Reserve Bank of India

Draft Guidelines for Licensing of "Payments Banks"

July 17, 2014

I. Preamble

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.

The last time when 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.

In this context, it may be mentioned that the Reserve Bank came out with a policy discussion paper on *Banking Structure in India – The Way Forward* on August 27, 2013. One of the observations in the discussion paper was that there is a need for niche banking in India, and differentiated licensing could be a desirable step in this direction, particularly for infrastructure financing, wholesale banking and retail 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).

In the Union budget 2014-2015 presented on July 10, 2014, the Hon'ble Finance Minister announced that:

> *"After making suitable changes to current framework, a structure will be put in place for continuous authorization of universal banks in the private sector in the current financial year. RBI will create a framework for licensing small banks and other differentiated banks. Differentiated banks serving niche interests, local area banks, payment banks etc. are contemplated to meet credit and remittance needs of small businesses, unorganized sector, low income households, farmers and migrant work force".*

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.

II. Guidelines

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. Scope of activities

The Payments Bank will be set up as a differentiated bank and shall confine its activities to further the objectives for which it is set up. Therefore, the Payments Bank would be permitted to undertake only certain restricted activities permitted to banks under the Banking Regulation Act, 1949, as given below:

i. Acceptance of demand deposits, i.e., current deposits, and savings bank deposits. The eligible deposits mobilised by the Payments Bank would be covered under the deposit insurance scheme of the Deposit Insurance and Credit Guarantee Corporation of India (DICGC). Given that their primary role is to provide payments and remittance services and demand deposit products to small businesses and low-income households, Payments Banks will initially be restricted to holding a maximum balance of Rs. 100,000 per customer. After the performance of the Payments Bank is gauged by the RBI, the maximum balance can be raised. If the transactions in the accounts conform to the "small accounts"[1] transactions, simplified KYC/AML/CFT norms will be applicable to such accounts as defined under the Rules framed under the Prevention of Money-laundering Act, 2002.
ii. Payments and remittance services through various channels including branches, BCs and mobile banking. The payments / remittance services would include acceptance of funds at one end through various channels including branches and BCs and payments of cash at the other end, through branches, BCs, and Automated Teller Machines (ATMs). Cash-out can also be permitted at Point-of-Sale terminal locations as per extant instructions issued under the PSS Act. In the case of walk-in customers, the bank should follow the extant KYC guidelines issued by the RBI.
iii. Issuance of PPIs as per instructions issued from time to time under the PSS Act.
iv. Internet banking - The RBI is also open to applicants transacting primarily using the Internet. The Payments Bank is expected to leverage technology to offer low cost banking solutions. Such a bank should ensure that it has all enabling systems in place including business partners, third party service providers and risk managements systems and controls to enable offering transactional services on the internet. While offering such services, the Payments Bank will be required to comply with RBI instructions on information security, electronic banking, technology risk management and cyber frauds.
v. Functioning as Business Correspondent (BC) of other banks – A Payments Bank may choose to become a BC of another bank for credit and other services which it cannot offer.

The Payments Bank cannot set up subsidiaries to undertake non-banking financial services activities. The other financial and non-financial services activities of the promoters, if any, should be kept distinctly ring-fenced and not comingled with the banking and financial services business of the Payments Bank.

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[1] In terms of Rule 2 clause (fb) of the Prevention of Money-laundering (Maintenance of Records of the Nature and Value of Transactions, the Procedure and Manner of Maintaining and Time for Furnishing Information and Verification and Maintenance of Records of the Identity of the Clients of the Banking Companies, Financial Institutions and Intermediaries) Rules, 2005 (Notification No. 14/2010/F.No.6/2/2007-E.S dated December 16, 2010) 'small account' means a savings account in a banking company where:

i. the aggregate of all credits in a financial year does not exceed rupees one lakh;
ii. the aggregate of all withdrawals and transfers in a month does not exceed rupees ten thousand; and
iii. the balance at any point of time does not exceed rupees fifty thousand.

The Payments Bank will be required to use the word “Payments” in its name in order to differentiate it from other banks.

5. 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.

6. 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. The Payments Bank shall be required to maintain a minimum capital adequacy ratio of 15 per cent of its risk weighted assets (RWA) on a continuous basis, subject to any higher percentage as may be prescribed by RBI from time to time. However, as Payments Banks are not expected to deal with sophisticated products, the capital adequacy ratio will be computed under simplified Basel I standards.

As the Payments Bank will have almost zero or negligible risk weighted assets, its compliance with a minimum capital adequacy ratio of 15 per cent would not reflect the true risk. Therefore, as a backstop measure, the Payments Bank should have a leverage ratio of not less than 5 per cent, i.e., its outside liabilities should not exceed 20 times its net-worth / paid-up capital and reserves.

7. Promoter’s contribution

The promoter’s minimum initial contribution to the paid up voting equity capital of Payments Bank shall be at least 40 per cent which shall be locked in for a period of five years from the date of commencement of business of the bank. Shareholding by promoters in the bank in excess of 40 per cent shall be brought down to 40 per cent within three years from the date of commencement of business of the bank. Further, the promoter’s stake should be brought down to 30 per cent of the paid-up voting equity capital of the bank within a period of 10 years, and to 26 per cent within 12 years from the date of commencement of business of the bank. Proposals having diversified shareholding and a time frame for listing will be preferred.

8. Foreign shareholding

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

9. 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.

10. 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.

11. 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.

12. Corporate governance

i. The Board of the Payments Bank should have a majority of independent Directors.

ii. The bank should comply with the corporate governance guidelines including 'fit and proper' criteria for Directors as issued by RBI from time to time.

13. Other conditions

i. 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.

ii. 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.

iii. The operations of the bank should be fully networked and technology driven from the beginning.

iv. The bank should have a high powered Customer Grievances Cell to handle customer complaints.

v. The compliance of terms and conditions laid down by RBI is an essential condition of grant of licence. Any non-compliance will attract penal measures including cancellation of licence of the bank.

14. Procedure for application

In terms of Rule 11 of the Banking Regulation (Companies) Rules, 1949, applications shall be submitted in the prescribed form (Form III). In addition, the applicants should furnish the requisite information in support of the business plan, shareholding pattern in the proposed bank, financial statements, income tax returns and credit reports for the last three years, names and addresses of banks from which credit facilities have been availed, etc. Applications for setting up of Payments Banks, along with other details as mentioned above, should be addressed to:

The Principal Chief General Manager
Department of Banking Operations and Development
Reserve Bank of India
Central Office, 13th Floor, Central Office Building
Shahid Bhagat Singh Marg
Mumbai -400001

Applications for Payments Bank will be received at the above address till the close of business hours as on -----------. After experience gained in dealing with the Payments Banks, applications will be received on a continuous basis. However, these guidelines are subject to periodic review and revision.

15. Procedure for licensing

i. 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.

ii. 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.

iii. 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.

iv. 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.

v. 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.

vi. 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.

vii. Banking being a highly leveraged business, licences shall be issued on a very selective basis to those who conform to the above requirements, 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.
