



# Reserve Bank of India's Payment System Gambit

*Despite receiving little fanfare, the central bank's effort to lay out a plan for modernising the country's electronic payment capabilities is a welcome and important step forward*

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While the world was engrossed in watching the LIBOR scandal unfold recently and banks across the world were reviewing every index with palpitation, an important development came up in India. The Reserve Bank of India (RBI) released the second edition of the 'Payment System Vision Document' that defines the railroad for the electronic payments industry for the second-largest market in the world.

At the outset, such a document should cause a ripple of vigorous interest in the payments industry and get the various players to come up with their responses. However, no such thing has happened.

This lack of reaction is a reflection of the 'under-performance' of India in the last few years on a number of economic fronts – as well as the fact that India's electronic payments and cards industry is

not getting anywhere near the grandiose projections made a decade ago.

The most obvious comparison this 'vision document' will elicit is with China Union Pay (CUP), although one might think that Brazil's recent moves in payments merits a closer comparison. One could argue that CUP has gone so far ahead that it deserves to be compared with Visa and MasterCard and not belittled by comparison with this nascent payment infrastructure in India that has yet to take off.

But in all fairness, the release of a payment vision document by the RBI is a highly commendable step in the right direction. Across the payments world, a positive push by the Central Bank is always a key growth accelerator. The Central Bank's blessing gives any pay-



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ments initiative the right amount of credibility for consumers to adopt and make it a part of their lives.

The Payment System Vision Document was immediately followed by a Circular on Merchant Discount Rates (MDR) that lays down the discount rate that merchants can be charged by acquirers for debit cards. The Circular (dated June 28) caps the debit MDR at 0.75 percent of transaction amount for a value up to Rs. 2000 (about US\$36) and 1 percent for transactions over Rs. 2000.

Unfortunately, due to the timing of the release of these two documents, the RBI's vision document has been reported in the

press as a debit interchange rules-fixing policy. This has diluted the effect and the intended purpose of outlining the RBI's vision: 'to proactively encourage electronic payment systems for ushering in a less-cash society in India.' It is important to understand the significance of this endeavor in light of the fact that India has an abysmally low rate of electronic payments usage (excluding cheques). Analysts have pegged the share of electronic payments out of total consumer spending at less than 3 percent.

Let's analyze the Vision document and try to put things in perspective on the potential way forward and if the RBI's initiative of RuPay (India's equivalent of CUP – domestic payment switch) will take life and fulfill its mission.

### The Battle Against Cash

The document very clearly opens up with an aim to take on the biggest opponent of electronic payments – CASH. In India's case, cash poses a very prominent challenge to pay-rolling the massive underground economy – euphemistically called 'Black Money'. Tax evasion by businesses and self-employed individuals is almost a norm and any moves to the 'electronification' of payments naturally poses a threat to this large economic pie.

**Under-banked and subsidies:** The document estimates that India has 145 million households with no access to banking services. Electronic payments are the only logical way to reach the goal of mass inclusion. RBI has laid out that the Government of India disburses subsidies to the tune of Rs. 2.93 trillion and, if moved from the current mode of cash to electronic channels, it will be 4.13 billion transactions a year. Hopefully, this vision document will accelerate a shift of government-to-consumer (G2C) payments to electronic channels. However, it remains to be seen as to how the government will play the game and manage the plethora of vested interests that impede the move to electronic payments.

**Myriad number of payment systems:** The RBI acknowledges that there are too many entities and systems in the clearing and settlement landscape. While a competitive environment is welcome, a large number of clearing agencies make it unviable and again force many consumers to fall back on the easiest mode – cash. Again, rules and regulations are too many and do not provide a standard infrastructure.

### Universal Next-Gen Infrastructure:

The RBI clearly wants to set up a payments infrastructure that covers all forms of electronic payments – present and future. The landscape involves ACH, credit, debit, prepaid, mobile payments and all variations of these in multiple forms. However, the document does not talk about P2P payments – which is the largest and most prominent arena of electronic payments. We have seen some great examples of P2P payments in countries like Kenya where customer adoption of mobile payments has made great strides. RuPay must enable a seamless and 'universal' payment mechanism for mass consumer adoption. The success of mobile phones (India has close to a billion mobiles) is a case in point.

