

Tracking Performance of Payments Banks against Financial Inclusion Goals

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1. Introduction

In this report, we analyse the payments bank (PB) model in terms of the performance of individual PBs in furthering the goal of financial inclusion placed on the payments bank model.

PBs were first conceptualised in the report of the Reserve Bank of India's (RBI) Committee on Comprehensive Financial Services for Small Businesses and Low-Income Households (CCFS)², 2013, chaired by Dr. Nachiket Mor. In 2014, RBI officially introduced a new type of differentiated bank (see Box 1³ for details on differentiated banking), the payments bank, by rolling out guidelines for their licensing⁴. Differentiated banks are niche banks, limited by the nature of banking functions they can undertake. As envisaged by CCFS, PBs are a type of differentiated bank

Box 1: Differentiated Banking in India

The CCFS Report lays out a framework to understand various types of current and potential banking system designs. The framework consists of two broad designs: Horizontally Differentiated Banking Design System (HDDBS) and Vertically Differentiated Banking Design System (VDDBS), which are constructed from the functional building blocks of payments, deposits and credit. In an HDDBS design, the basic design element remains a full-service bank that combines all three building blocks of payments, deposits, and credit but is differentiated primarily on the dimensions of size or geography or sectoral focus. In a VDDBS design, the full-service bank is replaced by banks that specialise in one or more of the building blocks of payments, deposits, and credit.

The RBI's articulation of what it considers as differentiated banks is somewhat different from this. According to it, 'Differentiated banks are distinct from universal banks; the differentiation is on account of capital requirement, scope of activities, or area of operations.' By this view, Urban Cooperative Banks, Regional Rural Banks and Local Area Banks too could be considered as differentiated banks. It must be noted that while these bank types are geographically focussed, they operate under several regulatory prescriptions on their business models which are different from those placed on full-service banks. Thus, they do not qualify to be differentiated under the CCFS's HDDBS design. Similarly, small finance banks (SFB), deemed differentiated banks by the RBI, cannot be so merely by having a differential capital requirement or differential restrictions on their lending portfolios, as they operate like a full-service bank, with permissions to undertake credit, payments and deposit functions. Under the CCFS's framework, the payments bank model is the only case of a differentiated bank license in India.

authorized to perform only the banking functions of providing deposits and payments, and with no permissions to undertake lending on own books. Most importantly, the real value from the PB model is in enabling cash-in cash-out (CICO) services in unbanked locations where cash will continue to dominate for a reasonable time. This cash-out feature sets them apart from the Pre-Paid Instrument (PPI) or wallet licenses which by design cannot provide the CICO service⁵. This restriction has however been relaxed to an extent by the RBI since then⁶.

² Committee on Comprehensive Financial Services for Small Businesses and Low Income Households Report available at: <https://rbidocs.rbi.org.in/rdocs/PublicationReport/Pdfs/CFS070114RFL.pdf>

³ From 'Differentiated Banks: Design Challenges' in a speech by Shri R. Gandhi, Deputy Governor, Apr 18, 2015. Available at: https://www.rbi.org.in/scripts/BS_SpeechesView.aspx?Id=954

⁴ Guidelines for Licensing of Payments Banks, RBI Circular Nov 27, 2014. Available at: https://www.rbi.org.in/scripts/bs_viewcontent.aspx?Id=2900

⁵ The Banking Regulation Act defines banking to mean "the accepting, for the purpose of lending or investment, of deposits of money from the public, repayable on demand or otherwise, and withdrawal by cheque, draft, order or otherwise". A strict reading of this definition would mean that any withdrawal in a financial form, even into a bank account (as with PPI wallets) could be construed as a deposit and hence any transaction that allows for financial value in and financial value out, rather than financial value in and goods and services out, could be construed to be a deposit.

⁶ While e-wallets have now been given permissions by RBI to withdraw upto Rs. 1000 per day in Tier 1 and 2 locations, and up to Rs. 2000 per day in Tier 3 and above locations. This is possible at specific merchant locations. The wallet holder transfers funds for 'cash-out' to the UPI-Id of the merchant who then disburses cash to the wallet holder.

RBI allows PBs to offer savings and current account services to their customers, with the account balance capped at Rs. 1,00,000 per customer. RBI affords some leeway regarding the cap on balance by allowing the PBs to make arrangements with any other Scheduled Commercial Bank (SCB) for amounts in excess of the prescribed limits to be swept into an account opened for the customer at that bank, with prior consent from the customer⁷. Among other activities, PBs can issue Automated Teller Machines (ATM)/debit cards, act as Business Correspondents (BCs) to other banks (but not to Non-Banking Financial Companies⁸) and undertake utility bill payments on behalf of their customers⁹. The RBI guidelines mandate that at least 75%¹⁰ of the deposit balances with the PB must be invested in Government securities/Treasury Bills for maintaining Statutory Liquidity Ratio (SLR) for operational and liquidity purposes. A maximum of 25% of the demand deposit balance can be invested in time/fixed deposits with other SCBs.

As the PBs do not have a lending function, they would not have significant credit risk and market risk. Instead, as they will be required to invest in technological infrastructure for their operations, they would be exposed to operational risk. Therefore, PBs are required to buffer against this risk by having a minimum paid up equity capital of Rs. 100 Crores (one-fifth of that of SCBs and half of that of SFBs). The minimum Capital Adequacy Ratio (CAR) to be maintained is 15% of its Risk Weighted Assets (RWA). This is greater than the 9% of SCBs; but same as that for Small Finance Banks. However, as PBs do not have significant RWA, the CAR alone would not adequately cover the risks in the business. Therefore, as a backstop measure, PBs are required to have a leverage ratio of at least 3%¹¹. The RBI has also mandated that the deposits with PBs shall be covered under the deposit insurance scheme of the Deposit Insurance and Credit Guarantee Corporation (DICGC)¹².

Unlike PPIs¹³, PBs are directly allowed to participate in the Payments and Settlements System (PSS). Most PPIs (except for open PPIs¹⁴) operate under a nested model, which require them to partner with a sponsor bank for clearing payments and participating in the PSS¹⁵. The CCFS report discusses the concern that the nested model creates opacity. The PPI (in this case taken as an example of a nested model) has to consider the riskiness of its sponsor bank that holds its deposits partner PPI, were it to become a large player.

