Will payments banks help foster financial inclusion?

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Unlike jurisdictions such as Singapore, India did not (until very recently) have differentiated licensing for banks, i.e. granting licences for conducting a specific line of banking business. The prevalence of universal banking licences coupled with the burden of fulfilling increasingly stringent prudential norms meant that banks that received licences rarely ventured outside Indian cities which were their main profit centres. Consequently, the avowed goal of successive central governments to make basic banking services available to all citizens was not fulfilled.

While the Reserve Bank of India (RBI) tried to work around this roadblock through means like allowing banks to use business correspondents, linking branch expansion to the opening of branches in lesser banked areas, and offering incentives for priority-sector lending, the lack of commercial viability meant that millions of Indian citizens in rural and lesser banked areas did not have access to basic banking services. Government initiatives such as requiring public sector banks to take an active role in lesser banked areas too had limited success.

The lack of access to basic banking services became glaring when the government tried to move away from the subsidy model towards the direct cash benefit model, in which the subsidy recipient's account would be credited with the amount of the subsidy enabling them to purchase goods like kerosene at non-subsidized rates. While the direct cash benefit model would have helped India's woeful balance of payments situation, its implementation required subsidy recipients to have access to low or zero balance accounts. The lack of basic banking services for most subsidy recipients meant that the direct cash benefit model could not be fully implemented.

Separate licensing for banks was raised in a discussion paper on banking structure in India released by the RBI in August 2013, which also voiced the requirement for non-universal banking. The discussion paper noted that differentiated licensing in India would be "a desirable step", and that banks with differentiated prudential regimes and levels of access to public deposits could be established.

The next fillip to the concept of differentiated licensing came from the report of the Committee on Comprehensive Financial Services for Small Businesses and Low Income Households, which recommended the differentiation of banks on the basis of design such as payments banks for processing payments and deposits, full-service banks, and wholesale consumer banks.

The central government noted in its budget for 2014-15 that the RBI would create "a framework for licensing small banks and other differentiated banks … to meet credit and remittance needs of small businesses, unorganized sector, low income households, farmers and migrant work force".

The RBI issued draft guidelines for licensing of payments banks in July 2014, finalized guidelines in November 2014, and clarifications on the guidelines in January 2015.

As per the guidelines, payments banks promote financial inclusion by providing small savings accounts and payments/remittance services to low-income households, small businesses, etc. Casting a wide net, the guidelines allow existing pre-paid instrument issuers, public sector entities, individual professionals, and entities such as mobile telephone companies and supermarket chains to establish payments banks.

A payments bank will be required to include "payments bank" in its legal name. Payments banks will be able to accept current and savings deposits up to ₹100,000 (US$1,620) from individuals, small businesses and other permitted entities. A payments bank cannot accept deposits from non-resident Indians.

To provide operational flexibility, the guidelines allow payments banks to conduct a series of transactions exceeding ₹100,000 as long as the balance at the end of the day does not exceed ₹100,000. This cap can be enhanced by the RBI based on the bank's performance.

Payments banks are allowed to issue "ATM" and debit cards, but not credit cards. Further, the banks can provide internet banking and undertake bill payments. The banks are also allowed to access payment gateways and process cross-border remittances that are in the nature of personal payments and current account remittances.

Although payments banks cannot engage in lending activities, they are permitted to engage in simple financial activities not requiring them to commit funds such as distributing mutual fund units and insurance products, with the prior approval of the RBI.

Payments banks are a step in the right direction to foster and encourage financial inclusion in India. The deadline for receipt of applications to establish payments banks is 2 February 2015, and many private sector participants as well as government-operated India Post are said to have applied to the RBI to establish payments banks. Similar to the granting of universal banking licences by the RBI in 2014 to IDFC and Bandhan, this too is expected to have a positive effect in strengthening and deepening the Indian financial market.

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