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Payment Banks: A Step towards Financial Inclusion

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Abstract

For the past several years, there have been a series of policy responses to the changing landscape of Financial Inclusion and Payments globally. The proliferation of non-bank participants in facilitating payment services, such as business correspondents, third-party service providers (who have created distribution networks to service diverse end user needs) and Mobile Network Operators has generated different approaches to delivering financial services access to hitherto un served and under-served populations. In particular, there have been a host of different innovations in Mobile Money in sub-Saharan Africa, in South East Asia as well as in the South Asian neighbourhood. In India, the Reserve Bank of India (RBI) has espoused a "Bank-led" approach to payments and inclusive financial services. The Business Correspondent (BC) model introduced in 2006 has thus far been the chief instrument of outreach. It is estimated that currently there are over 200,000 BC agents2across India. In addition, Prepaid Payment Issuers (PPI) licenses were issued to cater to a host of different transaction use cases The guidelines on Payment Banks issued by the RBI is a policy step towards creating differentiated banking structures to respond to the difficulties faced by certain underserved segments of the population in accessing formal financial services as well as to promote a "less-cash" economy through digital payments. It is also a response to address longstanding concerns of BCs as well as PPIs. Owing to the high cost of cash transactions, the RBI has been advocating a movement towards a "less-cash" economy through institutions that can facilitate the adoption of digital money that can manifest itself through smart cards, mobile phones or other technologies that offer a secure access to a stored value account. The present study is based on the role of the payment banks in the financial inclusion and RBI's Ist draft for the payment banks.

Keywords:- Payment Banks ; Financial Inclusion.

Introduction

India has struggled with financial inclusion; with just 400 million of the 1.2 billion population have bank accounts and with getting urban centric banks to include the urban poor and the rural population. In India, RBI has initiated several measures to achieve greater financial inclusion, such as facilitating no-frills (PMJDY) accounts and General Credit Cards (GCCs) for small deposits and credit. Recently Prime Minister Narendra Modi has announced the Jan Dhan Yojana which is a National Mission for Financial Inclusion. This National Mission has an ambitious objective of covering all households in the country with banking facilities and having a bank account for each household. Every account holder is to provide with Rupay debit cards with access to mobile banking and accidental insurance. The Reserve Bank of India (RBI), in its attempt to give impetus to financial inclusion in the country, has announced a new category of 'niche' or 'differentiated' bank. Two new types of banking systems have been introduced under this category, namely: Payment Banks and Small Banks. While small banks will provide all sorts of banking services in a limited operational area, payment banks will provide a limited range of banking products but will have a greater accessibility, especially in the rural areas.

Reserve bank of India (RBI) Statistics suggests that more than 40% of India's 1.2 billion population has little or no access to formal banking services. And this is a conservative estimate. Needless to say, for an economy flourishing at a steady rate of 7.5% to 8.0% per annum, this limited access to financial services is acting as a constraint to growth. Financial inclusion not only assists a nation's growth but also increases employment opportunities and empowers the poor.

Payment banks are commercial banks with a low starting capital and are generally targeted to bring the financial inclusion in the country. Payments banks will offer most of the banking services except loans and credit card products to retail customers. Customers can deposit money up to Rs 1 lakh in these banks, transfer money, make payments and buy financial products such as insurance and mutual funds.

Payment Banks is based on the concept of PPI that is to load cash into mobile and use it to do various transactions such as transferring money using your mobile to another mobile phone holder or to another bank account or to point-of-sale terminals at large retailer and take out cash. Need for Payment Banks erupted because India has around 94 crore mobile subscribers which is approx. 75% of the population of 125 crore but if we see the number of bank accounts this figure comes down to 60 crore that is around 50% of the population. Most of the unbanked people lives in the rural area and are poor people or small businessman. So from financial inclusion point of view, this model (PPI) seems to be sound concept.

