

Comments to the report of the “Committee to review the framework related to Digital Payments” dated 09 December 2016 (Committee), constituted by the Ministry of Finance, Government of India (Report)

The Future of Finance Initiative (FFI) is housed within the IFMR Finance Foundation (IFF)¹ and aims to promote policy and regulatory strategies that protect citizens accessing finance given the sweeping changes that are reshaping retail financial services in India. Our vision is for regulation and policy to develop to support universal access for all citizens to a range of channels through which they can transact securely and confidently.

A. COMMENTS:

We have listed our comments in the table below, referenced against the corresponding section and page number(s) of the Report.

Sl. No.	Section Reference	Page	Comment
1.	Hierarchy of Demand of Financial Products	27-28	<p>The bedrock of financial inclusion efforts in the country is predicated on the understanding that all individuals should have access to a mix of financial products to improve their financial well-being.</p> <p>The pyramid (provided in the Report at page 28) used to demarcate population segments and their demand for financial products appears to be an incorrect conceptualisation of consumers’ financial needs. The aim should be to ensure that every consumer and every enterprise has complete access to financial services. Exactly which products get used is a function of the lifecycle and profile of the customer, not just income. For example: we find that there is significant demand for a micro-money market mutual fund (that has the potential to deliver better real returns than savings accounts with banks) among the self-employed business segments in rural and urban centres.</p>

¹ IFF is a policy research and advocacy institution guided by our mission of ensuring that every individual and every enterprise has complete access to financial services. IFF has made several contributions to the Indian financial system and participated in engagements with financial sector regulators (the Reserve Bank of India (RBI), the Pension Fund Regulatory and Development Authority and the Securities and Exchange Board of India) and the Government of India. Notably, we were the technical secretariat to the RBI’s ‘Committee on Comprehensive Financial Services for Small Businesses and Low Income Households’ (CCFS) (Chair: Dr. Nachiket Mor).

2.	High Cost of Cash	29	<p>We are supportive of enhancing consumers’ choice to access a range of channels to undertake payment transactions. Consumer preference to use cash for transactions or other modes (such as debit and credit cards, electronic wallets etc.) is driven by a range of factors which are economic and cultural. The trends in the use of cash are variable across the world.</p> <ul style="list-style-type: none"> - <u>Use of cash is variable across countries</u>: Consumers in several leading economies such as Austria, Germany (Bagnall, J et al, 2014) and Japan (Warnock, 2014) use cash for the majority of their transactions. The legitimate use of cash is in itself not harmful to the economy. - <u>Cost of digital payments</u>: The Report highlights the cost of cash to the economy. We note that digital transactions also have costs, as illustrated in the Appendix (Some costs for digital payments). - <u>Consumers bear the costs of going digital</u>: An important point for consideration is who bears the cost of cash versus digital. There is no dispute that state institutions bear the cost of printing and maintaining cash in circulation. However, banknotes - which are essentially IOUs issued by government to citizens - allow the citizens to execute transactions without additional costs. Digital modes of payment levy costs at the consumer’s end in order for transactions to be executed. These can bite consumers harder, especially those making lower value transactions, for whom transaction costs (which are a flat percentage of the value of the transaction) can be a larger proportion of their absolute income. - <u>Neutrality in ecosystem</u>: In order to keep to the spirit of the Committee’s commitment to competitive neutrality in the ecosystem, it is submitted that cash and digital payments should be priced equally to make them neutral so that they operate in a way that does not “pick a winner”. Whilst the Committee can no doubt recommend incentives to enable use of more digital payment formats, it would be incorrect to levy disincentives on the use of cash.
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3.	Vision	41	<p>There is a contradiction between consumer choice and the Report’s target of achieving a cash-to-GDP ratio of six percent over the next three years.</p> <p>The Committee’s vision statement is laudable for foregrounding the need for “real choice” for consumers on whether they should transact in cash or in digital form. However the final sentence of the vision statement appears to negate this aspiration by setting a target to reduce the cash-to-GDP ratio by 50% in three years. To achieve such a drastic target, a significant number of citizens will be undoubtedly forced to transact digitally and therefore not be able to exercise a “real choice”.</p>
4.	<p>Recommendations (R-1: Make regulation of payments independent from the function of central banking)</p>	<p>77 – 79, 84 – 89, 155</p>	<p>We are supportive of the Report’s recommendations to create clear regulatory and operational rules around payment systems and Payment Service Providers (PSPs). This will improve competitiveness and also facilitate innovation. Clarifying the regulatory regime for payments and advocating for neutrality in the treatment of payments infrastructure are strong principles from the Committee.</p> <p>However, the rationale behind calling for an independent board within the RBI to regulate payments is unclear. Greater role for non-banks in payments is not inconsistent with RBI remaining the payment system regulator. On the contrary, it has the potential to ensure consistent regulation in a way that reinforces stability considerations. In addition, we note the following facts which make the rationale for this recommendation unclear:</p> <ul style="list-style-type: none"> - The Report already recommends (in recommendation 7) that the RBI begin taking steps to consider the spinning out the operation of payment systems like RTGS and NEFT, which will eventually reduce any conflicts from the RBI’s commercial function. - There is a need for the regulator to be able to look across the entire system to mitigate heightened settlement risks and counterparty risks, where payments systems have independent rules. The central board of the RBI will be best placed to have this view. We reiterate the interdependence between the various functions of the central banking system and the payments systems. For instance, new PSPs which grow large can affect liquidity and general stability of the financial system.