⁷ Bank Deposits, Operating Guidelines for Payments Banks, October 6, 2016, RBI Notifications. Retrieved from: <https://www.rbi.org.in/scripts/NotificationUser.aspx?Mode=0&Id=10635>

⁸ 'Financial Inclusion by Extension of Banking Services – Use of Business Correspondents (BCs)', RBI Circular DBOD.No.BL.BC.43 /22.01.009/2010-11. Available at: <https://www.rbi.org.in/scripts/NotificationUser.aspx?Mode=0&Id=6017>

⁹ Scope of Activities, Guidelines for Licensing of Payments Banks, RBI Circular Nov 27, 2014. Available at: https://www.rbi.org.in/scripts/bs_viewcontent.aspx?id=2900

¹⁰ In comparison, the SLR applicable for SCBs as of March 2020 is 18.25%.

¹¹ The payment banks' outside liabilities should not exceed 33.33 times its net-worth (paid-up capital and reserves), as specified in: Capital Requirement, Guidelines for Licensing of Payments Banks, RBI Circular Nov 27, 2014. Available at: https://www.rbi.org.in/scripts/bs_viewcontent.aspx?id=2900

¹² The limit of the insurance cover per depositor is Rs. 5 lakhs. This limit was raised from an earlier Rs. 1 lakh per depositor. "Deposit Insurance and Credit Guarantee Corporation (DICGC) increases the insurance coverage for depositors in all insured banks to ₹ 5 lakh", RBI Press Release, Feb 04, 2020. Available at: https://www.rbi.org.in/Scripts/BS_PressReleaseDisplay.aspx?prid=49330

¹³ PPIs are payments methods where an instrument, such as a card or a wallet, is used to purchase goods or services against the value stored in those instruments. The purpose of these instruments is to facilitate digital transactions, which is why the upper limit on the balance on these instruments is low and the balance does not accrue any interest.

¹⁴ Open PPIs are PPIs issued only by banks, hence obviating the need to set up an escrow account (as the bank can directly access the payments system). This model of operations is called the independent model.

¹⁵ Such a nested model of operations was the cause of trouble for one of the PPIs, PhonePe. In 2020, it saw an outage in services as its partner bank, Yes Bank, was issued a moratorium on its services by the RBI. "Yes Bank moratorium hits PhonePe services." (Mar, 2020). *The Economic Times*. Retrieved from: <https://economictimes.indiatimes.com/small-biz/startups/newsbuzz/yes-bank-moratorium-hits-phonepe-services/articleshow/74505513.cms>

In February 2015, RBI announced the names of 11 applicants¹⁶ who were given the in-principle approval for setting up PBs. Five¹⁷ out of these applicants have surrendered their licenses; three of them having done so prior to beginning operations¹⁸. While seven PBs had begun operations¹⁹ at varying scales, only four are operating at full scale. Our analysis is mainly based on these four PBs – Airtel PB, IPPB, Paytm PB and Fino PB. The analysis for Jio PB and NSDL PB (where available) have been presented outside of this analysis, as a direct comparison with the four PBs would not be suitable (as of January 2020, the former are operating at limited scale, with their services available to only a sample of the population). A timeline of significant events with the licenses is shown in Figure 1.

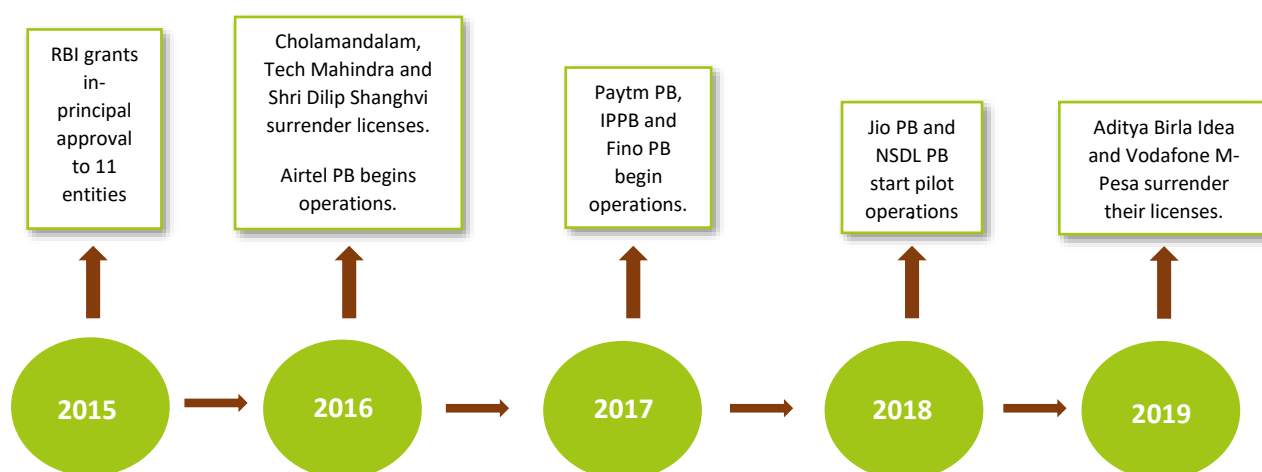


Figure 1: Timeline of PBs' Operations in India
Source: RBI Notifications

2. Rationale and Methodology

The RBI in its guidelines for licensing of PBs states that the primary objective of setting up payments banks is 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.'*

In order to study the performance of PBs and to track the progress made by them against the above objectives, we studied aspects such as the nature of PB touchpoints to estimate progress towards access to deposit and payments services and the features of digital transactions enabled through them. However, it must be noted that these measures are not entirely sufficient to determine whether the objectives have been met.