It is an attempt by the RBI and government of India to increase the financial inclusion with the help of Payment banks in the country. Currently 11 entities have been approved for the payment banks and they can establish their banks in various part of the country. These banks are generally meant to produce the loan and money requirement of the small farmers, migrant labours, artisans, low income households, small businesses, other unorganised sector entities and users , who do not get access of the financial instruments in most of the commercial banks.

The Reserve Bank of India (RBI) has chosen just 11 out of 41 applicants to set up payments banks in the country. The eleven names include

1	**Aditya Birla Nuvo**
2	**Airtel M Commerce Services**
3	**Cholamandalam Distribution Services**
4	**Department of Posts**
5	**FINO PayTech**

6	**National Securities Depository**
7	**Reliance Industries**
8	**Dilip Shanghvi, (founder of Sun Pharmaceuticals)**
9	**Vijay Shekhar Sharma, (CEO of Paytm)**
10	**Tech Mahindra**
11	**Vodafone M-Pesa**

From the above entities some of them have already started the mobile wallet and payment system. For instance, both Airtel and Vodafone have fund transfer services. Airtel already partly undertakes the functions of a payments bank by offering fund transfer services under Airtel money that has over 1.7 million users. Vodafone too has a similar offering.

Reliance industries limited (RIL) has a tie-up with State Bank of India (SBI) for the payments bank roll-out. The partnership between India's largest commercial bank and largest corporate entity comes with huge promises and will be keenly watched.

The announcement and approval of 11 payment banks by the Reserve Bank of India (RBI) is expected to pave the way for financial inclusion through a combination of branches and digital platforms. It goes without saying that this step was very much needed more so because the large unbanked areas had to be covered and save the economically weaker sections from unscrupulous persons and chit fund scams. While the private sector banks may not be in any way affected because of their strong technology base, the small and medium public sector banks may feel an impact in the realm of deposit growth, specially in rural and semi-urban areas. Added to this is the huge pile of bad debts, which cannot be tackled effectively. This along with increasing costs, their profitability and ability to grow has been badly affected. While the private sector banks may not be in any way affected because of their strong technology base, the small and medium public sector banks may feel an impact in the realm of deposit growth, specially in rural and semi-urban areas. Added to this is the huge pile of bad debts, which cannot be tackled effectively. This along with increasing costs, their profitability and ability to grow has been badly affected.

The license for India Post will greatly help in spreading out to the villages with their huge network, spanning 139,000 post offices. It is expected that these have the wherewithal and capacity to do effective business in rural areas. Moreover, since payment banks are allowed to take deposits up to Rs 1 lakh, there would obviously be a tendency to shift the post offices from public sector banks. Thus, India post is expected to get huge customers in the not-too-distant future. The new banks may completely revolutionise the financial outlook in rural India. With strict screening procedures, small banks project would let serious players like Sahaj, having one of the largest IT connected rural networks; carry forth its benefits across the country.

According to the 2015 Brookings *Financial and Digital Inclusion Project* report, India ranks nine among 21 countries in financial and digital inclusion efforts - trailing after countries like Kenya, South Africa and Brazil. That means the country has a long way to go before its banking system successfully reaches most of the population. However, it is heartening to see the several measures that are being put in place to reach that target.

Features of the Payment banks:-

1) Payment banks will cater to migrant labour workforce, low income households, small businesses, other unorganized sector entities and other users.

2) Payments banks can take deposits. Deposits up to only Rs 1 lakh per person are allowed currently. They can issue ATM or debit cards.
3) Payments banks cannot give loans or issue credit cards.
4) Customers who do not have the means to maintain minimum balance will be welcomed into payments banks as revenue will be earned through transaction charges and not on the spread of interest between deposits and loans.
5) Payments banks can sell financial products like mutual fund units and insurance policies.
6) Money collected from depositors can be invested either in government bonds or can be deposited with other commercial banks.
7) The operations of the payment banks will be fully networked and technology driven from the beginning.
8) The payment banks will also have high-powered customer care cell to handle customer complaints.
9) The minimum paid-up equity capital for payments banks is Rs 100 crore. This means owners of payments banks have to put in a minimum of Rs 100 crore in return for equity in the company
10) Payment Banks will charge a fee as commission. This will be the sole earning for the banks.
11) Payment bank will also have to maintain CRR (Cash reserve ratio) just like other Scheduled commercial banks (SBI, PNB, BoB, Dena, ICICI etc).

