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### New Arena in Banking Sector – Payment Banks in India



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ARTICLE INFO	ABSTRACT
<p><b>Received:</b> 12-04-2023 <b>Received in revised form:</b> 08-05-2023 <b>Accepted:</b> 10-05-2023 <b>Available online:</b> 30-06-2023</p> <hr/> <p><b>Keywords:</b> Digital Payment; Financial Inclusion; Payment Banks; Reserve Bank of India.</p>	<p>After a long period, the concept of “financial inclusion” was finally recognised in India’s banking industry. The goal of RBI has always been to include unbanked regions in normal banking operations by covering small villages and low-income households. Digital payments after the COVID-19 pandemic have increased banking operations in rural areas. Pradhan Mantri Jan Dhan Yojna also helped increase the number of bank accounts in rural areas, but many accounts are still inaccessible. A recent report by the World Bank found that 21% of Indians still do not have bank accounts. So, RBI has developed differentiated banking called Payment Banks to reach the rural population. The present paper discusses the concept of payment banks, their inception and the role of payment banks in India. For the study purpose, secondary data was collected from various sources.</p>
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#### 1.0 INTRODUCTION

Since 1991, the Indian economic system has undergone a remarkable fitness transformation. The banking industry, which is one of the best performing, and the performance of the banks may be linked to important financial reforms and efforts implemented by the RBI. Because of this, advances in technology have been possible throughout time. The Reserve Bank of India (RBI) expanded the Indian banking industry in 2014 by establishing two new types of institutions: payment banks and small finance banks. The primary goal of establishing these banks was to provide banking services to the underserved and unbanked people in rural areas. In order to boost the country's economy and broaden Indians' access to financial services, the Reserve Bank of India and the Government have launched several programmes. Special consideration has been given to the people in rural regions, those on low incomes, migratory labour, and small-scale businesses. Several programs have been introduced, including the “Pradhan Mantri Jan Dhan Yojana, the Digital India Campaign, the introduction of electronic cash transfer systems like NEFT in RTGS, and the promotion of mobile payments using e-wallets.” The Reserve Bank of India has promoted the idea that payment banks play

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a crucial role in expanding access to banking services for low-income groups and small businesses in India's rural regions.

### 1.1 Statement of Problem

With the economy being severely hit by the COVID-19 pandemic, the financial outlook of the digital payments sector is expected to be abundant since the physical movement of people seems to be less in that period, and digital payments have increased. Being a convenient, time-saving, hassle-free digitalized payment system, RBI has developed the concept of differentiated banking, namely Payments bank, to analyse further progress in the financial inclusion target digitally. Hence, we need to understand the role and performance of payment banks in our country.

### 1.2 Objectives of the Study

- To understand the concept of payment banks
- To know the importance of initiation of payment banks
- To understand the role of payment banks in financial inclusion

### 1.3 Concept of Payment Banks

The purpose of establishing payment institutions was to conduct business on a smaller scale and with minimal credit risk. The Nachiket Mor committee, whose chairman is Nachiket Mor, recommended the establishment of these banks. The major objective of the banking sector is to expand the availability of banking services and products for the underbanked and unbanked and to aid low-income families, new enterprises, and other groups in these communities. The Companies Act of 2013 governs payment banks. Still, they are additionally registered under the “Banking Regulation Act of 1949, the Reserve Bank of India Act of 1934, the Foreign Exchange Management Act of 1999, and the Payment and Settlement Systems Act of 2007”. The payment banks originally consisted of 11 banks. Right now, only six payment banks are operating. These are “Airtel Payment Bank, India Post Payment Bank, FINO Payment Bank, Paytm Payment Bank, NSDL Payment Bank and Jio Payment Bank.”

### 1.4 Features of Payment Banks

The special characteristics of payment banks are mentioned below:

1. Payment banks differ from universal banks in several ways.
2. Payment Bank is required to have a minimum paid-in capital of ₹100 crores.
3. These payment banks run on a more compact scale.
4. For the first five years after the start of its operations, the promoters must contribute at least 40% of the paid-up capital to the payment bank.
5. Demand deposits in savings and current accounts of up to ₹100000 can be made by customers at Payment Banks. Customers' deposits in this amount can only be used to purchase government securities up to 75% of the time following the balance of their demand deposits; the remaining 25% must be deposited with other commercial banks as time deposits.
6. Payment banks can receive cross-border transfers on current accounts and make personal payments.

7. Payment banks cannot make loans because they hold a different licence.
8. Payment banks cannot issue credit cards.
9. Payment banks do not accept time deposits and NRI deposits.
10. Establishing subsidiaries to carry out non-banking financial activities.

