RBI Guidelines for Licensing of Payments Bank
Opportunities and Challenges

December 2014

Contents

Introduction

Overview of Payments Bank License

- In September 2013, the RBI constituted a committee to study 'Comprehensive financial services for small businesses and low income households' headed by Dr. Nachiket Mor. The focus of the committee was to recommend innovative solutions to the RBI to accelerate financial inclusion in unbanked and under-banked sections of the society in sustainable and cost effective way
- The committee submitted its report to the RBI report in January 2014. One of the key recommendations of the committee was to introduce specialized banks ('Payments Bank') to cater to the lower income groups and small businesses. The report also provided high level criteria to assess 'Fit and Proper' status of the Payments bank license aspirants
- The draft guidelines for setting up Payments Bank were issued by the RBI in July 2014, and comments were sought from various participants by August 2014. Finally, the RBI has released the final guidelines for licensing of Payments Bank on November 27, 2014 keeping the application submission deadline as January 16, 2015

Likely considerations of the RBI for issuing Payments Bank license

Financially Inclusive and Sound Business Model	• Through the issue of Payments bank license, the RBI wishes to further its goal of broader financial inclusion • Applicants for Payments Bank licenses will be required to forward their business plan for a Payments Bank along with their applications addressing how the bank proposes to achieve financial inclusion • Further, a Payments Bank will only provide deposit and payment products and not the credit products. As a result, the applicants may need to convince the RBI about financial viability of the venture
Adequate Capital Structure	• As a Payments Bank does not assume any credit risk, the RBI has prescribed the minimum capital requirement of Rs. 100 crore for a Payments Bank (lower than that for universal bank license which was pegged at Rs. 500 crore) • The RBI is likely to prefer applicants with strong capital base since 'financially sound' applicant may be better positioned to sustain the 'financial inclusion' agenda
Strong management track record	• The RBI will evaluate: – the 'fit and proper' status of the promoter/ promoter groups as well as the board of directors and look for a sound track record of running businesses for at least a period of 5 years – the credentials, integrity and track record of the promoter/ promoter groups for awarding a Payments Bank license – the corporate governance practices followed, the board composition, and the level of ring fencing of the Payments Bank from other promoter group companies

Executive Summary (1/2)

The guidelines aim at creating a banking entity which is adequately capitalized, financially inclusive and has a competitive business model

The key **objective of setting up a Payments Bank** is to further the cause of financial inclusion by widening the spread of payment services and deposit products to small businesses, low-income households, migrant labour workforce, and other unorganized entities by enabling high volume-low value transactions in deposits and payments/ remittance services in a secured technology-driven environment

The **entities eligible to set up a Payments Bank** include existing non-bank pre-paid instrument issuers, and other entities such as individuals/ professionals; non-banking finance companies, corporate BCs, mobile telephone companies, super-market chains, companies, real sector cooperatives; that are owned and controlled by residents; and public sector entities. A promoter/ promoter group can have a JV with an existing scheduled commercial bank to set up a Payments Bank

A Payments Bank can **accept demand deposits**, **issue ATM/ debit cards/ PPIs**, offer **remittance services** (incl. cross-border remittances) and internet banking services, act as a **BC for another bank** and undertake **non-risk sharing simple financial services activities** not requiring any fund commitment, such as distribution of MFs, insurance products, pension products, etc. and **undertake bill payments.** A Payments Bank **can not undertake** lending activities, issue credit cards, accept NRI deposits or become a "virtual" bank or branchless bank

The **minimum paid-up equity capital has been fixed at Rs 100 crores** with a **minimum CAR of 15%** on the RWAs. Once the net worth reaches Rs. 500 Crore, listing will be mandatory within 3 years of reaching the net worth. For others, listing is voluntary. The **promoter's minimum initial contribution** to the paid-up equity capital shall be **at least 40% for the first 5 years.** The Payments Bank should maintain a **leverage ratio of not less than 3%**

Executive Summary (2/2)

The guidelines aim at creating a banking entity which is adequately capitalized, financially inclusive and has a competitive business model

Foreign shareholding has been **allowed up to 74%** (automatic up to 49% and approval route beyond 49% to 74%). **Individual FII/ FPI is restricted to below 10%.** Aggregate limit for FII/FPI and QFI cannot exceed 24%, which can be raised to 49% through a Board resolution followed by special resolution by General meeting. **Individual NRI holding restricted to 5% and aggregate limit of 10%**, which can be allowed up 24% through a special resolution in General meeting

At least 25% of a Payments Bank's physical access points (own or others' network; not branches) have to be in **rural centers**; the RBI will **prefer** those applicants who propose to set up Payments Bank with access points primarily in the under-banked States/ districts in the **North East, East and Central Regions** of the country

As the Payments Bank will not have loans and advances in its portfolio, the **prudential as well as priority sector lending** norms and regulations as applicable to loans and advances will **not apply to a Payments Bank**

The Payments Bank would be required to **invest minimum 75% of its demand deposit balances in SLR eligible G-securities/ T-bills** with maturity up to one year and hold **maximum 25% in current and time/ fixed deposits** with other scheduled commercial banks apart from the maintaining CRR requirements

The operations of the bank should be **technology driven from the beginning**, conforming to generally accepted standards and norms; while new approaches (such as for data storage, security and real time data update) are encouraged, a detailed technology plan for the same should be furnished to the RBI

Payments Bank – An Attractive Opportunity

Despite the significant efforts to further financial inclusion, a large section of the country remains deprived of basic financial and payment products

Penetration Levels of Financial Services

Penetration levels of new age payment mediums	India	China	USA
Number of people with bank accounts (per '00)	58	70	92
Number of bank branches (per 1 lakh)	11	8	36
Number of ATMs (per 1 Lakh)	11.4	30.7	137.6
PoS Terminals (per million)	684	5,245	17,020
Total Cards (per '000)	283.6	2,604	3,699
Credit by FIs to GDP ratio	75%	155%	229%