Review of literature

The concept of payment bank is new so there is not any research paper regarding it. So I have read the articles of the prominent leaders from the newspapers and other social Medias.

Arun Jaitley,Finance Minister said that payment banks is an important step for the expansion of rural banking system ."Payment bank will ensure more money comes into banking system, Payments banks will change the banking habits of people, it will change the way they think, it will change the way they keep the money, where they keep their money, it will change the way they pay,"Using banks for all transactions, small and middle, will become a habit of the people. More and more outside of the regular economy will get into the economy. Payments banks will change banking habits in the country and act as a "game changer" for the economy.

Abhishek Bhattacharya SBI Chairperson, associate director at India Ratings & Research, a Fitch Group company. "The payments banks will offer the reach and the regular banks can offer their credit product through these additional channels, It is a good way to deepen financial inclusion in a country where mobile phone subscribers outnumber bank account holders,"

Arundhati Bhattacharya, Chairperson, SBI: "We are pleased to note that RBI has granted payments bank licence to Reliance Industries in which SBI has proposed a 30 per cent stake. This partnership brings together the combined strengths of two of India's Fortune 500 corporations committed to making a transformative impact on India's financial inclusion landscape. We see this licence as an opportunity to promote financial inclusion by providing banking and transaction services to unbanked, under-banked and small businesses."

Vijay Shekhar Sharma, Founder and CEO, Paytm: "This is indeed a great moment for us. We have managed to significantly reduce the cash usage in the economy. With this nod from the RBI we will be able to further drive our overall commitment to financial inclusion for the unbanked segment, modernise payment systems and build more trust for our services".

Shaswat Sharma says that "Payment banks will appoint their merchants and users would be able to pay them electronically. This means, you could soon be using your mobile to transfer funds to a retail store or at a restaurant. You could also be making payments to the milk man and domestic help through your mobile rather than going to the bank, withdrawing cash and then handing it over to them," he says. Services like paying utility bills, booking train tickets and fund transfers could see an improvement as banks will offer innovations.

Sunil Sood, Vodafone CEO. Said "The payment bank licence will enable us to build on this further and offer a more comprehensive portfolio of banking and financial products and services, accelerating India's journey into a cashless economy, We want to provide bank accounts to people in the villages, to bring them into the digital economy, to send money, buy goods and services, through the digital economy." The new payment banks will also make people less dependent on cash, even for small sums, and since a mobile wallet could be a bank account soon, this move could, over time, have a big impact on m-commerce. . they will help bring millions of unbanked citizens into the banking sector

Chanda Kochhar said the payments bank will play a complimentary role in the banking system and the universal banks like ICICI Bank stand to gain from their entry. "The entry of new players will enhance the financial ecosystem and will also make existing banks technology savvy and get them to come out with new products," she said. She said all the services which would be undertaken by the payments bank are already done by the universal banks

Dipak Gupta, Joint Managing Director, Kotak Mahindra Bank Limited said, "We are delighted that Airtel M Commerce Services Ltd., where we have agreed to invest 19.9%, has received in-principle approval from Reserve Bank of India for setting up a Payment Bank. Payment Banks will play a crucial role in fulfilling India's financial inclusion agenda, and have the potential to change the paradigms of retail banking especially in the payments space. They will also promote the habit of savings by driving cashless transactions. We are truly excited to participate in this opportunity."

Objectives of the study:-

1) To study the RBI draft guidelines for the payment banks in India.
2) To understand role of payment bank in financial inclusion in India.

