, which is why many farmers or village-living people do not have a bank account. Also, illiteracy is one of the prime sources of not accessing banking services. The government of India and RBI responded to the penal report and started to establish payment banks in India with the object of providing banking services on the doorsteps of people, especially in rural India.

HISTORY (RELATED TO ESTABLISHMENT OF PAYMENTS BANK IN INDIA)

In September 2013, under the chairmanship of NachiketMor,[4]A panel constituted by the Central government with the RBI studied the "**comprehensive financial services for small businesses and low-income households**." [5]Three months later committee submitted its report to the RBI. And committee strongly recommends the urgent need for the formation of a new category of the bank called Payments banks in India to provide doorstep banking services in India for financial inclusion. The reserve bank of India issued a notification regarding establishing a payments bank within six months of submitting the report by the committee. The object was to promote financial inclusion among rural areas, migrant workers, and small business owners. Committee during their research finds that in 1950-51 7.2 % share of institutional credit which was increased up to 61.2 % share in 1980-81. It increases by a very higher rate of growth of institutional credit in rural areas. This share of institutional credit grew marginally in the next decade to sixty-four percent. After adopting the liberalization agenda, the relative share of institutional credit has fallen to 57.1%. It is also a very important point here that the share of the landing of banks falls in that decade, but the relative share of cooperative banks rises. The share of moneylenders also went up. It concludes that the need

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[4] RBI Committee, *Report on Comprehensive Financial Services for Small Businesses and Low-Income Households* (2013) <https://rbidocs.rbi.org.in/rdocs//PublicationReport/Pdfs/CFS070114RFL.pdf> accessed 14 April 2022

[5] *Ibid*

for banks' greater involvement to attack poverty.[6] Also, the report emphasizes the increase of branches, and licensing policy, especially in rural areas of India. The committee criticizes the state partnership cooperative banks and models. The *MOR committee's* approach is to look at the bigger structure that is available for delivering banking services, their supporting systems like ATMs, e-banking services that are required, and the legal and regulatory framework of such banks under which these banks run their business. If the method of running these banks is unaffected by institutional structures, then it creates a positive approach for the RBI. The committee also wants to externalize all delivery costs. It promotes last-mile interoperability. Interoperability refers not only to access to banking services at a 15-minute walk away from the contact point but also to other financial services. These services must be provided ethically, with no misspelling based on a concept of suitability. While opening plain vanilla accounts and implementing direct benefit transfers for these individuals has proven difficult, supplying a product that meets the appropriateness criteria is a daunting task. The client is responsible for the costs of these products, as stated in the committee report.

Some experts also criticized this committee's suggestion because we already have regional rural banks in India[7]. They said that the resources of rural areas were not utilized in a good way. After the establishment of payments banks, people get banks at their doorsteps. All of this was done to reshape the Indian economy and create a safe environment for online commerce. These transactions will be simple to complete and time-saving. It will also reach a big portion of the population that was previously excluded from standard banking techniques. Despite these alternatives, the establishment of payment institutions was necessary. This procedure was implemented after the recommendations of two expert panels chaired by M Narasimham between 1991 and 1998. The committees focused on efficiency, giving public banks more autonomy, resolving bad loan issues, introducing foreign banks to Indian markets, adjusting liquidity to stimulate borrowing from the RBI through buyback agreements, and introducing monetary policy instruments. These improvements resulted in the establishment

[6] Department of Banking Operations and Development (DBOD) & Department of Economic and Policy Research (DEPR), *Banking Structure in India - The Way Forward (Discussion Paper)* (2013) <https://rbidocs.rbi.org.in/rdocs//PublicationReport/Pdfs/DPBS27082013_F.pdf> accessed 15 April 2022

[7] Amartya Lahiri, The Great Indian Demonetization' (2020) 34 (1) The Journal of Economic Perspectives <https://www.jstor.org/stable/10.2307/26873529> accessed 15 April 2022

of low-cost credit banks and growth in the formal financial sector. The committee advocated **two types of systems," vertically differentiated banking system (VDBS)"** and another is **"horizontally differentiated banking system (HDBS)**," for financial inclusion in the country. The HDBS system contains all core banking systems, and they aim to create more branches in the unbanked areas vdbs is designed to be the mainstay of the financial inclusion program. These verb systems contain a flexible system of banking. Their main aim is to receive deposit and payment services banking at the doorsteps of rural or unbanked areas. This vdbs system is already in practice in South Korea, where under this system, only banks make payments and deposits of money.