Source: Bank branches, Credit to GDP ratio: World Bank
ATM: Secondary Research
PoS, Cards: CPSS – Red Book 2012, Deloitte Analysis
Credit to GDP ratio; World Bank

Comments

- The RBI, Indian Banks, the Government of India as well as other stakeholders have undertaken a number of initiatives in the past to further financial inclusion
- Some of these initiatives include SHG Bank Linkages, Banking Correspondents, Ultra Small Branches and deployment of Electronic Payments Systems
- Despite these initiatives, penetration levels in India are significantly lower than countries such as China and United States with ~40% of the population not having even a basic bank account
- Apart from bank accounts, penetration of electronic payments (PoS and Cards) also stands abysmally low
- The key reasons for this financial exclusion is lack of financially viable business model to serve the 'Bottom of the Pyramid' customer segment in cost effective manner

Payments Bank's focus on providing basic banking and payment services is essential to fulfill the needs of unbanked and under-banked

	Value Proposition of a Traditional Bank	Value Proposition of a Payments Bank focussed on providing basic banking services
Business Model	Focus on all customer segments - retail, MSMEs and corporates; Unbanked population only for fulfilling regulatory obligations	Financial inclusion and unbanked/under-banked population are the priority target market
Business Model	Follows Brick and Mortar 'Branch' centric distribution model	Though internet banking services has been encouraged, the RBI does not envisage a Payments Bank to become "virtual" or branchless bank
Business Model	Cost to serve unbanked population is traditionally high	Cost to serve unbanked population is lower due to technology adoption right from the inception
Business Model	Offers product variants across entire product range of accounts, deposits, payments and credit; Credit is the primary product for revenue generation	Focus on only simple accounts, deposit products and transactions; Fee earned from transaction is primary product for revenue generation
Enablers	Adopt outsourcing of only administration and other non core functions	Heavy focus on technology and IT infrastructure. Only core banking operations such as risk management, treasury, finance and accounts expected to be in-house
Enablers	Follow asset heavy approach by investing in technology, infrastructure, office space, branches, etc.	Follow asset light approach with pay per transaction for technology, customer acquisition, collections, transactions, etc.
Enablers	Technology plays only an enabling role in few functions and processes	Technology is the backbone and plays a central role across all functions and processes
Enablers	Heavy and continual investment in technology and lower ROI due to leverage and legacy issues	Cost efficient technology platform to reduce overall cost of transaction

Opportunities and challenges of business structure and model of Payments Bank

Benefits to prospective applicants	Challenges/limitations to prospective applicants
Enhance customer relationship beyond core business Enhanced customer relationship beyond core business through new offerings in the form of accounts, deposits, payments and cash withdrawals. A prepaid issuer may also be able to offer interest on the balances enhancing value to its customers.	**Limited customer ownership and managing customer loyalty compared to universal banks** Payments Bank shall be restricted to offer accounts, deposits and payment products. No credit exposure is permitted and also maximum deposit limit of Rs. 1.00,000 per customer. A Universal Bank shall always have an edge over a Payments Bank due to broader product portfolio.
Profitable sourcing and deployment of funds Players operating in pre-paid issuance space shall be able to put funds in government securities to earn Interest income rather than holding funds in escrow account in other banks. As these players would be able to retain escrow account in their own bank, it would also give them benefit of float income earned on escrow balance.	**Regulatory requirements** Regulatory requirements to keep adequate CRR, invest "demand deposit balances" in Statutory Liquidity Ratio (SLR) eligible Government securities/ treasury bills with maturity up to one year and in current and time/ fixed deposits with other scheduled commercial banks, enhanced reporting and compliance might drive down profitability.
Launchpad for universal banking business Setting up a Payments Bank shall help players to put in place key enablers such as people, process and systems which can be easily scaled up in future to operate a full fledged bank Operating a Payments Bank shall provide a strong credential for players to apply for a universal banking license in future.	**Ensuring sustained profitability** Business viability would be a challenge as target customer is from financially excluded segment, where cost of acquisition is high and ticket sizes are small. Payments Bank is likely to be a low margin business as demand deposit balances need to be invested in SLR eligible securities (minimum 75%) and current and time/ fixed deposits with other scheduled commercial banks (maximum 15%) giving a returns of 7-9% on overall cost of capital of 4-5% reducing spread to 2-4%.

Existing players in Telecom sector, Pre-paid card issuers, BCs, Payment and Remittance Service Providers, E-commerce players can consider Payments Bank license…