Reserve Bank of India Draft Guidelines for Licensing of "Payments Banks"

The Reserve Bank of India (RBI) issues licences to entities to carry on the business of banking and other business in which banking companies may engage, as defined and described in Sections 5 (b) and 6 (1) (a) to (o) of the Banking Regulation Act, 1949, respectively. RBI came out with a set of guidelines for licensing of new banks in the private sector was in February 2013. The process of licensing culminated with the announcement by the RBI vide its Press Release dated April 2, 2014, that it would grant "in principle" approval to two applicants who would set up new banks in the private sector within a period of 18 months. While announcing the decision to grant "in-principle" approval to the two applicants, the RBI indicated in its above Press Release that going forward, RBI intends to use the learning experience from this licensing exercise to revise the guidelines appropriately and move to grant licences more regularly. Further, RBI would work on a policy of having various categories of "differentiated" bank licences which will allow a wider pool of entrants into banking. Similarly, the Committee on Comprehensive Financial Services for Small Businesses and Low Income Households (Chairman: Dr. Nachiket Mor) in its report released in January 2014 examined the issues relevant to an ubiquitous payments network and universal access to savings and recommended, inter alia, that given the difficulties being faced by the Pre-paid Payment Instruments Issuers (PPI issuers), and the underlying prudential concerns associated with this model, the existing and new PPI issuer applicants should instead be required to apply for a Payments Bank licence or become Business Correspondents (BCs).

Taking the above into account that there is a need for niche banking in India, and differentiated licensing could be a desirable step in this direction, the following guidelines are laid down for licensing of Payments Banks as differentiated or restricted banks. The guidelines for continuous authorisation of universal banks will be issued separately.

Guidelines of RBI for the setting of Payment Banks

1. Objectives

There is a need for transactions and savings accounts for the underserved in the population. Also remittances have both macro-economic benefits for the region receiving them as well as micro-economic benefits to the recipients. Higher transaction costs of making remittances diminish these benefits. Therefore, the primary objective of setting up of Payments Banks will be to further financial inclusion by providing (i) small savings accounts and (ii) payments /

remittance services to migrant labour workforce, low income households, small businesses, other unorganised sector entities and other users, by enabling high volume-low value transactions in deposits and payments / remittance services in a secured technology driven environment.

2. Registration, licensing and regulations

The Payments Bank will be registered as a public limited company under the Companies Act, 2013, and licensed under Section 22 of the Banking Regulation Act, 1949, with specific licensing conditions restricting its activities to acceptance of demand deposits and provision of payments and remittance services. It will be governed by the provisions of the Banking Regulation Act, 1949, Reserve Bank of India Act, 1934, Foreign Exchange Management Act, 1999, Payment and Settlement Systems Act, 2007, other relevant Statutes and Directives, Prudential Regulations and other Guidelines/Instructions issued by RBI and other regulators from time to time, including the regulations of SEBI regarding public issues and other guidelines applicable to listed banking companies.

3. Eligibility criteria

The existing non-bank PPI issuers authorised under the Payment and Settlement Systems Act, 2007 (PSS Act) and other entities such as Non-Banking Finance Companies (NBFCs), corporate BCs, mobile telephone companies, super-market chains, companies, real sector cooperatives and public sector entities may apply to set up a Payments Bank. Even banks can take equity stake in a Payments Bank to the extent permitted under Section 19 (2) of the Banking Regulation Act, 1949. The entities and their Promoters/ Promoter Groups as defined in the SEBI (Issue of Capital & Disclosure Requirements) Regulations, 2009 should be‘fit and proper’ in order to be eligible to promote Payments Banks. RBI would assess the ‘fit and proper’ status of the applicants on the basis of their past record of sound credentials and integrity; financial soundness and successful track record of at least 5 years in running their businesses.

4. Deployment of funds

The Payments Bank cannot undertake lending activities. Apart from amounts maintained as Cash Reserve Ratio (CRR) with RBI, minimum cash in hand and balances with a scheduled commercial bank/RBI required for operational activities and liquidity management, it will be required to invest all its monies in Government securities/Treasury Bills with maturity up to one year that are recognized by RBI as eligible securities for maintenance of Statutory Liquidity Ratio (SLR). The Payments Bank will participate in the payment and settlement system and will have access to the inter-bank uncollateralised call money market and the collateralised CBLO market for purposes of temporary liquidity management.