¹⁶The 11 entities that were granted licenses are : 1) Aditya Birla Nuvo Limited 2) Airtel M Commerce Services Limited 3) Cholamandalam Distribution Services Limited 4) Department of Posts 5)Fino PayTech Limited 6) National Securities Depository Limited 7) Reliance Industries Limited 8) Dilip Shantilal Shanghvi 9) Vijay Shekhar Sharma 10) Tech Mahindra Limited 11) Vodafone m-pesa Limited

¹⁷The entities that folded their licenses are: 1) Aditya Birla Nuvo Limited 2) Cholamandalam Distribution Services Limited 3) Shri Dilip Shantilal Shanghvi 4) Tech Mahindra Limited 5) Vodafone m-pesa Limited.

¹⁸Cholamandalam Distribution Services Limited, Shri Dilip Shantilal Shanghvi (promoter of Sun Pharma) and Tech Mahindra Limited surrendered their in-principle licenses without starting operations. Aditya Birla Idea PB is the only one, so far, that had surrendered its license after having started operations.

¹⁹ The seven PBs which had begun operations are: 1) Airtel Payments Bank 2) India Post Payments Bank 3) Fino Payments Bank 4) Paytm Payments Bank 5) Aditya Birla Payments Bank 6) Jio Payments Bank and 7) NSDL Payments Bank, hereafter referred to in this note as Airtel PB, IPPB, Fino PB, Paytm PB, ABIPB, Jio PB and NSDL PB respectively.

The data used for the analyses were obtained from RBI website, including from the Database of Indian Economy (DBIE), data from the Ministry of Corporate Affairs' Master Data, information from company's/parent company's annual reports (where available) of PBs and their respective websites.

3. Performance of Payments Banks

We analyse the performance of each of the four PBs in question – IPPB, Fino PB, Airtel PB and Paytm PB, along metrics such as touchpoints and transactions to see how the PBs have fared on financial inclusion goals.

3.1. Has there been a proliferation of transaction touchpoints?

To analyse the reach of PBs in providing banking services, we look at the spread of their physical access points beyond fixed points or brick-and-mortar structures. We refer to these points as touchpoints in this analysis. Touchpoints made available by PBs include BCs, Point of Sale Terminals (POS) handle by BCs (or merchants), branches²⁰ points of any other banking outlet²¹, and unmanned points such as ATMs.

One of the major differentiation strategies expected of PBs (in comparison to full-service banks) is that they would set up and utilize a large network of touchpoints, going beyond branch touchpoints to engage an extensive network of partners and BCs. For this very reason, RBI in the PB licensing guidelines, invited applications from entities such as corporate BCs, mobile telephone companies, super-market chains and real sector cooperatives. The guidelines further state that for the business model to be effective, PBs should ensure widespread network of touchpoints particularly in remote areas, either through their own branch network, ATMs or BCs, or through networks provided by others.

Shown in Table 1 is an illustration of the branch network strategies across different kinds of entities – PB, SFB, newly established full-service banks and an incumbent SCB.

Bank	No. of Branches	No. of BC Touchpoints	BC Touchpoint: Branch Ratio
Yes Bank	1,120	31,000	27.7:1.0
Bandhan Bank	986	3,014	3.1:1.0
IDFC First Bank	698	100	0.1:1.0
Au SFB	322	67	0.2:1.0
Fino PB	103	2,00,000	1941.7:1.0
Paytm PB	7	2,00,000	28571.4:1.0
IPPB	650	1,95,000	300.0:1.0

Table: 1 - BC Touchpoint: Branch Ratio²²

²⁰ Branches of banks refer to those offices which are engaged in either: 1) banking business (i.e., either accepting deposit and/or offering credit to their customer), 2) banking and foreign exchange business, 3. administration, banking & foreign exchange, 4) administration and banking 5) administration and foreign exchange, or 6) only foreign exchange business. Directory of Bank Offices, RBI Publication. Available at: <https://www.rbi.org.in/scripts/certainconcepts.aspx>

²¹ RBI defines a Banking Outlet for a domestic SCB, SFB and a PB as “a fixed point service delivery unit, manned by either bank's staff or its Business Correspondent where services of acceptance of deposits, encashment of cheques/ cash withdrawal or lending of money are provided for a minimum of 4 hours per day for at least five days a week. It carries uniform signage with name of the bank and authorisation from it, contact details of the controlling authorities and complaint escalation mechanism. The bank should have a regular off-site and on-site monitoring of the 'Banking Outlet' to ensure proper supervision, 'uninterrupted service' except temporary interruptions due to telecom connectivity, etc. and timely addressing of customer grievances. The working hours/days need to be displayed prominently.” Rationalization of Branch Authorization Guidelines – Revision of Guidelines, May 18, 2017. RBI Circulars. Available at: <https://rbidocs.rbi.org.in/rdocs/notification/PDFs/NOTI3062319C9C94C33494794C2B5271CF92878.PDF>

²² Source: Banks' Websites/Annual Reports

We see from Table 1 that it may well be the case that the number of touchpoints for PBs is much higher than that of individual full-service banks in general. As PBs are permitted to become BCs of other banks²³, a portion of these could be touchpoints which are part of other banks' networks and not exclusively of PBs. That banks can employ PBs to be their BCs, gives them the opportunity to service those regions which they previously considered as unviable to serve. Therefore, SCBs and SFBs can leverage the PB network to expand their network of touchpoints. For instance, Fino has partnered with ICICI Bank to provide BC services²⁴. The wide network of PBs indicates that their model is better positioned to pursue the objective of transactions inclusion than that of SCBs or SFBs.

PBs are uniquely positioned as they both employ BCs and can be employed as BCs. Possibly to counteract operational risk issues such as that encountered with the misuse of consent by Paytm's agents²⁵, RBI's operating guidelines for PBs state that 'in cases where a PB is acting as the BC for a bank, the BC engaged by the PB shall not open deposit accounts for the partner bank for whom the PB acts as the BC or undertake KYC documentation for that bank²⁶'. The role of a BC engaged by a PB, therefore, is limited to undertaking transactions for the PB's partner bank.