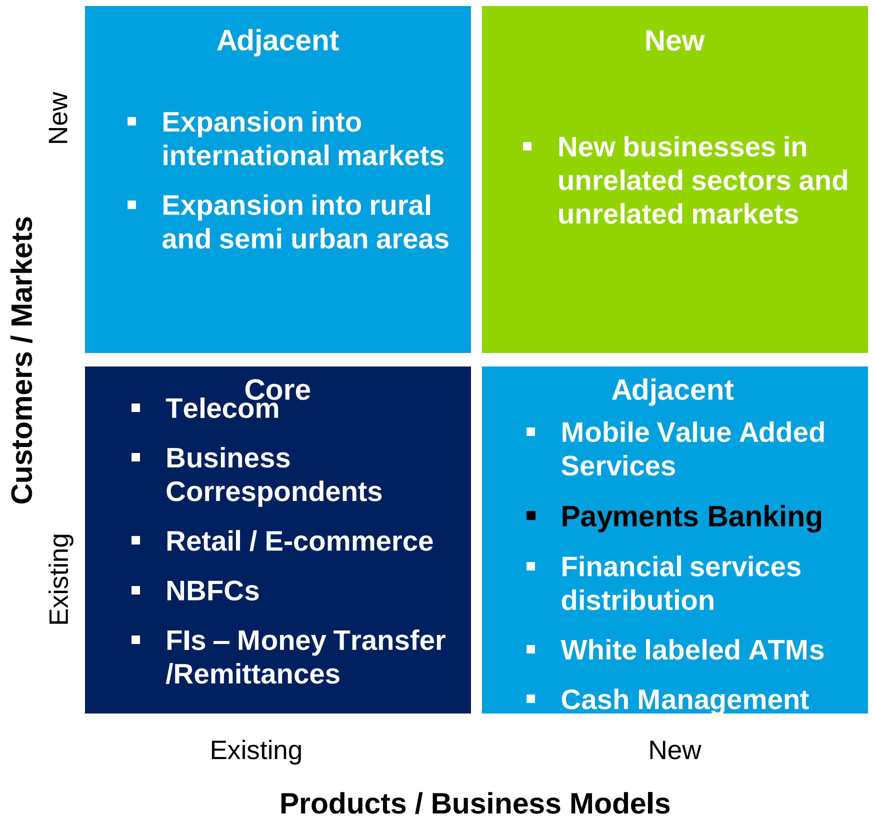
Key Business model considerations for a Payments Bank

Focus on unbanked and under-banked customers	• Penetration of mobiles has gone far ahead of bank account penetration resulting in Telecom companies penetrating unbanked and under-banked customer segment • Third party payment service providers (Business correspondents) have developed unique models to further banking services to excluded segment • Pre-paid card issuers (non-bank) have chosen to play in unbanked and under-banked segment to develop their niche
Extensive reach in rural areas	• The number of bank branches and banking correspondents have limited coverage (~40% of the 6,00,000 villages) in rural areas • Telecom companies, pre-paid card issuers, third party service providers have developed a much leaner and far reaching network in rural areas to acquire and service customers
Experience in payment related products and services	• Telecom companies, pre-paid card players, payment service providers have developed significant experience in providing basic payment services • Mobile recharges, pre-paid card/wallet top ups, cash handling for e-commerce deliveries, cash handling for remittances has helped these players in developing robust processes for customer acquisition and servicing for payment related products

….as part of their broader business model which will help them to run it sustainably and profitably

Opportunity space

(Illustrative)



Key Considerations for players for Payments Bank business

Core Businesses:
- Building scale for Payments Bank business
- Achieving optimal organization structure and processes for Payments Bank business

Adjacent Businesses:
- Linking Payments Bank to existing business as well as other adjacent businesses
- Managing transition of organizational focus from core to ‘core+adjacent‘ businesses

New Businesses:
- Incubating new capabilities to target new markets and develop new business models
- Leveraging Payments Bank and other businesses to tap new opportunities
- Managing high risk of ‘venturing out’ and developing risk mitigation strategies

Evaluation of Guidelines on Payments Bank Licenses

The guidelines for the Payments Bank have to assessed in the context of Applicant's background and proposed business plan (1/3)

Eligible Promoters	• Existing non-bank Pre-paid Payment Instrument (PPI) issuers; and other entities such as individuals/ professionals; Non-Banking Finance Companies (NBFCs), corporate Business Correspondents(BCs), mobile telephone companies, super-market chains, companies, real sector cooperatives; that are owned and controlled by residents; and public sector entities • A promoter/ promoter group can have a joint venture with an existing scheduled commercial bank to set up a Payments Bank. However, scheduled commercial bank can take equity stake in a Payments Bank to the extent permitted under Section 19 (2) of the Banking Regulation Act, 1949 • Promoter/ promoter groups should be 'fit and proper' with sound credentials and integrity, and financial soundness and a successful track record of professional experience or running their businesses for at least a period of 5 years in order to be eligible to promote Payments Bank • If a government entity desires to set up a Payments Bank, the entity should first obtain necessary approvals from the government and submit its application • If the promoter succeeds in obtaining a Payments Bank license, it would be required to set up the Payments Bank under a separate corporate structure unless it is an existing PPI license holder opting for conversion into a Payments Bank
Scope of activities	• Acceptance of demand deposits i.e., current deposits, and savings bank deposits from individuals, small businesses and other entities, as permitted. No NRI deposits should be accepted. Payments bank will initially be restricted to holding a maximum balance of Rs. 100,000 per individual customer. However, simplified KYC/AML/CFT norms will be applicable to the "small accounts"[1]transactions • Issuance of ATM/ debit cards. Payments Bank, however, cannot issue credit cards • Payments and remittance services through various channels including branches, ATMs, BCs and mobile banking – cash outs allowed at POS terminal locations in addition to other channels. A Payments Bank can be part of any card payment network (other than credit card) • Issuance of PPIs as per instructions issued from time to time under the PSS Act • Internet banking services – a Payments Bank is expected to leverage technology to offer low cost banking solutions. However, the RBI does not envisage Payments Bank to be a "virtual" or a branchless bank • Act as a BC for another bank, subject to the RBI guidelines on BCs • Act as a channel to accept remittances to be sent to or receive remittances from multiple banks under a payment mechanism approved by the RBI, such as RTGS / NEFT / IMPS • Permission to handle cross border remittance transactions in the nature of personal payments/ remittances on the current account • Undertake other non-risk sharing simple financial services activities, not requiring any fund commitments such as distribution of products such as mutual fund units, insurance products and pension products as well as utility bill payments

The guidelines for the Payments Bank have to assessed in the context of Applicant's background and proposed business plan (2/3)