			<ul style="list-style-type: none"> - In any event, the Report separately recommends that the proposed new Board for Regulation and Supervision of Payment and Settlement Systems (BPSS)/ Payments Regulatory Board (PRB) would not regulate systemically important payment systems but only more minor systems, calling into question the real need/logic for such a new independent board. - The nature of such a structure i.e. an independent board within the RBI is unprecedented as the RBI currently functions entirely through its sub-committees and departments. This could create opacity and barriers to regulatory action, especially since it is foreseeable that events affecting payment systems will have a direct impact on the banking system (and even potentially on monetary stability). - This recommendation would also confuse the treatment of payment banks, which have just been licensed. If the Committee’s recommendations were taken, payment banks could be viewed as PSPs, not banks and would have nothing to do with the RBI.
5.	Recommendations (R-2: Update the current Payment and Settlement Act, 2007 – Competition and Innovation)	155	We refer you back to our reasoning in the response at Sl. No. 4 above. It is unclear why a new PRB is required in the current scenario. The objectives of competition and innovation can be fulfilled by clear regulatory and operational rules around payment systems and PSPs.
6.	Recommendations (R-2: Update the current Payment and Settlement Act, 2007 – Consumer protection and graded penalties)	89, 109-110, 156, 172	<p>We welcome the Report’s recommendation to include a section on consumer protection explicitly in primary legislation dealing with payment systems.</p> <p>In addition to the points mentioned in the Report in this section, we would like to highlight the risk of “automatic authorisations” in the case of PSPs. This can lead to unintended authorised transactions for consumers, as illustrated in the case below.</p> <p>In 2015, PayPal Inc. was the subject of a consumer action in the U.S. The company offers a line</p>

		<p>of credit known as PayPal Credit that consumers can use to pay for online and other purchases. Consumers often enrol in PayPal Credit while purchasing a good or service online or while creating a PayPal account. The U.S. Consumer Financial Protection Bureau (CFPB) alleged that many consumers who were attempting to enrol in a regular PayPal account, or make an online purchase, were signed up for the credit product without realising it. Further, the CFPB alleged that the company automatically set or preselected the default payment method for all purchases made through PayPal as PayPal Credit, without getting explicit consent from the consumer. Other consumers were not able to select another payment method, finding that their purchases were charged to a PayPal Credit account even when they affirmatively selected another payment. Many of these consumers incurred late fees and interest because they did not know they had made purchases through PayPal Credit. Tens of thousands of consumers experienced these issues.</p> <p>The CFPB levied a \$10 million fine on PayPal and required it to pay \$15 million in order to redress the victims. PayPal was also required to take steps to improve its consumer disclosures related to enrolment in PayPal Credit to ensure that consumers know they are enrolling or using the product for a purchase (See CFPB consent order).</p> <p>We note the redress mechanism envisioned for consumer disputes within the proposed PRB. This needs to take account of developments in connection with the proposed Financial Redress Agency (FRA).</p>
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7.	Recommendations (R-2: Update the current Payment and Settlement Act, 2007 – Open access)	62-66, 156, 173	<p><i>What is the effect of allowing non-bank PSPs access to payment systems on escrow/banking arrangements used in payments and for settlement related processes?</i></p> <ul style="list-style-type: none"> - The Report’s recommendation around open access to non-bank providers will have a knock-on effect on the existing banking and escrow arrangements. Currently, non-bank PSPs hold their funds with scheduled commercial banks, which in turn have current accounts with the RBI that interface with the payment systems. <p>We request the Committee to share its thinking on the recommendation on current escrow banking arrangements for non-bank pre-paid instrument issuers (PPI) (see paragraph 8.3 of the RBI Master Circular – Policy Guidelines on Issuance and Operation of Pre-paid Payment Instruments in India, 2016) should be envisioned further.</p> <ul style="list-style-type: none"> - In particular, payments banks were envisaged as an improvement over PPIs by the CCFS committee due to the mitigation of contagion risk associated with PPIs². Besides, contagion risk, the ‘demand deposit’ nature of consumer monies in non-bank accounts will not have access to Lender of Last Resort (LOLR) facilities that commercial banks enjoy during a liquidity crunch.
8.	Recommendations (R-2: Update the current Payment and Settlement Act, 2007 – Regulating systemic risk)	157, 174	<p>The RBI under the current Payment and Settlement Systems Act, 2007 has oversight and regulation of payment systems in the country. It also has insight into the pressures and risks to the financial system as a whole, given the interdependence between the various functions of the central banking system and the payments systems. Therefore the designation of rules on criteria for designating payment systems “systemically important” and designation of systemically important payment systems (SIPS) should rest with the RBI.</p>