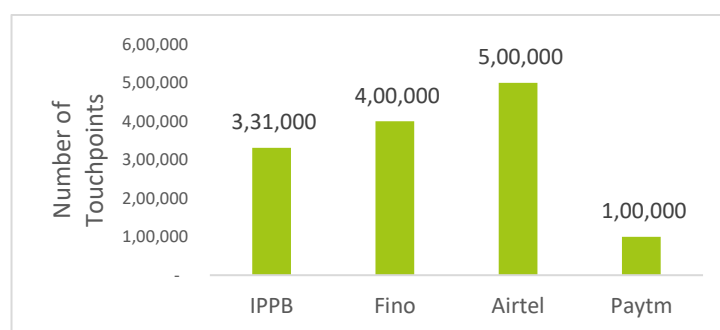


Figure 2: Total Number of Touchpoints of PBs - Mar 2020
Source: Annual Report/Website/Newspaper Articles²⁷

Figure 2 shows us the self-declared number of touchpoints for each of the four PBs in question as of March 2020, with the exception of IPPB where the number was taken as the sum of number of IPPB branches and number of postmen/postwomen who have been engaged in providing banking services. It is likely that there are significant definitional differences in what each of the PBs has counted as a touchpoint. For example, Fino and Airtel PBs use the term 'banking point' to describe their touchpoint network. It is unclear what these banking points entail; since RBI does not have a definition for a banking or a merchant point, it is possible that banks have been using the terms Banking Outlets and Banking/Merchant Points interchangeably. In addition to the typical retail merchant points, Fino PB has a wide variety of touchpoints such as petrol outlets and e-Mitra service points due to its

²³ VI. Functioning as Business Correspondent (BC) of another bank, Scope of Activities, Guidelines for Licensing of Payments Banks, RBI Circular Nov 27, 2014. Available at: https://www.rbi.org.in/scripts/bs_viewcontent.aspx?Id=2900

²⁴ <https://www.icicibank.com/managed-assets/docs/personal/agri-and-rural/business-correspondent-list-as-at-march-31-2019.pdf>

²⁵ Ramanathan.A and Mishra.A.K (2018, August). Inside the Paytm Payments Bank Fiasco. *The Ken*. Retrieved from: <https://the-ken.com/story/inside-the-paytm-payments-bank-fiasco/>

²⁶ 6.2 Regulation of Business Correspondents, Operating Guidelines for Payments Banks, RBI Notification October 6, 2016. Available at: <https://www.rbi.org.in/scripts/NotificationUser.aspx?Mode=0&Id=10635>

²⁷ Paytm ka ATMs - <https://www.paytmbank.com/home>

IPPB Annual Report 2018-19 : <https://ippbonline.com/documents/31498/0/Annual+Report+ Final+English.pdf/6187dac3-3a59-ae0f-c462-c5c3c3c49dc7>

Airtel – 2019, September. Airtel Payments Bank offers Bharosa Savings Account Scheme: 5 things to know. *LiveMint*. Retrieved from : <https://www.livemint.com/money/personal-finance/airtel-payments-bank-launches-bharosa-savings-account-scheme-5-things-to-know-1568777998036.html>

Fino - <https://www.finobank.com/about-us/news-media/media-coverage/national-coverage/2020/fino-payments-bank-to-more-than-double-merchant-points-by-fy23-says-md--ceo/>

partnership with Bharat Petroleum Corporation Limited (BPCL)²⁸, and Rajcomp, which runs the Government of Rajasthan's citizen service initiative²⁹.

Airtel PB, whose touchpoint network is the largest, is the only PB with a Mobile Network Operator (MNO) parent. Therefore, it is well-positioned to make use of its parent's existing network of more than 10 lakh retailers³⁰ who provide mobile connections and recharges at their shops.

IPPB has enabled 1,36,000 post offices to provide a complete suite of banking services. There are 1,55,015 post offices of India Post across the country. Therefore, the IPPB branch numbers indicate about 88% utilization of the existing India Post network. According to IPPB's 2019 Annual Report, out of the total banking-services-enabled post offices, 1,10,000 are in rural areas. Therefore, the rural outreach of the IPPB network is possibly greater than that of other PBs, especially taking into account the 1,95,000 postmen/postwomen who have been equipped with skills and devices needed for door-to-door delivery of IPPB's banking services.

In 2017, Paytm PB's first year of operation, the bank had started 3000 branded banking outlets run by local BCs³¹. These banking outlets were the first form of physical presence set up by the bank, who in its earlier role of a wallet provider (Paytm Wallet), had only digital operations. The plan was to scale these branded outlets to 1 lakh outlets by the end of an operational year. Another form of touchpoint enabled by Paytm PB is their 'KYC point' through which customers can get their KYC compliance done³². However, it is not clear if these KYC points are in addition to the banking outlets or if they are subsumed within the banking outlets definition.

While it is clear that PBs collectively have a large network of touchpoints, it is also important to assess the composition of these touchpoints. Therefore, in the following subsections, we take a closer look at each of the PBs to understand the nature and distribution of their branch network, as well as the non-branch network enabled through the physical touchpoints of ATMs and POS terminals. An analysis of touchpoints beyond branches/ATMs/POS enabled touchpoints, could not be undertaken due to a paucity of data. Finally, this section ends with an examination of how PBs fare in using their touchpoint network to fulfil the mandate of servicing unbanked rural centres.

3.1.1 Has there been an increase in Branch Spread?

As of May 2020, the total number of branches of the four PBs in question was 765^{33,34} as shown in Figure 3. IPPB has the greatest number of branches, forming close to 85% of these branches³⁵.

²⁸ URL: [https://www.finobank.com/about-us/news-media/press-release/2016/fino-paytech-in-a-strategic-partnership-with-bpcl-for-its-payments-bank-foray/#:~:text=Mumbai%2C%20July%202016%3A,Petroleum%20Corporation%20Limited%20\(BPCL\).](https://www.finobank.com/about-us/news-media/press-release/2016/fino-paytech-in-a-strategic-partnership-with-bpcl-for-its-payments-bank-foray/#:~:text=Mumbai%2C%20July%202016%3A,Petroleum%20Corporation%20Limited%20(BPCL).)