### 1.5 Details of Payment Banks

In March 2017, Bharti Airtel established India's first payment bank under the name Airtel Payment Banks. "Paytm payment bank, Indian Post Payment Banks, Fino Payment Bank and Aditya Birla Payment Banks" have also launched their services.

The Reserve Bank of India (RBI) granted provisional approval to the following 11 Payments Banks out of 41 applications.

- Aditya Birla Nuvo Limited
- Airtel M Commerce Services Limited
- Cholamandalam Distribution Services Limited
- India Department of Posts
- Fino Pay Tech Limited
- National Securities Depository Limited
- Reliance Industries Limited
- Shri Dilip Shantilal Shanghvi
- Paytm Payments Bank Limited
- Tech Mahindra Limited
- Vodafone m-pesa Limited

At present, below listed six Payments Banks are in operation:

1. Airtel Payments Bank
2. Fino Payments Bank
3. India Post Payments Bank
4. Paytm Payments Bank
5. NSDL Payments Bank
6. Jio Payments Bank

### 1.6 Advantages of Payment Banks

1. It helps in the expansion of rural banking and financial inclusion.
2. Payment banks also expense the formal financial system.
3. Commercial banks have a viable alternative in the form of banks.
4. Payment banks can efficiently deal with low-value, high-volume transactions.
5. Payment Banks can issue ATM cards or Debit cards to enable them to operate via online banking and mobile banking.

### 1.7 Challenges Faced by Payment Banks

1. As most of the transactions are done online, people face technological hurdles in rural areas.

2. There is a lack of awareness among the masses to benefit from these services.
3. Need more facilities and resources for running a business.
4. Lack of additional incentives for agents to encourage themselves to promote such activity.

### **1.8 Need and Importance of Payment Banks**

The Indian Government has defined specific regulations and restrictions for the banking and non-banking financial sectors, and it also provides differentiated licenses to small-scale banks. All this was done to redefine the Indian economy and provide a secure gateway for online transactions. These transactions will be easily accessible and time-efficient. It will also cover a large chunk of the population, which previously remained left out through traditional banking methods. However, despite these options, the introduction of payment banks was imperative.

Payments banks are banks involving no credit risk. This means they cannot perform lending services but can accept deposits, facilitate remittances and provide a debit card facility. A payment is categorised as a 'Scheduled Bank', but businesses must integrate the term 'payments bank' in their names. This is done to make distinguishing it from traditional banks easy. Since Independence, the development of the Indian financial sector and the role of banks has been the chief objective of policymakers in India.

Further, in the 1990s, the general picture of financial inclusivity was abysmal. The 1991 crisis made it clear that the banking sector was in disarray with no signs of achieving financial inclusivity on a large scale. In 1991, the Government started the process of liberalization, which focused on restoring the financial well-being of banks. This process was introduced based on the suggestions from two expert committees working under the chairmanship of M Narasimham in the years 1991 and 1998. The committees focused on efficiency, greater autonomy to public banks, bad loan issue resolution, the introduction of global banks in Indian markets, adjustment of liquidity to encourage borrowing from RBI through buyback agreements and monetary policy instrument introduction. These changes led to institutions of cheap credit avenues and a boom in the formal financial sector. In the early 2000s, the focal area shifted to financial inclusion. Former RBI Governor Y V Reddy mentioned the phrase 'financial inclusion' for the first time in 2005 while delivering the annual policy statement.

In 2005, the Khan Committee, constituted by the RBI, declared that banks could now open 'no frills' accounts. These accounts were zero-balance or low-balance accounts. The Rangarajan Committee report followed this. This committee was constituted to examine the financial inclusion state in India under the chairmanship of a former RBI governor C. Rangarajan. This committee stated that people experiencing poverty were excluded from the formal financial sector. Under the chairmanship of the future RBI governor Raghuram Rajan, the Rajan Committee suggested comprehensive reforms for deepening the financial sector to make it more inclusive. For instance, it suggested making an all-service sector that could protect insurance policies, savings accounts, payment services, credit, and pension schemes from inflation.

The committee also pushed for a change to reach the financial inclusion goals. It preferred to overburden public sector banks with these goals using small-scale private banks.

The Mor Committee report elaborated on this recommendation by introducing 'payments banks' as a part of Vertically Differentiated Banking Systems (VDDBS). The committee believed there should be regulatory flexibility concerning payments, credit, and deposits. This would ensure good efficiency and low operating costs. In this regard, it cited the South Korean Post Office Bank as an

example of VDBS, which accepted only payments and deposits, GE Capital with only credit and payment facilities and the MasterCard Visa with only payment service. Before the VDBS recommendation, there had been attempts to create small-scale banks within the sector to achieve 'last-mile connectivity'. For instance, these banks include agricultural societies, local area banks, urban cooperative banks, and rural and regional banks.