**Standardisation and Inter-operability:** The biggest challenge for consumer adoption of electronic payments is the lack of standardisation across the acceptance landscape. While e-commerce and m-commerce platforms are mushrooming, the fact that India has one of the lowest levels of acceptance points is a major

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detriment. However, it also provides an opportunity to implement standards at a lower cost and effort as compared to advanced payment markets. The document talks of the grand 'Universal Identification Number' (UID) project, named Aadhaar (or "Foundation" in Hindi) by the government as a first step towards standardisation and routing. However, the UID has yet to take off and is not accepted yet by banks as a proof of identification! The document also talks of examining the feasibility of forming a standard-setting body under the RBI – an approach that is likely to be mired in bureaucracy.

**Building capacity:** The document acknowledges that the current payment infrastructure is woefully inadequate to handle a surge of growth. India has a measly ATM penetration of 63 per million population and POS terminals at 497 per million population. Clearly, an all-encompassing 'cloud-based' payment system that traverses all channels – online and offline – is the only option. The RBI has indicated taking steps to build linkages between payment systems and ensure convergence.

**Risk Management:** The document delves at length into managing the risk in operating a huge payment system. It is not only the Operational Risk but also the Liquidity Risk that needs a lot of attention. Again, the document notes that the entire POS acquiring is run by only three banks, pointing to a near monopoly. But the RBI needs to ponder why banks in India never considered acquiring to be a standalone business. The country's largest bank, State Bank of India, is just starting to make moves in acquiring – while it started issuing cards in 1998! Given the low literacy levels and even lower financial literacy levels in India, ensuring the safety and security of electronic transactions is a formidable challenge. It requires not only implementation of stringent global standards but also a lot of education and investment by the financial institutions. The absence of strong laws protecting the consumer is a fundamental issue. While the RBI can issue guidelines to banks, the lack of regulatory protection further adds to the challenge of consumer adoption of electronic pay-

ments. It is only through a nationwide switch like RuPay that India can build a strong acceptance infrastructure.

**Affordability:** The document accepts that one of the dilemmas facing the payments industry is the contentious issue of pricing. It further investigates whether the RBI should play a role in pricing of electronic payments or let the market forces drive them. This thought was, however, quickly clarified by the release of the Circular soon thereafter, which caps the debit merchant discount rates. The world is seeing increasing intervention by Central Banks in pricing. The Central Bank of Australia is an extreme example in this sphere. This may not be a great issue in India as banks operate in a highly interventionist regime and wouldn't react too much. But it may have its bearing on the launch of new payment products and the amount of investment that banks are likely to make.

**Incentives for growth:** The document does not touch upon the important item of incentives to consumers and merchants to adopt electronic payments. Unfortunately, the recent history in this space has been more of disincentives. Case in point

is the Income Tax authorities treating credit card holding as an object of suspicion and with consumers reacting by retreating back to cash. In other places, there are some outstanding examples of government encouraging electronic payments through tax breaks – South Korea being the most prominent one. The government of India has to take an enlightened view of laying out incentives to consumers to adopt electronic payments and push to get the RBI to enable the banks to take a similar view.

**Innovation and new products:** The document rounds off with a lot of aspirational views on ‘payment innovation’ and taking advantage of rapid technological progress. However, one would take a stand here that the need of the hour is more basic and any innovation has to be in hastening the adoption of electronic payments – not spending time and effort on so-called ‘state of art’ payment gizmos.

**Conclusion:** To sum up, the second edition of the Payment Vision document does indeed hold out a lot of promise and says

the right things. The RBI’s intended mission of a safe, efficient, accessible and inclusive world-class payments system is appropriate and is a very critical cog in the giant wheel of India’s economic growth.

The payments industry and the outside world will be watching the strategy to unfold in the coming years. We all hope that all the good intentions get translated to actions and that India’s payments system takes its rightful place among the leading markets for electronic payments. ■