² Since PPIs are “nested” within a sponsor bank, if the sponsor bank fails for some reason, then since the amounts held by the PPI with the sponsor bank are at risk, the amounts held by individuals with the PPI are also at risk and do not enjoy the benefit of deposit protection unlike the direct depositors of the sponsor bank itself. And, if the size of the total balances held by the sponsor bank grows to be large relative to its own balance sheet size, the failure of the PPI could threaten the survival of the sponsor bank itself. Thus, nested approaches potentially create opacity in the system by screening the build-up of systemic risk. This issue is avoided since Payments Banks do not follow a nested design.

9.	<p>Recommendations (R-2: Update the current Payment and Settlement Act, 2007 – Data protection and security)</p>	94-96, 97, 158, 175	<ul style="list-style-type: none"> - The definition of ‘sensitive personal data or information’ under the Information Technology Act, 2000 (IT Act) framework covers: “financial information such as bank account or credit card or debit card or other payment instrument details” (see Rule 3(ii) of the Information Technology (Reasonable security practices and procedures and sensitive personal data or information) Rules, 2011). <p>It is unclear whether there is any data protection for transaction records of individuals (such as say credit card spending patterns or utility bill payments) undertaken through payment channels.</p> <p>Newer forms of personal data that may be of a sensitive nature, such as browsing history, call records, social media behaviour, and so on, that are recently finding use in underwriting in financial services, do not have protections that sensitive personal data or information has, and they should also be covered.</p> <ul style="list-style-type: none"> - It remains an open question whether the IT Act will apply to foreign banks branches operating in India (of which there were 325 as of 31 December 2015 – see (RBI, 2015a)) where they have not set-up Indian subsidiaries. The IT Act will also not apply to non-profit organisations, banking business correspondents, individual chartered accountants/ mutual fund distributors/ investment advisors/ insurance brokers etc. - Moreover, while PSPs are not allowed to hold ‘sensitive personal data or information’ beyond the purpose for which the information was collected, there are no bright-line rules (such as purging the information within 30 days of purpose expiry) to actually enforce this. Market practice has also evolved in the direction of taking all-encompassing consents, making purpose limitation difficult to enforce. - PSPs should also be required to provide a clear and standardised privacy notice to each consumer at the point of first engagement and on an annual basis subsequently. The notice can have the provider’s privacy policy in plain language, details of consumer information collected, entities with which it can share the information and an accessible opt-out option to prevent information sharing (other than for compulsory purposes such as credit
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			<p>reporting).</p> <ul style="list-style-type: none"> - To strengthen the current regime, PSPs could be required to have privacy officers for overseeing compliance with privacy requirements. - Using the Committee’s principle that all PSPs facing similar risks must be treated similarly, there should be similar rules for all entities accessing personal data irrespective of bank/ non-bank/ direct PSP/ indirect PSP status. <p>We also note that the present legal rubric already contains provisions to extend anti-money laundering (AML) monitoring requirements to issuers of pre-paid instruments. Such entities are already entitled to process personal data for AML and fraud detection purposes (see paragraphs 6.2, 6.4 and 14.2 of the RBI Master Circular – Policy Guidelines on Issuance and Operation of Pre-paid Payment Instruments in India, 2016). Therefore, the observation in the Report that PSPs have limited ability to process personal data/information to detect fraud and money laundering appears to be unfounded (the Report, page 96).</p>
10.	Recommendation (R-3: Promote digital payments within Government – (j))	160	<p>It is submitted that this recommendation is contradictory with the Committee’s vision to support consumer choice. Despite the fact that the Report has recommended that a threshold be agreed only above which payments need to be made digitally, the recommendation could still risk being an excessive burden on less literate citizens, those without access or means to make digital payments or disabled people.</p>
11.	Recommendation (R-4: Create a fund from savings generated from cash-less transactions)	142, 160	<p>It is unclear how savings generated from digital payments to the Central Government will be tracked, as well as how these will be analysed as against the costs absorbed by Government in order to lower the barrier of use to digital payments (including through the rough costs of recommendations 3(a), 3(b), 3(c), 3(d) and 3(h) to the Government).</p> <p>We request the Committee to share the financial analysis used in connection with this recommendation.</p>