Furthermore, digital wallets or Prepaid Instrument Providers (PPI) that work as quasi-banking organisations were a precedent to the Mor Committee report. This was because, since 2010, the PPIs have provided a crucial extension of low-operating cost services for individuals. However, PPIs mandate 'Know Your Customer' (KYC), for which the norms are lax, leading to security breaches. Other issues with PPIs include lack of interest payment on balances and possible contagion risk leading to massive security issues. All these issues paved the way for the recommendation of payment banks by the Mor Committee.

### **1.9 Role of Payment Banks in Financial Inclusion**

Financial inclusion aims to transform banking services by giving low-income groups a place to save their lifetime earnings. Without such a platform, the income of the disadvantaged group, which includes wage employees in both urban and rural areas, is frequently kept as gold or is utilised for excessive spending. With these barriers to economic progress and prosperity in mind, creating payment banks were viewed as a way to get around them.

Payment Banks are a unique type of bank that can provide specific services to their clients, including sending and receiving payments. These banks largely set themselves apart from Differentiated banks by not being permitted to provide lending services in the form of making loans or distributing credit cards. Payment banks have been essential to developing financial inclusion, which supports promoting accessible financial services to underprivileged and low-income groups.

Payment Banks utilise the Mobile Platform to facilitate financial dealings between several individuals. They were established to facilitate economic growth by providing banking services to underserved areas. Payments banks will be accessible when physical penetration is difficult compared to specialty banks, and their availability will probably lead to a reduction in the price of banking services. By fostering financial inclusion, they have evolved into a tool for reaching out to hitherto unbanked regions and bringing them into the fold of established financial systems.

Banking and telecommunications companies have joined together to form Payment Banks. Payment banks that function via mobile phones is best suited for such a circumstance since rural and remote regions need more infrastructure for the institutional expansion of banks and finance systems. These banks will probably help the underprivileged groups conduct transactions electronically, eliminating the need for intermediaries and facilitating organised money nationwide. It was suggested that Payment Banks be established in order to ensure Financial Inclusivity. As a first step, it allows people from low-income backgrounds to start a bank account and deposit their earnings. Second, to encourage entrepreneurship by making transactions and payments for small enterprises easier. For instance, to pay migrant workers' wages and to defray the cost of raw materials. Payment Banks will enable the illiterate to do all financial transactions, such as paying bills, transferring money to others, making deposits, and so forth, in one location. They will give users the ability to complete end-to-end transactions. Payment banks would also make sending money to far-off places easier, which will help the migrant workers. The youth have also been drawn to payment banks since they operate through mobile phones because transactions can be completed with just a click.

To make a long tale short, the RBI's Committee on Comprehensive Financial Services and Low-Income Households' idea of Payment Banks, which encourages greater participation of underprivileged groups in mainstream financial services, has been a significant step towards ensuring financial inclusion.

## 2.0 SUGGESTIONS

Here are some suggestions to make payments banks more accessible, sustainable and efficient in the banking sector.

- The Government should collaborate with these banks to organise awareness campaigns in areas/regions with less financial literacy. This will make people more aware of the benefits of the financial services offered by the regulated banking sector.
- Something like payment banks needs steady and cheap internet access. So, the Government should make provisions for internet access to the people in rural areas.
- The Government could draft separate legislation to streamline the governance of payments banks in India. However, the legislation should be technologically unbiased and centered on payment activities.
- The legislation should be clear and adaptive to emerging services and products.
- The legislation should also offer a risk-based framework for incorporation in the payments banks to different activities based on their risk.
- The existing Payment and Settlement Systems Act should be amended to accommodate and regulate all the services currently offered by the payment Banks.

## 3.0 CONCLUSION

The advent of payment banks in the Indian banking sector has been a striking step. The issue of financial inclusion in a country with a low overall literacy rate could only be solved with something so radical. Financial inclusion and literacy are crucial to forming and developing a digital ecosystem. In addition, these banks have helped the Government immensely in implementing government welfare schemes, transfer schemes and subsidies in various sectors. These schemes and subsidies are now directly paid to the beneficiaries' accounts rather than a physical payment.

Moreover, such competition will expand banking services' quality and reduce service costs. Currently, the banking sector's payments banks can be called game-changers due to their user-friendly app-based platform and attractive services. Plus, they are a gateway for low-income and middle-income groups to access banking services in a more accessible form. Although it's too early to judge the competency of payments banks, the effects till now are positive. They are becoming popular amongst the youth as a model of digital transactions, bill payment and recharging.

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