Deployment of funds	• The Payments Bank cannot undertake lending activities • Apart from amounts maintained as Cash Reserve Ratio (CRR) with the RBI on the outside demand and time liabilities, a Payments Bank will be required to invest minimum 75% of its "demand deposit balances" in Statutory Liquidity Ratio (SLR) eligible Government securities/ treasury bills with maturity up to one year and hold maximum 25% in current and time/ fixed deposits with other scheduled commercial banks for operational purposes and liquidity management • The Payments Bank will participate in the payment and settlement system and will have access to the inter-bank uncollateralized call money market and the collateralized repo and CBLO market for purposes of temporary liquidity management.
Capital Requirement	• The minimum paid-up equity capital for Payments Bank shall be Rs. 100 crore. The Payments Bank shall be required to maintain a minimum CAR of 15% of its RWAs on a continuous basis. Tier I capital should be at least 7.5% of RWA and Tier II capital should be limited to a maximum of 100% of total Tier I capital • A Payments Bank is not expected to deal with sophisticated products; hence, the CAR will be computed under Basel Committee's standardized approaches. The Payments Bank should have a leverage ratio of not less than 3%, i.e., its outside liabilities should not exceed 33.33 times its net worth (paid-up capital and reserves)
Promoter's Contribution	• Since a Payments Bank cannot undertake lending activities, it is not mandatory for it to have a diversified ownership structure. Therefore, no maximum shareholding limit for promoters is prescribed • The promoter's minimum initial contribution to the paid-up equity capital of such Payments Bank shall at least be 40% for the first five years from the commencement of its business • When the Payments Bank reaches the net worth of Rs. 500 crore, and therefore becomes systemically important, diversified ownership and listing will be mandatory within three years of reaching that net worth; for others listing is voluntary subject to fulfilment of the requirements of the capital market regulator
Foreign Shareholding	• Foreign shareholding to be as per existing FDI policy for private sector banks i.e. up to 74% of the paid-up capital of the bank (automatic route up to 49% and approval route beyond 49% to 74%) • Individual FII/ FPI is restricted to below 10%. Aggregate limit for FII/FPI and QFI cannot exceed 24%, which can be raised to 49% through a Board resolution followed by Special resolution by the General Meeting • Individual NRI holding (both on repatriation and non-repatriation basis) restricted to 5% and aggregate limit of 10%, which can be allowed up 24% through a Special resolution of General Meeting • At all times, at least 26% of the paid-up capital will have to be held by residents

The guidelines for the Payments Bank have to assessed in the context of Applicant's background and proposed business plan (3/3)

Prudential norms	• As the Payments Bank will not have loans and advances in its portfolio, the prudential norms and regulations of the RBI as applicable to loans and advances, will therefore, not apply to it
Business Plan	• The applicants 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 behind setting up of Payments Bank • The business plan should cover aspects relating to business model proposed to be used; bank's access points in rural and semi-urban areas; control over its BCs and customer grievance redressal; JV partnership with a scheduled commercial bank, if any; etc. • 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 Bank with access points primarily in the under-banked States/ districts in the North-East, East and Central regions • In case of deviation from the stated business plan after issue of license, the RBI may consider restricting the bank's expansion, effecting change in management and imposing other penal measures as may be necessary
Channel/ Geography Coverage	• The Payments Bank should ensure widespread network of access points particularly to remote areas, either through their own branch network, ATMs or BCs or through networks provided by others. The Payments Bank is expected to adapt technological solutions to lower costs and extend its network • The Payments Bank shall operate in remote areas mostly through BCs, ATMs and other networks. Therefore, the requirement of opening at least 25% of branches in unbanked rural centres (population up to 9,999 as per the latest census), is NOT stipulated • However, the bank would be required to have at least 25% of physical access points including BCs in rural centres. The bank would also establish a controlling office for a cluster of access points for control over various outlets and customer grievance redressal
Corporate Structure & Governance	• Corporate Governance : (i) The Board of the bank should have a majority of independent directors, and (ii) The bank should comply with the corporate governance guidelines including 'fit and proper' criteria for Directors as issued by the RBI from time to time • Irrespective of the holding, the voting rights in private sector banks are capped at 10%, which can be raised to 26% in a phased manner by the RBI. Further, any acquisition of 5% or more of paid-up share capital in a private sector bank will require prior approval of the RBI. This will also apply to the Payments Bank • It cannot set up subsidiaries to undertake non-banking financial services activities
Other Conditions	• The operations of the bank should be fully networked and technology driven from the beginning, conforming to generally accepted standards and norms • The bank should have a high powered Customer Grievances Cell to handle customer complaints

Eligible promoters
Broad Analysis and Remarks

Guideline	Broad Analysis	Remarks
Existing non-bank Pre-paid Payment Instrument (PPI) issuers; and other entities such as individuals/ professionals; Non-Banking Finance Companies (NBFCs), corporate Business Correspondents(BCs), mobile telephone companies, super-market chains, companies, real sector cooperatives; that are owned and controlled by residents; and public sector entities Existing PPI license holders could opt for conversion into Payments Bank. It is not mandatory for an existing PPI issuer to apply for a Payments Bank license and it may continue as a PPI issuer as per the guidelines issued by RBI from time to time	• The guidelines bring a number of B2C sectors under the gamut of the Payments Bank license • The expectation is that the companies in these sectors would leverage their vast retail network to support the banking business • The guidelines have expanded the applicant space to individuals/ professionals • The promoter/ promoter group would need to be owned and controlled by residents	• While the field has been expanded to multiple sectors, a key consideration point for the applicants would be the ease with which the transition from the current business model to the new business model would be made
A promoter/ promoter group can have a joint venture with an existing scheduled commercial bank to set up a Payments Bank. However, scheduled commercial bank can take equity stake in a Payments Bank to the extent permitted under Section 19 (2) of the Banking Regulation Act, 1949	• The guidelines allow existing scheduled commercial banks to participate under Section 19 (2) in the form of a JV which provides that a scheduled commercial bank can not hold shares in any company exceeding 30% of the paid –up share capital of that company or 30% of its own paid-up share capital and reserves	• An existing bank can not hold more than 30% stake in a Payments Bank and, hence, can not be a promoter
The RBI would assess the ‘fit and proper’ status of the applicants and group entities on the basis of their past record of sound credentials and integrity; financial soundness and successful track record of at least 5 years professional experience or in running their businesses	• New companies keen to get the Payments Bank license but with a track record of less than 5 years would not be able to apply	• The RBI would look for sound credentials, integrity, financial soundness and a successful track record of professional experience or running their businesses for a minimum of 5 years while issuing licenses to the entities and their promoters/ promoter groups