5. Capital requirement

Since the Payments Bank will not be allowed to assume any credit risk, and if its investments are held to maturity, such investments need not be marked to market and there may not be any need for capital for market risk. However, the Payments Bank will be exposed to operational risk. The Payments Bank will also be required to invest heavily in technological infrastructure for its operations. The capital will be utilised for creation of such fixed assets. Therefore, the minimum paid up voting equity capital of the Payments Bank shall be Rs. 100 crore. Any additional voting equity capital to be brought in will depend on the business plan of the promoters. Further, the Payments Bank should have a net worth of Rs 100 crore at all times.

6. Foreign shareholding

The foreign shareholding in the bank would be as per the extant FDI policy.

7. Voting rights and transfer/acquisition of shares

As per Section 12 (2) of the Banking Regulation Act, 1949, the voting rights in private sector banks are capped at 10 per cent, which can be raised to 26 per cent in a phased manner by the RBI. Further, as per Section 12B of the Act *ibid*, any acquisition of 5 per cent or more of voting equity shares in a private sector bank will require prior approval of RBI. This will also apply to the Payments Banks.

8. Prudential norms

As the Payments Bank will not have loans and advances in its portfolio, it will not be exposed to credit risk and, the prudential norms and regulations of RBI as applicable to loans and advances, will therefore, not apply to it. However, the Payments Bank will be exposed to operational risk and should establish a robust operational risk management system. Further, it may face liquidity risk, and therefore is required to follow RBI's guidelines on liquidity risk management, to the extent applicable.

9. Business plan

The applicants for Payments Bank licences will be required to furnish their business plans and project reports with their applications. The business plan will have to address how the bank proposes to achieve the objectives of setting up of Payments Banks. The business plan submitted by the applicant should be realistic and viable. Preference will be given to those

applicants who propose to set up Payments Banks with access points primarily in the under banked States / districts in the North-East, East and Central regions of the country. However, to be effective, the Payments Bank should ensure widespread network of access points particularly to remote areas, either through their own branch network or BCs or through networks provided by others. The bank is expected to adapt technological solutions to lower costs and extend its network. In case of deviation from the stated business plan after issue of licence, RBI may consider restricting the bank's expansion, effecting change in management and imposing other penal measures as may be necessary.

10. Corporate governance

- The Board of the Payments Bank should have a majority of independent Directors.
- The bank should comply with the corporate governance guidelines including 'fit and proper' criteria for Directors as issued by RBI from time to time.

11. Other conditions

- Entities other than the promoters will not be permitted to have shareholding in excess of 10 per cent of the voting equity capital of the bank.
- The Payments Bank shall operate in remote areas mostly through BCs and

other networks. Therefore, the requirement of opening at least 25 per cent of branches in unbanked rural centres (population up to 9,999 as per the latest census), is not stipulated for them. However, the Payments Bank will be required to have at least 25 per cent of access points in rural centres.

- The operations of the bank should be fully networked and technology driven from the beginning.
- The bank should have a high powered Customer Grievances Cell to handle customer complaints.
- The compliance of terms and conditions laid down by RBI is an essential condition of grant of licence. Any non-compliance will attract penal measure including cancellation of licence of the bank

Procedure for licensing

1) The applications will be initially screened by RBI to ensure *prima facie* eligibility of the applicants. RBI may apply additional criteria to determine the suitability of applications, in addition to the prescribed 'fit and proper' criteria.
2) Thereafter an Expert Advisory Committee (EAC) comprising eminent professionals like bankers, chartered accountants, finance professionals, etc. will evaluate the applications. The names of the professionals in EAC will be placed on RBI's website.
3) The External Advisory Committee will reserve the right to call for more information as well as have discussions with any applicant/s and seek clarification on any issue as may be required by it. The EAC will submit its recommendations to RBI for consideration. The decision to issue an in-principle approval for setting up of Payments Bank will be taken by RBI and RBI's decision in this regard will be final.
4) The validity of the in-principle approval issued by RBI will be one year from the date of granting such approval and would lapse automatically thereafter. The Payments Bank would therefore have to be set up within one year of grant of in-principle approval.
5) After issue of in-principle approval for setting up of Payments Bank, if any adverse features are noticed subsequently regarding the promoters or the companies/group entities with which the promoters are associated or have significant interest and control, the RBI may impose additional conditions and if warranted, may withdraw the in-principle approval.
6) In order to ensure transparency, the names of applicants for Payments Bank licences will be placed on the RBI website on receipt of the applications. The names of successful applicants will also be placed on the RBI website.
7) Banking being a highly leveraged business, licences shall be issued on a very selective basis to those who conform to the above requirements,