THE CURRENT REGULATION OF PAYMENTS BANKS[8]

Banking is the complete word in itself. It gives a complete picture in your mind of an institution that provides deposit and payments services to its customers. The legal and statutory definition of banking given under section 5(b)[9] of the banking regulation act 1949 is accepting the money from the public for lending or investment purpose and repaying that amount whenever demanded by the public and withdrawing through cheques, ATMs, drafts, or otherwise. And reserve bank of India created the guideline for every bank to establish under such an act. These regulatory guidelines divide into thirteen broad headings, which are as follows.

REGULATION REGARDING THE REGISTRATION AND LICENSING OF PAYMENTS BANKS[10]

1. The Payments banks would be registered as a public limited company which would be registered as a company under the Companies Act, 2013.
2. Licensing is given to payments banks as rules made according to the sec. 22[11] of the banking regulation act 1949.

[8] RBI Committee (n 4)
[9] Banking Regulation Act, 1949, s 5(b)
[10] RBI Committee (n 4)
[11] Banking Regulation Act, 1949, s 22

3. The main activity of payments banks is the core banking services like deposits and payments of money to their customers.

OBJECTIVES

- Need of the savings and transactions accounts in unbranched areas;
- Need for payments and credit services at a low rate to low-income households, small businesses, and unorganized business groups.
- Need for a secured technology-driven environment for high-value transactions.

ELIGIBLE PROMOTORS

- The exiting prepaid payment instrument issuers authorized;
- Individual, professional, nonbanking finance companies, supermarket chains, public limited companies, and retail sector cooperatives society that is owned and controlled by residents of India because according to the regulation banks such be called Indian banks not to be foreign banks.
- Exiting public sector companies who want to spend their business can also eligible candidates for applying promoters of payments banks.
- Any scheduled commercial bank already in business can also apply for a payments bank.
- Any government organization can apply for the promotors of the payments banks with the approval of the government.

SCOPE OF ACTIVITIES

- Doing the core banking business like acceptance of demand deposit- holding a maximum balance of Rs 100000/- per individual / per account. Which is increased as of now Rs 200000/- per individual/ per account.
- Payments banks can issue ATM and debit cards for withdrawal of money without any physical interference from banks. But these banks cannot issue credit cards to their customers.

- Payment service through various channels, including branches, business correspondents, and mobile banking.
- Payments banks must provide their customers with Internet Banking and mobile banking services.
- Payments banks can also Function as business correspondents- which means they can open a new account; every transaction is done, deal with every loan application, etc., earning Business Correspondents a commission from the bank.
- Payments bank provides services as a channel- Channel banking is a set of formats and channels made available by a bank to its customers so that they can use several ways to access the bank's various services (Collections and Payments) without the assistance of a bank officer.
- Handle to cross border remittance transactions.
- Banks can do no risk financial services with the prior approval of the RBI
- Banks can undertake utility bill payments.

DEPLOYMENTS OF FUNDS

- The payments bank cannot provide credit facilities to their customers.
- Compulsory for a payments bank to invest seventy-five percent of their demand deposit amount in government securities/ treasury bills with a maturity of up to 1 year for their income.
- The compulsory maintenance of SLR banks has to hold 25% in a fixed deposit of other banks for operational and liquidity purposes.
- Banks will participate in payments and settlement systems for temporary liquidity management.

CAPITAL REQUIREMENT

- The minimum paid-up capital requirement for taking licensing and running these payments banks shall be Rs100 Crore.

- Payments Banks Shall be required to maintain a minimum capital adequacy ratio of fifteen percent of their risk-weighted assets for the smooth running of their business.
- According to Basel norms requirements, payments banks have to maintain their tier 1 capital should be at least 7.5 % of risk-weighted assets.
- The Second requirement, as per Basel norms, payment bank's tier 2 capital should be limited to 100% of total tier 1 capital.
- Payments banks’ outside liabilities should not exceed 33.33 times their net worth. The reason for these norms is that these banks never have a shortage of capital.

PROMOTERS’ CONTRIBUTION

- No maximum shareholding limit is prescribed for the promoters.
- Promoters must hold at least forty percent of their paid-up capital for the first five years. The promoters need to hold up such a higher rate of capital because they need to prepare for the early years of losses that must be faced by them.
- When bank net worth reaches 500 crores, then necessary to diversify ownership within three years. Also eligible for listing their shares.

