*Retail Payments at Crossroads: Economics, Strategies and Future Policies**

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I am deeply honoured to be here and thank the European Central Bank and Banque de France for inviting me as a member of this important panel. I have been asked to specifically comment on three aspects of the topic we are discussing and let me attempt that in seriatim.

I. How can financial intermediaries and financial inclusion contribute to the economic growth of the country?

1. As Global Payments 2013[1] report points out, we are facing a "two speed world" as far as payments activities are concerned – one in mature economies and the other in emerging or rapidly developing economies. This calls for two different approaches for the two types of economies.

2. Developed economies have already reached a level of market maturity in terms of retail payments and are looking for the next generation of efficiencies in these systems by re-discovering their relevance in the society. However, in the case of emerging markets, retail payments have been on the policy radar as we try and get away from cash based and paper based payments. Hence we continue to 're-dedicate' on its development rather than 're-discover' its importance. Our challenge has been to enable such systems to 'develop', 'consolidate' and 'converge' with innovation at each stage.

3. So in India we have continued to focus on both paper based and electronic payment systems. But realising the rapid scale of innovations and for focus we decided to encourage the formation of a separate organisation – a non-profit organisation called the NPCI (National Payments Corporation of India) as the umbrella organisation for retail payment systems in India. This entity is now spear-heading the innovations in retail payments in India and has introduced several products and payment services such as the inter-operable inter-bank mobile payments with 24 x 7 real-time transfer of funds (IMPS – Immediate Payment Systems), payments based on Aadhaar (Unique national id based on biometrics), a domestic card network – RuPay which is being used for various purposes *viz.*, ,enhancing financial inclusion, food procurement, farmer credit, *etc.* Besides, NPCI has also enabled ISO compatible National Automated Clearing House (NACH) systems.

4. It is a well-accepted fact that a well-functioning payment system contributes to monetary and financial stability and ensures economic efficiency. How do you define the term "well-functioning"? In the emerging market context, such a system must ensure users' trust in these payment methods similar to the trust they have in cash transactions. There is always the "fear of unknown". One bad experience in the beginning can make them rush back to cash usage. This is even a bigger challenge particularly when we are reaching out to the financially excluded to adopt electronic payments.

5. It must be appreciated that financial inclusion (FI) has been accorded high priority in policy hierarchy in recent times as the advent of technology has enabled increased reach and delivery of financial products in a cost effective and viable manner. So more appropriately what is being aimed is technology led financial inclusion. Business correspondents (BCs) play an important role in this effort since the lack of penetration of brick and mortar bank branches could be attributed to financial exclusion. Different countries have adopted different models but in any model business correspondents are important entities in the chain. Further, alternate payment models are the hallmark of the FI efforts across the countries.

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* A summary of remarks by Shri G. Padmanabhan, Executive Director of the Reserve Bank of India, during the Panel discussion at the Joint European Central Bank/Banque de France Conference, Paris, 21 October 2013.

[1] BCG-SWIFT "Global Payments 2013- Getting Business Models Execution Right", September 2013

6. In this regard, various studies[2] have shown that customers who have quick and reliable access to payment points and customers who use alternate non-cash payment methods tend to keep more funds in their accounts for larger periods of time. Therefore, provision of safe, accessible and efficient alternate payment channels assumes critical importance. This is crucial for the banking systems in India when the savings and loan spreads are high. So financial inclusion makes huge commercial sense. In fact, the CGAP report[3] also highlights the beneficial impact of financial inclusion through increased deposit and lending to GDP ratios on national income.

7. As I have said earlier, different countries have adopted different models to achieve financial inclusion. For example, Pakistan has put in place a mechanism of person-to-person funds transfer through the banking system using BCs without the need for opening accounts; customer identification being based on national identity as well as mobile number. In India while BCs play an important role, financial inclusion aims not merely at remittances but also aims at savings product, a loan/credit product, remittance product as also insurance product. Further, the basis for a remittance product outside banking systems pre-supposes the existence of a national identity system in the country.