²⁹URL: <https://www.finobank.com/about-us/news-media/press-release/2017/fino-payments-bank-signs-up-e-mitra-as-bc-points-in-rajasthan/>

³⁰ Our business and value creation model, Bharti Airtel Annual Report – FY 2018-19, Accessed from: <https://assets.airtel.in/static-assets/cms/Bharti-Airtel-Limited-Integrated-Report-Annual-Financial-Statements-2018-19.pdf>

³¹Paytm Staff. 2017, December. Paytm Payments Bank brings banking access near you with 'Paytm ka ATM'. *Paytm Blog*. Retrieved from: <https://blog.paytm.com/paytm-payments-bank-brings-banking-access-near-you-with-paytm-ka-atm09afb35e1b0#:~:text=These%20specially%20branded%20outlets%20will,help%20and%20support%20among%20othe rs.>

³² Paytm's website: <https://www.paytmbank.com/kyc>

³³ Directory of Commercial Banks in India. Available at <https://dbie.rbi.org.in/DBIE/MOFSelectParam.jsp>

³⁴ ABIPB had 7 branches. Jio PB (still in pilot phase) has 9 branches. NSDL has none yet.

³⁵ We must note that there is some inconsistency in branch data for Fino PB. While the RBI's Database on the Indian Economy (DBIE) shows only 103 branches as of May 2020, Fino PB's website mentions that they launched with around 410 branches. It is possible that the bank had included banking outlets and/or merchant/banking points in counting branches, or that Fino PB closed down as many as 307 branches between June 2017 (launch date) and March 2020. No clarification could be found on either the RBI's or Fino PB's website regarding this matter.

Figure 4 shows the region-wise distribution of these branches. It is not surprising that IPPB exhibits the best spread of branches across all regions. While the plan is for all post offices to be enabled as touchpoints, in terms of branches, only 650 have been set up— one for each district. Each of these branches acts as a controlling office³⁶ for all the touchpoints within the district. Due to their full district coverage policy, IPPB has been able to mark its presence in the North-Eastern region as the only PB, so far, to open branches³⁷.

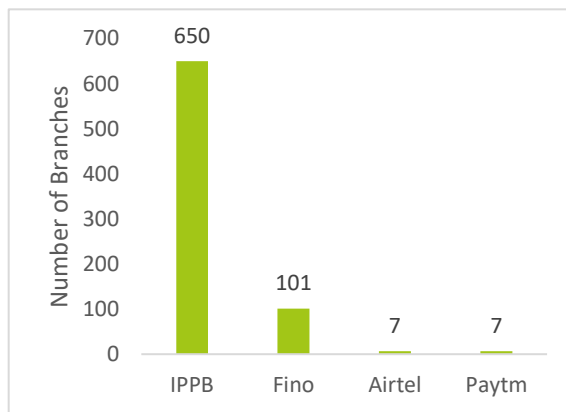


Figure 3: Number of Branches of the full-scale PBs
Source: DBIE

Based on its relatively high presence in the Western region, it appears that Fino PB is aiming to emerge as a strong regional player as it is already ahead of other PBs (except IPPB) in its branch network in

the Western belt.

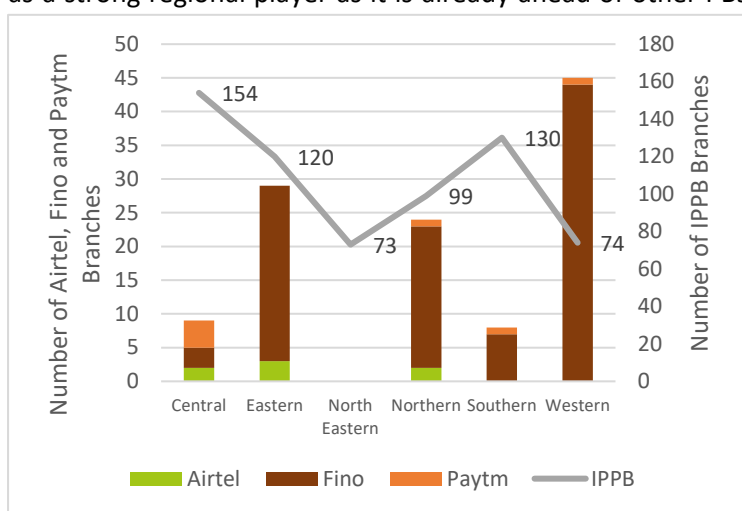


Figure 4: Region-wise Spread of PB Branches – May 2020
Source: DBIE

As for Paytm and Airtel PBs, they collectively have 14 branches across the country, whereas their access points are 6 lakh in number, indicating their non-branch based strategy for service delivery.

Rural areas have the least presence of PB branches, and urban areas have the highest number of branches as seen in Figure 5, from a population group-wise³⁸ distribution of PB branches as of May 2020. While IPPB’s branch presence is relatively

less in rural areas than in semi-urban and urban areas, in absolute terms, it is considerably greater than that of all the other PBs. Further, the urban-skewed distribution of IPPB's branches may be attributed to IPPB’s strategy of placing one branch in each district, often in the district headquarters. However, we must note again, that these figures are only for branches which form a small proportion of the total number of touchpoints of the PBs.

³⁶ One of the conditions stated in the PB licensing guidelines is that a controlling office for a cluster of access points be established for control over various outlets and customer grievance redressal.

³⁷ The RBI guidelines for licensing of Payments Banks state that a preference would be given to those applicants who propose to set up PBs with access points primarily in the under-banked states/ districts in the North-East, East and Central region. However, unlike in the case of SFBs where RGVN (later renamed as North East SFB) which had sole presence in the North East was given a banking license, Payments Banks saw no such strong regional player in the underbanked regions.

³⁸ Population Groups are classified by RBI accordingly: Rural – up to 9,999; Semi-urban – 10,000 to 99,999; Urban – 1,00,000 – 9,99,999 and Metropolitan – above 10,00,000.