12.	Recommendation (R-6: Other measures: (a) Promote eKYC and paperless authentication -(b))	122,162	<p>The Report recommends the usage of Aadhar number if PAN has not been obtained. This recommendation ties back to analysis on page 122 which refers to the U.S. experience on using a single social security number used to file tax returns and to access other services. Box 31 of the Report also highlights Section 205(c)(2) of the U.S. Social Security Act of 1935. The Committee’s report states that today, social security number (SSN) is required to be furnished to obtain a driver's license, public assistance, donate blood, or take out a loan.</p> <p>However, we would like to highlight that whilst the understanding above reflects the U.S. approach from the 1940s to the 1960s, the country has changed its approach entirely since the 1970s with regard to the SSN. Since then, the U.S. government has rowed back from the extensive use of the SSN. This was as a result of the universality of the SSN leading to its abuse, and also becoming a key piece of information used to commit identity theft (i.e. the using of personally identifiable information to commit fraud or other crimes) (Puckett, 2009). In 1974, the U.S. Privacy Act of 1974 included a provision making it unlawful for any public agency to deny rights, benefits or privileges they were due because of refusal to disclose their SSN (5 U.S.C. § 552a, see U.S. Department of Justice, 2015). U.S. states have passed rules restricting disclosure and use of the SSN, prohibiting the printing of the number on bills etc. (EPIC, 2017).</p> <p>The Committee’s view that the Attorney General’s opinion be obtained is therefore welcomed, and should be considered very seriously before taking forward this recommendation.</p>
13.	Recommendation (R-6: Promote eKYC and paperless authentication – (c))	24, 162	<p>This recommendation does not relate to digital payments and it may not be appropriate for the Committee to offer a recommendation on these matters as it is beyond the purview of its terms of reference.</p>
14.	Recommendation (R-9: Allow non-bank PSPs to directly access payment systems)	166	<p>As this recommendation overlaps with ‘R-2: Update the current Payment and Settlement Act, 2007 – Open access’, please see our comments at Sl. No. 7 above.</p>
15.	Recommendation (R-	49,50,	<p><i>Direct carrier billing (DCB):</i></p>