Scope of activities (1/2)
Broad Analysis and Remarks

Guideline	Broad Analysis	Remarks
A Payments Bank cannot undertake lending activities and would be permitted to undertake only certain restricted activities: • Acceptance of demand deposits –initially be restricted to holding a maximum balance of Rs. 100,000 per customer – *No NRI deposits to be accepted* • Issuance of ATM/ debit cards – Payments Bank can't issue credit cards • Offer payments and remittance services through various channels • Issuance of PPIs • Offer internet banking services – *However, RBI does not envisage Payments Bank to be a "virtual" or branchless bank* • Act as BC of another bank, subject to the RBI guidelines on BCs • Act as a channel to accept remittances to be sent to or receive remittances from multiple banks under a payment mechanism such as RTGS / NEFT / IMPS • Handle cross border remittances in the nature of personal payments/ remittances on the current account • Distribute non-risk sharing simple financial products like mutual fund (MF) units and insurance products, etc. • Undertake utility bill payments	• A Payments Bank would not be allowed to offer its own credit products (e.g. loans, advances, credit cards, etc.) • The bank would be able to accept deposits, provide payments and remittance related services, issue ATM/ debit cards/ PPIs, and can act as a BC for other banks • The bank would be able to act as a channel to send or receive remittances from multiple banks • The bank would be able to handle cross-border transactions • The bank would be able to distribute non-risk sharing simple financial products like MFs and insurance products as well as undertake utility bill payments	• The bank would earn revenues primarily from following: (a) Fee and commissions income generated from payments and remittance services, the BC business as well as from the distribution of non-risk sharing simple financial products such as MFs, insurance and pension products (b) Interest income from the spread between the interest paid against CASA deposits and interest earned from investing in approved SLR securities/ treasury bills with maturity up to one year and in current and time/ fixed deposits with other scheduled commercial banks • Although the bank would not have credit products on its own books, it may act as BCs for other banks and provide the same to complete its portfolio of offerings

Scope of activities (2/2)

Broad Analysis and Remarks

Guideline	Broad Analysis	Remarks
A Payments Bank cannot set up subsidiaries to undertake non-banking financial services activities	• A Payments Bank would not be able to diversify into non-banking financial services activities	• The RBI mandates the Payments Bank to focus their efforts on the allowed activities and not take undue risks of expanding to other 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 business of the Payments Bank The Payments Bank will be required to use the words “Payments Bank” in its name in order to differentiate it from other banks	• The guidelines suggest a complete ring fencing of the Payments Bank’s business	• With the applicant pool open to players that may have varied business lines (e.g. mobile phone companies, super-market chains, companies, real sector cooperatives, etc.), the RBI wants the licensees to treat the Payments Bank business as an independent business so as to avoid any conflict of interest as well as eliminate any dependence of the banking business on the success/ failure of other business lines of an applicant

Deployment of funds & Capital requirement

Broad Analysis and Remarks

Guideline	Broad Analysis	Remarks
“Apart from amounts maintained as CRR with the RBI on the outside demand and time liabilities, a Payments Bank will be required to invest minimum 75% of its "demand deposit balances" in SLR eligible Government securities/ treasury bills with maturity up to one year and hold maximum 25% in current and time/ fixed deposits with other scheduled commercial banks for operational purposes and liquidity management”	• Though the bank can raise deposits, it can not offer any credit products of its own • The bank would need to invest of its "demand deposit balances" in the relatively lower yield, SLR eligible securities (minimum 75%), as well as in the current and time/ fixed deposits with other scheduled commercial banks (maximum 25%)	• The bank would be able to earn only a limited spread income from its investments portfolio
The minimum paid-up equity capital for Payments Bank shall be Rs. 100 crore	• The minimum paid-up capital requirement would ensure that the bank is able to invest heavily in technological infrastructure (creating fixed assets) for its operations utilizing this capital • Further, a Payments Bank is exposed to operational risk and hence, maintaining a minimum equity capital would be important	• A relatively lower capital requirement as compared to the consideration of Rs. 500 crores for a universal bank license reflects the fact that the Payments Bank business model is a low-risk business – the guidelines don’t allow the bank to assume any credit risk and mandate the bank to invest in relatively safer securities
The Payments Bank shall be required to maintain a minimum CAR of 15% of its RWAs on a continuous basis. Tier I capital should be at least 7.5% of RWAs. Tier II capital should be limited to a maximum of 100% of total Tier I capital. As a Payments Bank is not expected to deal with sophisticated products, the CAR will be computed under Basel Committee’s standardized approaches	• Given the higher CAR of 15%, the promoter/ promoter groups may have to continuously recapitalize the balance sheet in the early years or go slow on growth	• The guidelines have proposed higher CAR compared to both the current norms for scheduled commercial banks (9%) as well as for the new universal bank licensees (13%) • This indicates that the RBI perceives that a Payments Bank would be exposed to higher risks compared to the universal banks due to its nature of business
The Payments Bank should have a leverage ratio of not less than 3%, i.e., its outside liabilities should not exceed 33.33 times its net worth (paid-up capital and reserves)	• A Payments Bank should have a leverage ratio of not less than 3%	• The restriction on leverage would lead to banks not being able to leverage beyond a limit without increasing the equity capital. This shall prevent any unnecessary leveraging of the balance sheet for the bank