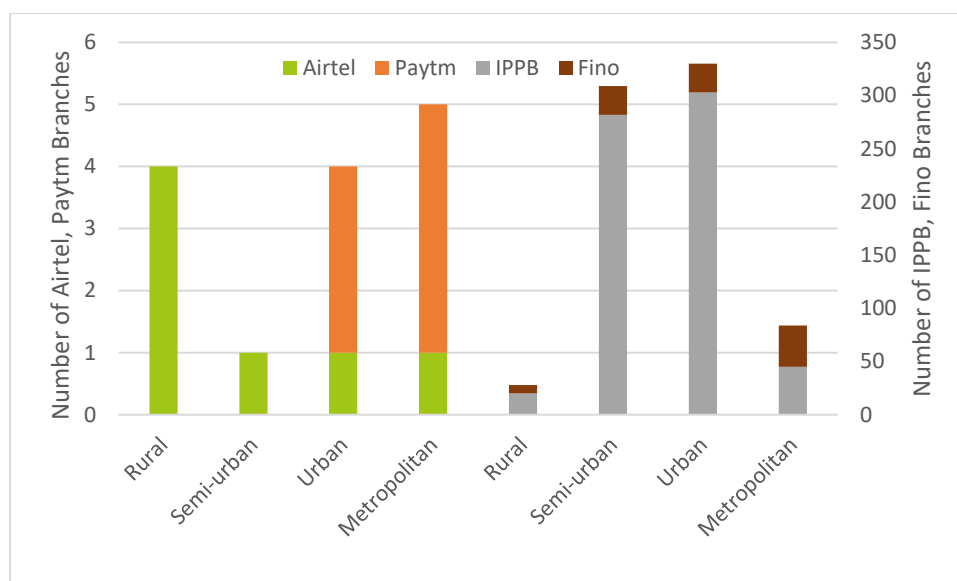


Figure 5: Population Groupwise Distribution of PB branches
Source: DBIE³⁹

Figure 6 plots the proportion of bank branches in under-banked centres across various types of banks, as of March 2020. Centres with five or fewer number of bank branches were considered under-banked for the purpose of this analysis. As shown below, Regional Rural Banks have over 75% of their branches in under-banked centres, whereas only 7% of the PB branches are in these centres. IPPB’s branches form around 60% of those PB branches in under-banked centres.

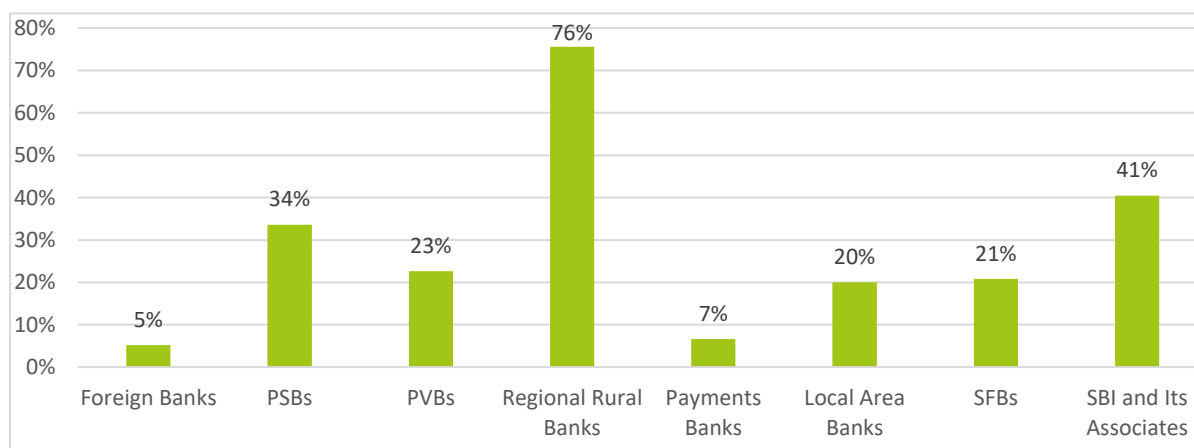


Figure 6: Bank Group wise Proportion of Branches in Under-Banked Centres
Source: DBIE

However, it will be inaccurate to draw inferences about the effects of establishing PBs on financial inclusion based only on branch-level data, since these banks have adequately established non-branch (BC/ATM/POS) networks in rural/under-banked regions. Since detailed data on touchpoint locations for PBs is unavailable, this remains inconclusive.

³⁹ Directory of Commercial Banks in India. Available at <https://dbie.rbi.org.in/DBIE/MOFSelectParam.jsp>

3.1.2 Establishment of own ATMs and Acquiring POS

ATMs, and POS terminals are important touchpoints that help in extending the reach of the banks' service delivery. ATMs are largely engaged in CICO services, although they may be additionally equipped to provide services such as bill payments and purchase of re-load vouchers for mobiles and so on⁴⁰. On the other hand, POS terminals are prominently used for purchases at a retail shops and for debit and credit card transactions at physical locations.

Shown in Table 2 are RBI's statistics on the number of ATMs and POS terminals⁴¹ deployed by PBs as of March 2020. These figures pertain to own ATMs established by the PBs and of POS terminals where the PB is the acquirer bank. No PBs other than Fino PB and Paytm PB are engaged in deploying ATMs/POS terminals. Paytm PB's number of deployed POS terminals is more than that of mid-sized banks such as Punjab National Bank and IndusInd⁴².

PB	ATM	POS
Fino	0	338
Paytm	16	1,56,178

Table 2: Number of PB ATMs and POS - March 2020

IPPB does not have any POS devices, neither do they issue debit cards. Instead, for the purpose of banking, QR cards and biometric enabled smart devices (micro-ATM⁴³) are used. IPPB's agents (the postmen/postwomen or the BCs) initiate transactions by taking the customers' biometrics and their Aadhaar number which is stored in the QR card⁴⁴. Further, for enabling customers to make payments at retail stores, IPPB is planning to onboard retailers into placing IPPB QR code at the stores.

Airtel PB too has not deployed any POS machines. Instead, it appears to have chosen to employ the Aadhaar enabled Payment System (AePS) which can be used to perform transactions at a micro-ATM manned by a BC⁴⁵. Therefore, those customers who have been Aadhaar-authenticated can engage in point-of-sale transactions even if the acquirer bank of the micro-ATM is not Airtel PB. Fino PB and IPPB too have the AePS system enabled⁴⁶. Moreover, Airtel PB has set up a form of card-less cash withdrawal, Instant Money Transfer (IMT), which can be used through its mobile app to withdraw cash from IMT-enabled ATMs. IMT can also be used by customers to transfer money to another customer with only a mobile number.