	<p>11: Enable payments to be interoperable between banks and non-banks as well as within non-banks (b))</p>	<p>131, 132, 167</p>	<ul style="list-style-type: none"> - <u>DCB and mobile value added services (MVAS) are not alike</u>: It is submitted that the Committee should examine whether there are any fundamental differences in the nature of DCB which would bar it from being considered a MVAS. For instance, MVAS have traditionally only been used to deliver services consumed on a mobile phone (e.g. ringtones, caller ring-back tones etc.). This analysis is particularly important, given significant concerns around consumer fraud which arose in the MVAS market in (Kak, 2015). Lakhs of complaints of unsolicited activation of services, unauthorised renewal of services and the billing of consumers including those who did not have necessary credit have been documented (Kak, 2015; BGR, 2014). This lead the Telecom Regulatory Authority of India (TRAI) to issue guidelines to combat this problem by requiring explicit consent to activate MVAS (PIB, 2013). More recently, consumers have been adversely affected by differential pricing as a result of disagreements between telecom service providers and MVAS providers – a major cause for concern (Financial Express, 2016). All this warrants caution and a full assessment before conflating DCB and MVAS. - <u>Pre-paid DCB is akin to a PPI</u>: As described in the Report, DCB is a facility that utilises stored value in mobile accounts and enables subscribers to use mobile phones as payment instruments (the Report, page 50). In keeping with the Committee’s focus on competitive neutrality to foster effective competition in the market, all payment instruments providers should be treated equally for regulatory purposes. If stored value in mobile phones is to be used akin to a PPI wallet, then the regulatory requirements and consumer protection standards for these services should be uniform. - <u>Post-paid DCB is akin to a form of credit</u>: Where DCB is provided on post-paid mobile connections, it appears to be akin to credit instruments, i.e., rather than payment instruments like PPI wallets, they are credit instruments which are used to finance a purchase made by the consumer. The Committee has noted in its report that DCB aimed at low-value micro-payments is offered to consumers as an alternative to a credit card (the Report, page 132). In keeping with the Committee’s focus on competitive neutrality to foster effective competition in the market, and in light of significant consumer protection concerns and systemic concerns when it comes to credit provision, any entity providing
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			credit should have similar regulatory requirements and consumer protection standards as other types of non-bank institutions advancing credit.
16.	Recommendation (R-13: Other Measures - Enable faster and cheaper credit)	167	This recommendation relates to Credit Information Companies (CICs) being allowed to access alternate data from like non-financial sources. This recommendation does not relate to digital payments and it may not be appropriate for the Committee offer a recommendation on these matters as it is beyond the purview of its terms of reference.
17.	Recommendation (R-13: Other Measures - Promote cross-border payments)	66, 169	This recommendation is intended to achieve parity between direct and indirect non-bank PSPs by allowing the latter to receive foreign inward remittances. However, the case for creating a new category of “Authorised Dealer” licence under the Foreign Exchange Management Act, 1999 is not clearly made out, especially as indirect PSPs can be allowed to enrol as ‘Indian Agents’ under the RBI’s Money Transfer Service Scheme.

B. APPENDIX

Some Costs for Digital Payments

Some system-level, merchant-level and consumer-level costs are set out in this appendix. These are not an exhaustive account of all the charges in the system, but serve to flag that there are also costs associated with digital payments just as there are costs for cash.

Section 1: System-level costs of the digital payments ecosystem

Cost Component	Cost (INR Crores.)
Payments infrastructure	One time cost 60,000-70,000 ³
Servicing costs of POS transactions through existing 1.3 million terminals	390 ^{4*}
Other costs	**

** Below we list the set of known costs relating to digital transactions at the system level, for which cost estimates are not readily available in the public domain.

- **On-going maintenance of digital payments infrastructure**
- **Annual fee levied on consumers for holding debit and credit cards and minimum cash balance requirements in mobile wallets**
- **Maintaining a grievance redressal mechanism in context of digital users**
- **Costs incurred in maintaining a secured digital payments infrastructure, along with risk and fraud monitoring costs**
- **Cost to the exchequer on account of the Government's absorption of transaction costs as recommended in Section 7.2**

³ McKinsey, The Benefits of E-payments to Indian Society, also cited in the Report at page 30.

⁴ Visa, 'Accelerating The Growth of Digital Payments in India: A Five-Year Outlook' October, 2016.

* There is ambiguity around the composition of servicing cost of POS transactions. For this reason the MDR charges haven't been included in the table separately.

Section 2: Merchant-level costs (tied to the acceptance infrastructure for POS and owned mobile devices)

The acceptance infrastructure for both point-of-sale (**POS**) based and mobile based transactions is not costless. This can make it unattractive and in some cases even unviable for merchants in comparison to cash.

In this regard, a study commissioned by EY in 2016 (Ernst & Young, 2016) illustrates that in case of low-transacting merchants (making 100 transactions a month with an average ticket size of INR 500):

- it costs merchants 1.4% of transaction value in POS based digital payments, and
- 0.84% of transaction value in case of payments settled on owned mobile devices.

Section 3: Consumer-level transaction charges digital payments through key payment systems

Transaction Charges	NEFT	RTGS	IMPS	UPI	USSD
Amounts up to Rs. 5,000	Rs. 2.50 + Service Tax*	Not Applicable	Rs. 5 + Service Tax*	Rs. 0.5	Rs. 0.5
Amounts above Rs. 5,000 and up to 10,000	Rs. 2.50 + Service Tax*	Not Applicable	Rs. 5 + Service Tax*	Rs. 0.5	NA
Amounts above Rs. 10,000 and up to Rs. 1 lakh	Rs. 5 + Service Tax*	Not Applicable	Rs. 5 + Service Tax*	Rs. 0.5	NA

*Service tax is levied at a rate of 14% of the transaction charge.

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