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who have an impeccable track record and who are likely to conform to the best standards of customer service and efficiency. Therefore, it may not be possible for RBI to issue licences to all the applicants meeting the eligibility criteria prescribed above. RBI will adopt a cautious approach in licensing Payments Banks in the initial years, and with experience gained, may suitably revise the approach.

Role of Payment Banks in financial inclusion in India

Regardless of the differences in product offerings, Payment banks will be able to provide a bank account that will allow the customer the following:

a) A bank account that is connected to the existing financial institutional and market infrastructure

b) A widespread network of locations where funds in such accounts can be conveniently accessed

Hence by enrolling savings account customers, Payment banks automatically further the cause of financial inclusion. By offering savings accounts, Payment banks are promising the customer cash withdrawals based on the pricing model that they adopt, the business model will need to be transaction based. As has been observed in mobile money deployments in other parts of the world, players often charge fees for withdrawals. Debit cards are offered in some cases but charges apply. At scale, the reach of Payment banks and their appetite to serve low-income customers are both expected to be superior to that of existing banks.

There are various reasons why payment banking will revolutionise money movement, the payment banks will change the way of the people think, the way they keep money and the way the pay.

First, and foremost, payment banks will bridge the last mile (or last 10-20 miles) between bank branches and the remote customer living in a rural hamlet. Payment banks will essentially rely on technology to reach payment services to all customers, using mobiles as the vehicle of banking. Mobiles go even where humans don't. Physical bank branches (or bankers or ATMs) will still be needed for some functions - opening an account, depositing cash, etc - but all day-to-day payments, including peer-to-peer payments) can be done remotely. The mobile phone will become the virtual ATM and small-payments cheque-book. In less than 10 years, every Indian will have a bank account. Payment banks are the key enablers.

Second, banking costs will come down due to intense competition driven by the expected proliferation of payment banks. Currently, we pay through our noses for banking services, whether it is above-limit ATM transactions, additional cheque-books, big money transfers, maintenance of minimum balances, or draft issuance fees. These costs will come down as payment banks start offering zero-balance accounts and low-cost services.

Third, the public sector banks are sitting ducks for bankruptcy and taxpayer bailouts if they do not change. Between then, efficient payment and private sector banks will take away their lucrative businesses and prized customers, as they will be both well capitalised and efficient. The government should privatise the weaker banks quickly if it is not to be stuck with feeding white elephants permanently. The weaker public sector banks are dead ducks.

Fourth, the arrival of payment banks - including India Post - will transform social welfare and subsidy schemes. Even if the Modi government does no other reform but this one, government subsidy payments to the poor - whether for LPG, kerosene or even food and fertiliser - can now be routed through regular and payment banks. India Post is already there in places where banks aren't there (with over 1.5 lakh post offices), and tomorrow Airtel and Vodafone and Idea (and Reliance Jio, when it enters mobile telephony later this year) will reach customers through mobile-enabled payment systems. The holy triad of Jan Dhan no-frills bank accounts, Aadhaar IDs and mobile banking will enable direct payments to the poor, eliminating fake recipients, ensuring cash in zero-balance accounts, etc. Inclusive banking and subsidy reforms are simply the biggest things to happen during the Modi government, even though the seeds for this were planted by earlier governments. The difference between State Bank and Airtel is simply this: both have over 200 million customers, but Airtel can go where State Bank cannot with a branch.