Promoter's contribution
Broad Analysis and Remarks

Guideline	Broad Analysis	Remarks
Since a Payments Bank cannot undertake lending activities, it is not mandatory for it to have a diversified ownership structure. Therefore, no maximum shareholding limit for promoters is prescribed. However, the promoters of the Payments Bank should hold at least 40% of its paid-up equity capital for the first five years from the commencement of its business	• The guidelines intend to create an ownership structure with the promoter/ promoter group in control of the business, minimizing chances of any vision conflict, dispute or disagreement. Further, promoters need to commit significant resources in the initial few years	• The guidelines do not mandate compulsory ownership dilution/ listing and this may encourage the promoters to focus on creating value (profit motive) while serving the financial inclusion agenda of the RBI
If the Payments Bank is set up as a JV with equity partnership with an SCB, the SCB can take equity stake in a Payments Bank to the extent permitted under Section 19 (2) of the Banking Regulation Act, 1949	• The guidelines allow an existing SCB to take a stake in a Payments Bank, however, the SCB can not hold shares in any company exceeding 30% of the paid –up share capital of that company or 30% of its own paid-up share capital and reserves	• An existing bank can not hold more than 30% stake in a Payments Bank and, hence, can not be a promoter
When the Payments Bank reaches the net worth of Rs.500 crore, and therefore becomes systemically important, diversified ownership and listing will be mandatory within three years of reaching that net worth. However, the Payments Bank having net worth of below Rs. 500 crore could also get its shares listed voluntarily	• After the Payments Bank has attained a significant size (net worth of Rs. 500 crores), the guidelines mandate listing within 3 years • For the others which are still to reach this milestone, the listing is voluntary	• The RBI perceives that once a Payments Bank breaches the Rs. 500 crore barrier (the minimum capital required to start a universal bank as per February 22, 2012 guidelines), the Payments Bank would have attained a significant size and scale • As a result, the RBI would push for a public listing to diversify the shareholding as well as bring the bank under the SEBI scanner with additional requirements for reporting, corporate governance, etc.

Foreign shareholding & Voting rights and transfer/ acquisition of shares

Broad Analysis and Remarks

Guideline	Broad Analysis	Remarks
The foreign shareholding would be as per FDI policy for private sector banks: • Aggregate foreign investment in a private sector bank will be allowed up to a maximum of 74% of the paid-up capital of the bank (automatic up to 49% and approval route beyond 49% to 74%) • At all times, at least 26% will have to be held by residents • In the case of FIIs/ FPIs, individual FII/ FPI holding is restricted to below 10%, aggregate limit for all FIIs /FPIs / QFIs cannot exceed 24%, which can be raised to 49% by the bank concerned through a Board resolution followed by a special resolution by General meeting • In the case of NRIs, the individual holding is restricted to 5% both on repatriation and non-repatriation basis and aggregate limit cannot exceed 10%. However, NRI holding can be allowed up to 24% provided the bank passes a special resolution in the General meeting	• A Payments Bank may initially be owned and controlled by residents; however, the guidelines do not put restrictions on foreign shareholding as stringent as that for the universal bank licensees	• With the restrictions on foreign shareholding not very stringent, going forward, this space may witness significant M&A activity
• As per Section 12 (2) of the BR Act, 1949, any shareholder's voting rights in private sector banks are capped at 10% (can be raised to 26% by the RBI) • As per Section 12B of the Act, any acquisition of 5% or more in a private sector bank will require prior approval of RBI	• This is in line with the current norms for the private banks	• Irrespective of the individual holding, shareholder's voting rights are restricted to 10%

Business plan
Broad Analysis and Remarks

Guideline	Broad Analysis	Remarks
The applicants will be required to furnish their business plans along with project reports with their applications The business plan submitted by the applicant should be realistic and viable In case of deviation from the stated business plan after issue of license, RBI may consider restricting the bank's expansion, effecting change in management and imposing other penal measures as may be necessary	• Applicants need to submit a business plan with sufficient logical backing and actionable strategies	• The RBI wants to ensure that the plans submitted are implementable and there are no implicit differences between a Business Plan and a Regulatory Business Plan
Preference will be given to those applicants who propose to set up a Payments Bank 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, ATMs or BCs or through networks provided by others. The Payments Bank is expected to adapt technological solutions to lower costs and extend its network	• An applicant with its business plan focused on setting up a Payments Bank in the under-banked States/ districts such as in the North-East, East and Central regions of the country would be preferred • The bank would leverage its own channel network as well as network of others to expand its reach • The bank would use technology led solutions to lower costs and extend its network	• A player with its initial focus on establishing operations in the regions earmarked by the guidelines would stand a higher chance of getting a Payments Bank license • Further, the RBI clearly wants the banks to leverage own/ 3rd party network and adopt technology to expand its reach and lower its cost of servicing which has been a major challenge area for the traditional large banks
The requirement of opening at least 25% of branches in unbanked rural centres (population up to 9,999 as per the latest census), is not stipulated for the Payments Bank. However, it will be required to have at least 25% of physical access points including BCs in rural centres	• The applicants have to show their due commitment to promote rural banking and financial inclusion as against more profitable commercial and urban retail banking	• While the traditional banks have this mandate in terms of number of branches, a Payments Bank represents a unique case where an access point (own or others' network) is a more suitable metric to monitor the reach of the bank in rural areas

Prudential norms, Corporate governance & Other conditions
Broad Analysis and Remarks