FOREIGN SHAREHOLDING

- Foreign investment in payments banks is made as per rules applicable in India for foreign investment in banking sectors.
- Maximum foreign shareholding in the banking sector is a maximum of 74 percent of the paid-up capital. And out of them, every time, 26 % of paid-up capital is mandatorily held by the residents of India because the rbi never wants these banks can be called foreign banks; they must be Indian banks.
- If FPI/FII wants to restrict in the banking sector, then they must be restricted their foreign shareholding to below 10 % of total paid-up capital, but in total, the aggregate limit is 24 % of total paid-up capital.

- If an NRI individual wants to invest in the banking sector, then their shareholding must be restricted to 5% of total paid-up capital, but the aggregate limit of their shareholding is 24% of paid-up capital both on a repartition and non-repartition basis.

VOTING RIGHTS AND TRANSFER AND ACQUISITION OF SHARE

- As per the regulations, any shareholder's voting right for a private sector bank is capped at 10%, but this limit can increase up to twenty-six percent in a phased manner.
- As per the regulations, if any private sector bank acquisition of shareholding is trying up to 5% or more requires prior approval of the rbi.

PRUDENTIAL NORMS

- Payments Banks will not provide loans and advances to their customers, and also they will not put loans and advances in their portfolio and prudential norms applicable to loan and advances schemes.
- Only operational risk is for payments banks, and they need to establish an operational risk management system.

BUSINESS PLAN

- When any public limited company applies for licensing of payments banks, then a business plan would be required with the application.
- The business plan has covered all aspects related to the business model.
- Applicants should be realistic and viable.
- The Government and RBI also focus on the committee report, according to which in India, there is a need to set up payments banks with access points primarily where the bank is not there.

CORPORATE GOVERNANCE

- The majority of the board of directors should independent.
- Bank directors should be covered under Fit and proper criteria as rbi.

OTHER CONDITIONS

- Payments Banks should operate in hill and tribal areas through business corporates and other internet or automatic networks.
- Opening their 25 % branches in unbanked rural areas.
- Established for control over various outlets.
- Banks should be taking care of data protection and should be operated in a real-time operation.
- These Banks should have a customer grievance cell to handle customer complaints and eradicate those complaints promptly.

BEFORE DEMONETIZATION: HEAVY LOSSES INCURRED BY PAYMENTS BANKS IN INDIA

Payment banks in India are not doing a successful business[12]. It was launched with the purpose of adding the rural population to banking services that promote financial inclusion. But they failed due to various reasons; we here deal with some of those reasons:-

Operational Cost: The operational cost of running these payments banks is higher. They should establish all higher-cost infrastructure and then do the limited business. Payments banks are required to develop their ATM in rural areas, and they develop their internet banking method. They should open all access points with full use of the internet and technology. They need to develop their method for data privacy. Their larger amount spends on the develop the infrastructure before providing their service to customers.

Prohibition of lending activities: The reserve bank of India did not allow the credit facility to payments banks to save them from higher NPA issues of commercial banks. But this is one of the primary sources of income for private commercial banks. Payment banks have very limited

[12] Linda S. Goldberg, 'Frontiers of Research on Financial Globalization (2009) 56 (1) IMF Staff Paper, 171-197 <https://www.researchgate.net/publication/227348349_Frontiers_of_Research_on_Financial_Globalization> accessed 15 April 2022

options for running as payments banks which is the reason for the failure of payments banks in India.

Less deposit Amount: Payment banks should establish their 25% branch in the rural areas or unbanked areas. Where the population did not believe in the financial system, they kept spending in cash. And taking a loan from their knowns at a higher rate of interest.

Higher Interest Return: Payments banks in their initial year provide a higher rate of interest on deposits to people for prevailing the banking services. This costs them higher because they do not get as much deposit as they want.

Limited source of Investment: It makes it compulsory for banks to invest 75% of their deposit into commercial paper or government securities for one year. And in the meantime, the government is struggling to boost its economy. So, the government provides less return on their investment. It creates so many problems for them to survive their business.

UPI business creates more competition: UPI model with collaborating with third-party apps provides a higher return to their customer, and people who use UPI are more comfortable than using of electronic service of Payments Banks.