Airtel	11,93,129
Fino	11,18,167
IPPB	30
Paytm	5,75,30,813

Table 3: Number of Debit Cards Issued by PBs – March 2020

⁴⁰ 5. What are the services/facilities available at ATM/WLAs? RBI FAQs. Retrieved from: <https://m.rbi.org.in/Scripts/FAQView.aspx?id=75>

⁴¹ A POS machine too is used to carry out financial transactions, except in a limited manner. POS is used largely for payments, often by merchants and BCs, although other operations like recording deposits, checking balance, providing mini statement can be undertaken. Unlike for ATMs, a cash-out option is not available for POS beyond Rs.2000 (and this feature is not widely used).

⁴² As of March 2020, Punjab National Bank and IndusInd Bank had deployed 80,303 and 1,15,793 POS terminals respectively. From Bankwise ATM/POS/Card Statistics, RBI Data – March 2020, RBI Data. Retrieved from: <https://www.rbi.org.in/Scripts/ATMView.aspx>

⁴³ Micro-ATM is specified by NPCI as an all-in-one integrated device or mobile/PC/tablet with accessories equipped to perform basic financial transactions such as deposit, withdrawal, funds transfer and balance enquiry using only a customer's Aadhaar number and their biometric/OTP as identity proof. Source: Micro-ATM Standards, NPCI. Retrieved from: https://www.npci.org.in/sites/all/themes/npci/images/PDF/MicroATM_Standards_v1.5.1_Clean.pdf

⁴⁴ As stated in IPPB's Annual Report 2017-18. Retrieved from: <https://ippbonline.com/documents/31498/0/Annual+Report+-+Final+English.pdf/6187dac3-3a59-ae0f-c462-c5c3c3c49dc7>

⁴⁵ ET Bureau. (2020, Feb). Airtel Payments Bank rolls out Aadhaar enabled payment system. *Economic Times*. Retrieved from: <https://economictimes.indiatimes.com/industry/telecom/telecom-news/airtel-payments-bank-rolls-out-aadhaar-enabled-payment-system/articleshow/74338371.cms?from=mdr>

⁴⁶ AePS Live Members, NPCI. Retrieved from: <https://www.npci.org.in/aeps-live-members>

It must be noted here that this extremely low number of ATMs held by PBs demonstrates a general approach that stays away from incurring these fixed costs but rides on existing banks' ATMs to allow for cash withdrawals for their customers. This approach is operationalised using the debit cards issued by the PBs. From Table 3⁴⁷, we see that Paytm PB has a considerably large number of debit cards issued, of which a sizeable portion may be virtual in nature. Airtel PB too primarily issues only virtual debit cards.

3.1.3 Banking Services in Unbanked Rural Centres

In order to extend financial services to hitherto unserved regions, the RBI requires banks to open 25% of their 'banking outlets' in Unbanked Rural Centres (URC). As defined in RBI's Rationalization of Branch Authorization Policy of 2017⁴⁸, 'an Unbanked Rural Centre is a rural (Tier 5 and 6) centre that does not have a CBS-enabled 'Banking Outlet' of a Scheduled Commercial Bank, a Small Finance Bank, a Payment Bank or a Regional Rural Bank nor a branch of Local Area Bank or licensed Co-operative Bank for carrying out customer based banking transactions'⁴⁹.

The earlier guidelines, prior to the 2017 revision, required that 25% of 'branches' be opened in URCs. Branches here include all branches, i.e., full-fledged branches, specialised branches, satellite offices, mobile branches, extension Counters, off-site ATMs, administrative offices, controlling offices, service branches (back office or processing centre), etc⁵⁰. This requirement was changed to 'banking outlet', expanded to include fixed point BC outlet as well as allowing for the consideration of part-time functioning of these outlets. This change in the authorization rules thus allows banks the flexibility to choose their business strategy in terms of a mix of different service delivery options, including low-cost ones such as BC points. At the same time, the requirement still ensures adequate outreach of banking facilities.

Figure 7 below depicts the constitution of banking outlets and other access points. The revised Branch Authorization Policy of 2017 has a provision for calculating the fulfilment of the 25% requirement for even part-time outlets on a pro-rata basis⁵¹.

⁴⁷ Bankwise ATM/POS/Card Statistics, RBI Data – March 2020, RBI Data. Retrieved from: <https://www.rbi.org.in/Scripts/ATMView.aspx>

⁴⁸ Reproduced from 'Rationalisation of Branch Authorization Policy – Revised Guidelines', RBI Notification, May 18, 2017. Available at: <https://rbidocs.rbi.org.in/rdocs/notification/PDFs/NOTI3062319C9C94C33494794C2B5271CF92878.PDF>

⁴⁹ RBI defines a centre as 'The revenue unit (and not the locality) classified and delineated by the respective State Government, i.e., a revenue village/ city/ town/ municipality/ municipal corporation, etc., as the case may be, in which the branch is situated.' Notes on tables on Master Office File (MOF) database. Available at: https://dbie.rbi.org.in/DBIE/doc/Notes_on_MOF_Tables.pdf; Rural centres are those centres with population of up to 9,999 as per the latest Census

⁵⁰ Master Circular on Branch Authorization, July 1, 2014, RBI Master Circulars. Available at: <https://www.rbi.org.in/scripts/NotificationUser.aspx?Mode=0&Id=9014>

⁵¹ The part-time banking outlets (those functioning for less than 4 hours per day and 5 days a week) are given a pro-rata benefit of being counted as fractional banking outlet in the calculation of the 25% requirement. For example, an outlet functioning for 2 hours a day for 5 days in a week counts as 0.5 banking outlet.