Guideline	Broad Analysis	Remarks
As the Payments Bank will not have loans and advances in its portfolio, the prudential norms and regulations of RBI as applicable to loans and advances, will therefore, not apply to it	• There would be no impact of prudential norms and regulations of RBI on the business operations of the Payments Bank	• With no lending business, the guidelines remain clear on the prudential norms. In addition, in a similar manner, the bank would not have to be concerned about the priority sector lending norms
The Board of the 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	• The regulator intends to follow the same guidelines that have been issued for the private banks in India	• This will help the Payments Bank to adopt the best corporate governance practices right from the commencement of business
Other conditions: • A controlling office for a cluster of access points should also be established for control over various outlets and customer grievance redressal • The operations of the bank should be fully networked and technology driven from the beginning, conforming to generally accepted standards and norms; while new approaches (such as for data storage, security and real time data updation) are encouraged, a detailed technology plan for the same should be furnished to the RBI • The bank should have a high powered Customer Grievances Cell to handle customer complaints	• The guidelines suggest that the bank operations should be fully networked and technology driven • The bank needs to set up a customer grievance cell from the beginning	• The guidelines make it imperative for the bank to maintain consistency and quality of service across all access points

Payments Bank License Evaluation Process

Evaluation Process would involve critical questions on Who is the promoter and What is the value proposition?

The final guidelines suggest that the RBI shall evaluate the application for the license on three categories of filters – Eligibility, Credentials & Governance and Business Plan suitability

Payments Bank License Evaluation

Banking Application → Filter #1: Eligibility → Filter #2: Credentials and Governance → Filter #3: Business Plan → Payments Bank License

Filter #1: Eligibility

Promoter Eligibility

- NBFCs, Telcos, Corporate BCs, PPI Issuers, super -market chains, companies, real sector co-operatives and public sector entities, individuals, professionals
- Partnering with a scheduled commercial bank
- Promoters should have a sound track record of professional experience or running their businesses for at least 5 years
- Conform to “fit and proper” and any other criteria prescribed by the RBI

Min. Capital & Shareholding

- Minimum starting capital contribution of promoter of Rs. 40 Crores (40% of Rs. 100 Crores)
- Restriction on aggregate shareholding of FDI, NRIs and FIIs

Filter #2: Credentials and Governance

Credentials

- Promoter groups should have sound credentials and integrity
- Source of promoters' equity should be transparent and verifiable

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 the RBI from time to time

Filter #3: Business Plan

Business Model

- Business model should compliant with allowed scope of activities provided in the guidelines
- Demonstrate focus to address financial inclusion
- Adoption of technology and other modern technologies to lower the operational costs and extend reach
- Best-in class customer service proposition

Post License Requirements

- Bank should be fully networked and technology driven from the beginning
- Should have well established customer grievance cell
- Maintain leverage ratio less than 33.33
- Capital Adequacy ratio to be maintained at 15% on a continuous basis
- Maintain CRR and SLR requirements
- If net worth reaches Rs. 500 crores, listing and diversification of ownership is mandatory within 3 years

Procedure for granting a Payments Bank license as suggested by the RBI

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) to the RBI
- In addition, the applicants should furnish the business plan and other requisite information as indicated. Applications will be accepted till the close of business as on January 16, 2015.

Procedure for the RBI decisions:

- The applications will be initially screened by the RBI to ensure prima facie eligibility of the applicants. The RBI may apply additional criteria to determine the suitability of applications, in addition to the prescribed 'fit and proper' criteria
- Thereafter, an External Advisory Committee (EAC) comprising eminent professionals like bankers, chartered accountants, finance professionals, etc., will evaluate the applications.
- The EAC 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. EAC may seek more information and call for discussions with the applicant.
- EAC will submit its recommendations to the RBI for consideration. The decision to issue an in-principle approval for setting up of a bank will be taken by the RBI. The RBI's decision in this regard will be final
- The validity of the in-principle approval issued by the RBI will be 18 months, within which bank will have to be set up

A structured and proven approach will help an applicant secure the Payments Bank license and effectively launch the bank

Prepare

Analyze internal & external environment & develop business case

- Have I ensured Management and key Stakeholder Buy-in?
- What are my internal capabilities that can be leveraged?
- Do I have a solid Business Case?
- How much capital do I need to raise?
- Do I need to partner with others?
- Am I eligible to apply for a Payments Bank license?
- Does new venture require corporate restructuring?
  What are tax and regulatory structuring implications?
- What should be the mix of debt-equity?
- Strategy for exit/ liquidity post 5 years of licensing

Plan/Structure

Develop overall business structure & business plan

- What is my Business and financial plan in terms of key markets, products, channels, risks, etc.?
- What are the key elements of strategy, business and financial plan that need to be reviewed?
- How best to implement the corporate, legal and tax structure?
- What is the financial structure required for the venture?

Apply

Apply for license as per the RBI guidelines

- What are the key criteria for a Payments Bank license?
- How to ensure the test of responsiveness set by the RBI?
- What are the other necessary documents to be submitted along with the application?
- What are the Liasioning requirements with the RBI?
- What are the timelines to send the documentation to the RBI?
- What about liaison / responding to queries of the RBI?

Build

Develop detailed design of the bank's operating model

- What is the proposed operating model for the bank?
- How should I establish PMO, implementation and communication plans?
- What are product features?
- How to get the bank structuring in place in terms of AOA/MOA/SHA
- How well is bank geared up to ensure compliance with new requirements of Companies Act, 2013?
- How to plan to ensure that bank meets with structure / shareholding as per Guidelines?
- What will be the risk, compliance and treasury function of the bank
- What should be the IT architecture?
- Which vendor should be selected for IT?
- How to develop org structure & staffing profile?