Instability of Economy: Despite demonetization in 2016, banks are started their operation in India in unbanked areas. Where people earn less and also spend less, they start saving in their households. The other urban outlets of payments banks are not gaining popularity due to already having a core banking unit in their area. And not providing the loan facility, credit card facility will stop the people from depositing in the Payments Banks. Also, the Caps of 100000/- Rupees per individual in a year also makes unpopular the Strategy of Payments Banks in India.

POST DEMONETIZATION: A SLOW GROWTH FOR PAYMENTS BANKS

Initially, 11 banks' applications were approved for licensing of Payments banks. But soon after starting their business, five banks shut down their business and surrendered their license to the reserve bank of India. The great demonetization was one of the factors which affected the economy at a higher level. People start to spend less, which increases inflation in the market and services and higher goods prices, which affects the middle income or lower-income people badly.

Soon banks decrease the rate of Interest provided on deposit accounts and increase the rate of interest on loans to balance their business. And their investment in the securities market and money market affected their return by their decision-making. But payments Banks do not have the facility to change their interest rate according to their business. Because they receive a very low deposit and out of them, they have to invest 75% of them into government securities in which they no receive so much return to incur their expenditure. This is the reason soon after demonetization and their starting their business incurred heavy losses due to their operational cost. Soon after assessment at the end of 18 months, according to the in-principal licensing policy, RBI gave leverage to running these payments banks after incurring heavy losses.

Some of the common factors that affect the growth of payments banks are as follows.

The Government securities Hurdle: A look at the investment structure of payments banks. The payment bank's minimum paid-up share capital is 100 crore. And they are required to maintain 75% of their deposit into government securities for only one year. Only 25% of their deposit they have to invest in small commercial banks. But there is also a cap on receiving a deposit per individual is Rs 100000/- per account, which means they never have such an amount to receive the higher return on their deposit amount. And the return on government securities is 7 to 7.8 % in the past three to four years, which decreased after post demonetization up to 5.5%. This will further squeeze their earnings.

Prohibition on Landing: The idea of not providing credit facilities by payments banks will save them from NPA, but this would affect them on a very large scale. A weaker revenue system and providing a higher rate of Interest on deposits in the initial phase will cause heavy losses. After demonetization, they decrease their rate of interest on deposits, which will decrease their customers.

RBI's current approach towards Payments Banks:[13] If we go through the latest notification of reserve banks of India, it shows that they provide the option to pay banks to convert into small commercial banks within three years. Because small commercial banks provide lending services to their customers, and they allow providing charges commission on every transaction is helping to boost their revenue. But how far is this commission helping the payments banks? It seems to be more important in the near future.

Adding the Payments banks with other new schemes: Most payment banks are failing to get a revenue model. They work on their strong core part. But soon, they enabled their transaction for payment of FasTAG partnerships, Payment of government dues, and payment of taxes creating little relief for them.

CONCLUSION AND SUGGESTIONS

Recently the government of India launched the schemes related to the digital banking unit (DBU) portal of the banking system, which works fully digitally announced by the finance minister of India, Shri Mati Nirmala Sitharaman, in their budget speech. In this system, all works of banking are done digitally, which targets the small cities' population the partnership with private players. All banking core services like a deposit of amount, withdrawal of the amount, opening and closing of Savings accounts, and current accounts were done with the help of Smart contract services digitally on the blockchain. This step forwards India closer to financial inclusion. The Indian government and RBI opened of Payments bank with the sole purpose of financial inclusion. Payment banks in their initial years failed to incur high losses, but this step increases the percentage of the population who uses the banking services. According to some experts, this step of opening Payments banks is the wrong step taken by the government of India. But also states evidence for the same, but with the help of payments banks, we Indian start using the banking services, especially in rural areas, which are the biggest victory for the government. In the upcoming years, a Limited credit facility with

[13] Abir Lal Dey, Satyadarshi Kunaf & Ananya Ghosh, 'Impact of the Digital Payments, and Neo Banks on Financial Inclusion in India and Its Interplay with the Data Protection and Cyber Security Regulations' (2021) 9 (1) Scholasticus <https://csbfnluj.files.wordpress.com/2021/02/scholasticus-volume-ix-issue-i-4-28.pdf> accessed 16 April 2022

secured and unsecured guarantees will also be allowed banks to pay through which they can do some decent business and earn profit and bolster the economy.