8. A few words about Indian approach to FI. We have always been alive to the need for extending the reach of the financial sector to the under-privileged sections of the society. Financial inclusion for us aims not merely at remittances but also aims at savings product, a loan/credit product, remittance product as also insurance product. Thus, in India we believe that financial inclusion has the potential to bring in the unbanked masses into the formal banking system, could lead to increased savings, provide timely credit to the unbanked masses and all these positive externalities would lead to economic growth. The efforts to channelise the Government benefits and subsidies through direct benefit transfers programs to beneficiaries' bank accounts directly would not only be helpful in plugging the leaks in distribution but also help in inculcating banking habits.

9. How has India approached FI? We have adopted a structured, planned and an integrated approach towards FI by focusing on both the demand and supply side constraints. We have permitted non-bank entities to partner with banks for their FI initiatives. The technological advancement has made it possible for us to think of novel and innovative ways to approach the objective of financial inclusion. For example, handheld devices, used by bank agents to draw people living in remote areas into the banking fold. Mobile technologies are trying to reach out to the populace starved of banking services as well. Financial institutions are also joining forces with network operators in providing access to mobile based payment services even to those who do not have bank accounts.

10. Let me give you some statistics on our financial inclusion initiatives[4]:

- Nearly 268,000 banking outlets have been set up in villages March 2013 as against 67,694 banking outlets in villages in March 2010.
- About 7,400 rural branches opened during this period.
- Nearly 109 million Basic Savings Bank Deposit Accounts (BSBDAs) have been added, taking the total no. of BSBDAs to 182 million. Share of ICT based accounts have increased substantially – Percentage of ICT accounts to total BSBDAs has increased from 25 per cent in March 2010 to 45 per cent in March 2013.

[2] BCG-SWIFT "Global Payments 2013- Getting Business Models Execution Right", September 2013; and Bill & Milinda Gates Foundation "Fighting poverty profitably- Transforming the economics of payments to build sustainable, inclusive financial systems", September 2013.

[3] CGAP "Financial Access 2012", July 2013.

[4] "Financial inclusion in India – journey so far and way forward"- Speech by Dr. K. C. Chakrabarty, Deputy Governor of the Reserve Bank of India, at the Finance Inclusion Conclave, organised by CNBC TV 18, New Delhi, 6 September 2013.

- With the addition of nearly 9.48 million farm sector households during this period, 33.8 million households have been provided with small entrepreneurial credit as at the end of March 2013.
- With the addition of nearly 2.25 million non-farm sector households during this period, 3.6 million households have been provided with small entrepreneurial credit as at the end of March 2013.
- About 490 million transactions have been carried out in ICT based accounts through BCs during the three year period.

II. The relevance of international standards and principles for stretching a retail payment services beyond domestic boundaries

11. It is my considered opinion that the international community for too long has not accorded adequate importance to the retail payment system. I agree that reasons could be many and relevant. For instance, retail payment systems are far too heterogeneous. However, the growing importance of retail payments, the increased complexities and technology driven payment systems call for a revisit. Further, there are some retail payment systems in most countries which are ubiquitous in nature and have system-wide importance. At least in a large country like India we are talking about retail payment systems which are quite significant. Let me state a few numbers. We clear on a daily basis approximately 4.5 million cheques, operate nearly 2 million person to person electronic fund transfers, handle around 1.5 million bulk payments *i.e.*, one-to-many and many-to-one payments. These are in addition to the large volume of card payments, internet and mobile transactions. We will be certainly better off having some principles and standards developed for the retail payment systems. Let me bring out a few issues to support my argument for international standards for retail payment systems.

12. There are retail systems that have cross-jurisdictional presence. For instance, card payments, international remittances, PayPal *etc.*

13. In the case of card payments, it is generally the leading global card networks which are taking the lead in determining the industry standards for form factor as well as security standards (EMV Chip; 2FA), without active regulatory intervention. However, such standards have implications for countries – in terms of cost of migration to newer standards, impact on domestic card networks (cost of certification, access to new standards/ technology *etc.*). Should the regulators be involved in standard setting so that there is a level playing field for both international and domestic entities?