Launch

Launch operations of the bank/ implement the operating model

- What are the key policies for business processes?
- What are my branch expansion plans?
- What is the branding spend I want to do?
- How to recruit and train staff?
- How to manage the change?
- How to build/ test systems?
- How to prepare for regulator review and regulatory reporting?
- What all alliances need to be in place?
- How to implement the risk requirements of the bank

Desirable outcomes for each stage of the process need to be individually and collectively managed

Defining the right strategy	• What customer segments and what geographies to focus on initially? How fast should the Bank grow? • What products and services should the firm offer? What channels should the firm focus on? • What capabilities does the firm have? What additional capabilities should be developed to succeed in the banking sector?
Implementing the strategy	• What initiatives should the firm launch to implement the strategy? How much will these initiatives cost? What should be the sequence of implementing? • What is the impact of these initiatives on the existing businesses? What is the risk associated with these initiatives? What can the firm do to minimize these risks? • Who are the key people for implementing these strategies?
Understanding the banking license application process	• What are the key gaps/opportunities in the market? • What preparation should the firm do before applying for the banking license? • Who are the key stakeholders in the banking license application process? What are their needs?
Addressing complex regulatory and compliance requirements	• What key regulations might impact the firm? • What can we learn from companies that have received banking licenses in the past? • What steps can be taken to improve the chances of securing a banking license?

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Disclaimer

Annexures

Abbreviations

AML	Anti Money Laundering
ANBC	Adjusted Net Bank Credit
BC	Business Correspondent
CAR	Capital Adequacy Ratio
CBLO	Collateralized Borrowing and Lending Obligation
CFT	Combating of Financing of Terrorism
CRR	Cash Reserve Ratio
EAC	External Advisory Committee
FDI	Foreign Direct Investment
FII	Foreign Institutional Investors
FPI	Foreign Portfolio Investors
IMPS	Immediate Payment Service
JV	Joint Venture

KYC	Know Your Customer
NBFC	Non Banking Financial Company
NEFT	National Electronic Funds Transfer
NRI	Non-Resident Indian
PPI	Prepaid Instruments
PSL	Priority Sector Lending
QFI	Qualified Foreign Investor
RBI	Reserve Bank of India
RTGS	Real Time Gross Settlement System
RWA	Risk Weighted Assets
SCB	Scheduled Commercial Bank
SLR	Statutory Liquidity Ratio

Key differences between the Draft and the Final Guidelines (1/2)

Guideline on…	Draft Guidelines (July 17, 2014)	Final Guidelines (November 27, 2014)
Eligible promoters	Banks could take equity stake in a Payments Bank (up to 30%)	A promoter/ promoter group can have a JV with an existing scheduled commercial bank (SCB) to set up a payments bank. The SCB can take equity stake in a payments bank up to 30% Also, the list of eligible promoters added individuals/ professionals under eligible promoting entities
Scope of Activities	Didn't clarify the position of Payments Bank for NRI deposits, envisaging Payments Banks as "virtual" bank or branchless bank, or cross border remittances	Allows a Payments Bank to undertake (A) cross-border remittances, (B) other non-risk sharing simple financial services activities such as distribution of mutual fund units, insurance products, and pension products, and (C) utility bill payments etc. on behalf of its customers and general public, in addition to others mentioned in draft guidelines The final guidelines do not allow a Payments Bank to accept NRI deposits and clarifies that the RBI doesn't envisage Payments Bank as "virtual" bank or branchless bank
Deployment of Funds	Required the Payments Bank to invest all its monies in SLR G-Securities/ T-Bills with maturity up to one year recognized eligible SLR securities	Requires the Payments Bank to invest minimum 75% of its "demand deposit balances" in SLR eligible Government securities/ treasury bills with maturity up to one year and hold maximum 25% in current and time/ fixed deposits with other SCBs for operational purposes and liquidity management
Capital Requirement	Required the Payments Bank to maintain a leverage ratio of not less than 5%. In addition, the draft guidelines mentioned that if the bank's 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. The bank should be required to maintain a minimum CAR of 15% of its RWA on a continuous basis, with the CAR computed under simplified Basel I standards	Requires the Payments Bank to maintain a leverage ratio of not less than 3%. A Payments Bank should maintain minimum CAR of 15% of its RWA as per BASEL norms with Tier I capital to be least 7.5% of RWA and Tier II capital at maximum of 100% of Tier I

Key differences between the Draft and the Final Guidelines (2/2)

Guideline on…	Draft Guidelines (July 17, 2014)	Final Guidelines (November 27, 2014)
Promoter's contribution	The promoter's minimum initial contribution to the paid up equity capital would be at least 40% which shall be locked in for a period of five years from the date of commencement of business. Shareholding by promoters in excess of 40% was mandated to be brought down to 40% within 3 years and thereafter, to 30% within a period of 10 years, and to 26% within 12 years from the date of commencement Proposals having diversified shareholding and a time frame for listing will be preferred by the RBI for a license	The promoter's minimum initial contribution to the paid-up equity capital of such Payments Bank shall at least be 40% for the first five years from the commencement of its business. No mention of reduction in the promoter shareholding going forward, preference for diversified shareholding or time frame for listing As per the final guidelines, as a payments bank cannot undertake lending activities, it is not mandatory for the bank to have a diversified ownership structure
Foreign shareholding	As per extant FDI policy	Detailed out the policy on individual and aggregate shareholding limits for FII/FPI, QFI, NRI
Business Plan	-	The final guidelines provide a few indicative pointers for the business plan to be prepared by an applicant – "The business plan, inter alia, should cover aspects relating to business model proposed to be used; bank's access points in rural and semi-urban areas; control over its BCs and customer grievance redressal; joint venture partnership with a scheduled commercial bank, if any; etc."
Timelines for the banking entity	The draft guidelines didn't provide any pointers around listing of the Payments Bank	The final guidelines clarify that whenever a Payments Bank reaches the net worth of Rs. 500 crore, and therefore becomes systemically important, diversified ownership and listing will be mandatory within three years of reaching that net worth; for others listing is voluntary
Validity of in-principle license	The validity of the in-principle approval issued by the RBI was one year from the date of granting such approval	As per the new guidelines, the validity of the in-principle approval issued by the RBI will be eighteen months