Fifth, mobile banking will create the conditions for cash-less banking. This means, over time, the mobile will perform the same role as credit and debit cards, obviating the need for too many cash payments. Even ATM expansion can now be slowed down in cities, and focused on distant villages or towns.

Sixth, we now have one additional tool to eliminate black money in large parts of the financial system. A government that wants to eliminate black money - which the Modi government says it wants to - can effectively ban cash transactions once a 95 percent mobile and Jan Dhan penetration rate is achieved. India is close to reaching a mobile user base of one billion, and Jan Dhan is said to have reached all households. The next target for Jan Dhan should be universal adult coverage through mobile, payment banking. It is achievable in five to 10 years, with some public and private investment in financial literacy education and empowerment of rural citizens, especially women.

Seventh, the government will be one of the biggest beneficiaries of payment banking, as payment banks will expand its access to cheap funds. Currently, banks are the major investors in government bonds. While this will remain so even with the entry of payment banks, the sheer impact of additional money coming into payment bank accounts which can only invest in short-term government bills of up to one year's maturity means short-term rates will come down, and the government can borrow more cheaply.

Eighth, bank depositors can expect to earn higher short-terms deposit rates from payment banks, and the old 4 percent savings bank norm will probably fade away.

After payment banks, the RBI will license “small banks”, which have to focus loans on small borrowers and not big corporates. Once this happens, non-bank finance companies will become "small banks" and make financial inclusion more complete from the small borrower's point of view. Between them, payments banks and small banks will make Indian banking more competitive and more inclusive on both the assets and liabilities sides – that is, for both depositors and borrowers. The era of the consumer is finally at hand.

Hence it is recommended that PB customers are encouraged to link their PB savings accounts with government benefit schemes in case that is their only formal institutional account. This would benefit the government, citizens, as well as invite transactions, benefiting the service provider. Presently it is not clear if there are incentives or fees that the government will provide participating banks for direct benefit transfers. The bulk of the cost incurred by banks and business correspondents in servicing benefit transfers is in cash management costs. In cases where an incentive is provided by the government agency disbursing the funds, it is usually linked to the cash withdrawal of the funds by the beneficiary. However, for transacting accounts, it is not feasible to distinguish credits or debits in an account that are a result of customer activity from those that are government payments. As such, most providers encourage the beneficiaries to use the accounts exclusively as a benefit transfers account to avoid reconciliation complexities that would deny provider commission receipts linked to such cash outs. This in turn results in low transaction activity as well as dormancy in such accounts. Regardless of any incentive payouts for servicing benefit payments, mandates requiring Payment banks to subsidize their pricing mechanism specifically to service benefit payment withdrawals or issue debit cards free of charge are likely to negatively impact the viability of PB business models or result in some other distortion.

Finally, given the recent positive momentum of the PMJDY program coupled with the fact that the licensing process for Payment banks has been finalized, there are concerns around what directed financial inclusion role the Payment banks will be able to play in the short-term, as the rollout of Payment banks is now expected to be in the later part of 2015.

Conclusion:

The recent guidelines on Small Finance Banks and Payment Banks are aimed at setting up institutions that will help in financial inclusion. These institutions shall provide the rural and unbanked population access to credit, wealth creation and contingency planning through lending and distribution of third party products such as mutual funds, insurance and pension products. Technology driven low cost model of payment and small finance banks overcome the challenge of high transaction cost faced by scheduled commercial banks in offering banking services in rural / unbanked areas. Further the regulation is a positive development for Non Banking Finance Companies (NBFCs), Micro finance institutions (MFIs) which already have operations in rural centres to convert into small finance banks. This would enable them to access low cost deposits to meet their funding needs and can prove to be a launching pad for becoming a universal bank. Also in the final guidelines, RBI has done away with geographical restriction, thus these entities can diversify risk arising from geographical concentration with the increase in size.

Overall, these guidelines are positive for the financial sector and can act as stepping stone for increasing the banking penetration.

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