14. For large value payment systems, regulatory arbitrage is sought to be addressed through international common standards and principles. How can similar concerns be addressed for retail systems with system-wide importance as the extant standards are either region-specific or country-specific? One area where there is ample scope for common standards is the areas of security in electronic payments. For instance, taking card payments once again, while on the one hand Europe has the EMV standard already implemented, USA is still continuing with Magstripe. So where does this leave other emerging countries such as India? We are striving to move towards EMV but are aware that Magstripe cards will be around for some time. Though we have strengthened our card transactions domestically using 2FA with Magstripe cards, there are still jurisdictions where magstripe is still in vogue but without 2FA requirements. Hence, such arbitrage opportunities need to be addressed by adopting minimum common security standards.

15. Despite several efforts at addressing the issues relating to international remittances (for instance, the World Bank has prescribed certain guidelines), challenges pertaining to reducing the cost of remittance and addressing the AML/FATF issues (lack of standards, legal and regulatory requirements between remitting and receiving countries is being exploited) continue to persist. Since it is a recognised fact that international remittances form a significant channel for cross-border payments, and form major part of GDP of few countries, the need for common standards and principles in this area would also be welcome.

16. The lack of international standards in retail payments could also affect the inter-operability between these systems – both at a domestic level as well as at international level. At a domestic level, currently in India, we are facing a challenge in promoting interoperability amongst the non-bank and bank operated payment systems. While considering the access of non-banks to inter-bank payment network, the challenges that need to be addressed are in terms of lack of standardisation of form factors, message formats, non-adoption of international standards for card security such as PCI-DSS *etc.*

17. At the same time, in India, we have also seen the advantages that standardisation can bring in, for facilitating inter-operability and contributing to the growth of certain payment systems. Right at the outset, the mobile banking guidelines issued in India prescribed certain standards for mobile banking message formats to ensure inter-operability in transactions. Going forward, the NPCI implemented the IMPS for mobile banking facilitating inter-operable mobile banking transactions in the country. This has given a very good impetus to instant funds transfer on 24x7 basis using mobile banking.

18. So, clearly there is a case for developing international standards and principles for cross border payment systems at the minimum. But the issue would be how to enforce such standards.

19. Then the issues related to home country and host country regulatory prescriptions also need to be addressed, with minimal scope for regulatory arbitrage. The final thought I have on this issue is besides international standards and principles, has the time come for "co-operative oversight" for internationally pervasive retail payment infrastructures?

III. What are the key considerations to be followed while innovating retail payment systems?

20. The first thought that comes to my mind when I consider this question, the remarkable foresight of the ECB in coming out with the document on minimum safety recommendations to improve online payment security to be implemented by 2015. I also want to acknowledge the seminal guidelines issued by the ECB on data quality. Both are outstanding documents.

21. To me, the thumb rule for any central bank has to be encouragement of innovations. But before innovations become a "product" of system wide importance, standards need to be put in place. Otherwise, there would be bigger issues to reckon with. (*e.g.,* cloud computing in the financial sector, rules for payment gateways, security standards for mobile banking or enabling NFC based payment instruments are some of the examples that come to my mind.) But be conscious that what is good for goose may not be good for the gander (mature systems *vs.* emerging systems).

22. The need and focus of innovations may vary significantly among countries – between countries with developed/mature payment systems and those where payment systems are evolving.

23. While safety and security are underpinnings of any innovation, in emerging payment system jurisdictions, the key consideration for innovations may revolve around accessibility, availability, affordability *etc.,* whereas in mature/developed payments market, the focus may have shifted towards convergence of payment channels and real-time payments.

24. Another important issue that is emerging in the innovations context, relates to legal and oversight issues of the innovative payment services. Two examples come to mind: (a) virtual currencies and (b) access to customer accounts by third party service providers.

25. When innovations take place outside the banking domain, *i.e.*, entry of non-banks in offering these services – raises certain issues: access to National Payment Systems by non-banks, extent of regulation, customer ownership and protection issues, data privacy and security.