The Universe of Touchpoints		
Banking Outlets		Non-Banking Outlet Access Points
<p>Full-time (functioning > 4 hours per day, 5 days a week)</p>	<ul style="list-style-type: none"> Full-fledged branch Part-Shifted branches Specialised branches Ultra small branches 	<ul style="list-style-type: none"> ATMs E-kiosks E-lobbies Mobile branches Cash Deposit Machines (CDM) Bunch Note Acceptor Machines (BNAM) BC point (equipped with POS terminal)¹
<p>Part-time (functioning <4 hours per day, 5 days a week)</p>	<ul style="list-style-type: none"> Extension counters Satellite Offices Fixed-point BC outlets 	
<p>Definition: A fixed point service delivery unit, manned by either bank's staff or its Business Correspondent where services of acceptance of deposits, encashment of cheques/ cash withdrawal or lending of money are provided for a minimum of 4 hours per day for at least five days a week.</p>		

Figure 7: Representation of Universe of Touch Points Available to Banks
Source: DBIE⁵²

The change from using branch to banking outlet for the authorization policy was a key recommendation made in the 2016 report of the Internal Working Group on Rationalisation of Branch Authorisation Policy⁵³. It was considered that the banking landscape would broaden with the advent of PBs and SFBs which would use technology for a wider distribution of services, and therefore necessitating the change in definition of branches to include a wider list of outreach methods.

Further, this report places the number of unbanked centres (defined in the report as those centres without a brick and mortar branch of a bank), at 5,55,722 (as on Dec 31, 2015), of which 99.7% are in the rural areas. The corresponding population in these unbanked centres forms 96% of the total population (as per population figures of Census 2011). Of the total number of PB touchpoints,

assuming adherence to the RBI's branch authorization policy, it is estimated that 25% of them, i.e., 3.3 lakh PB touchpoints, would be in URCs (See Figure 8). To put this into perspective, as of March 2019, there are 5.4 lakh BC points in villages as reported by RBI⁵⁴ for a total of about 6.4 lakh villages (as per Census 2011). The CCFS report had envisioned that the number and distribution of electronic payment access points should be such that every single resident would be within a fifteen-minute walking distance from such a point anywhere in the country⁵⁵. Therefore, the contribution by PBs towards deepening financial inclusion moves us closer to the vision of ubiquitous access to payment services.

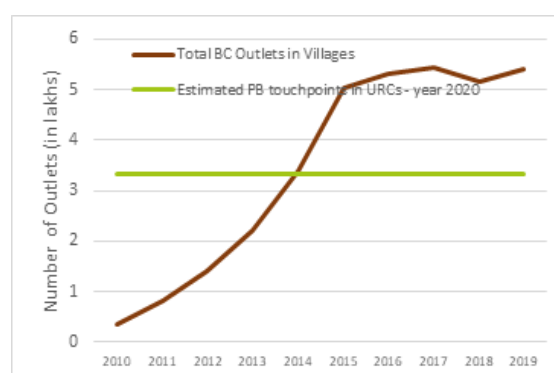


Figure 8: No. of BC points vs PB points

⁵² Produced using 'Rationalisation of Branch Authorization Policy – Revised Guidelines', RBI Notification, May 18, 2017. Available at: <https://rbidocs.rbi.org.in/rdocs/notification/PDFs/NOTI3062319C9C94C33494794C2B5271CF92878.PDF>

⁵³ Available at: <https://www.rbi.org.in/scripts/PublicationReportDetails.aspx?UrlPage=&ID=854>

⁵⁴ Table IV.6: Financial Inclusion Plan: A Progress Report, Credit Delivery and Financial Inclusion, RBI Annual Report 2018-19. Available at: <https://m.rbi.org.in/Scripts/AnnualReportPublications.aspx?Id=1259>

⁵⁵ Vision Statement for Financial Inclusion and Financial Deepening in India, Section 2, Committee on Comprehensive Financial Services for Small Businesses and Low-Income Households, RBI Publications. Retrieved from: <https://rbidocs.rbi.org.in/rdocs/PublicationReport/Pdfs/CFS070114RFL.pdf>

Information on the district-wise or region-wise or population group-wise (urban/semi-urban/rural) spread of these touchpoints is needed to understand which parts of the country have been covered and what the density of touchpoints is. This would help in estimating the effect of PBs in furthering access to payment services in remote regions which digital strategies may not possible immediately.

3.2 What are the relative volumes and the nature of transactions through PBs?⁵⁶

One of the two key objectives of the PB model as specified in the PB licensing guidelines is that they will ‘provide payments/remittance services to the underserved population such as migrant labour workforce, low income households, small businesses and other unorganised sector entities’. An analysis of the transactions enabled by PBs at a centre/tier-wise customer accounts level would help us in understanding whether this objective has been met. While it is required for banks to capture this information and their Board of Directors set internal targets for financial inclusion⁵⁷, this information is not publicly available, thus limiting the discussion in this section to only an aggregate bank-level analysis.

In the following subsections, we analyse transactions enabled by PBs at physical touchpoints of ATMs and POS terminals, and digitally through mobile banking (as a channel) and the transaction modes⁵⁸ of National Electronic Fund Transfer (NEFT) and Real Time Gross Settlement (RTGS) to understand their nature and volumes in comparison with other banks.

3.2.1 Transactions at Physical Touchpoints

The charts in Figure 9 show data on transactions done on debit cards issued by PBs, at ATMs and POS terminals, for the financial year ending March 2020. These figures do not include IPPB which did not issue debit cards. We observe that for Paytm PB, the number of transactions carried out through ATMs is lower than those done through POS, but the value of ATM transactions is much higher than those through POS, thus indicating the usage of the POS channel for making low-value retail payments. The numbers for Fino PB are significantly smaller than those for Paytm PB, likely due to Fino PB having fewer cards in circulation⁵⁹. However, the average number of physical touchpoint transactions (at ATM and POS) per card in the month of March 2020⁶⁰ is higher for Fino PB than for Paytm PB, implying greater utility of its debit cards for its users. Comparing with two other SCBs, we see in the chart below that the average value of transactions for PBs is relatively low, demonstrating their model of servicing small-ticket transactions.

⁵⁶ The discussion in this section considers the sum of outward and inward transactions as the ‘number of transactions.’

⁵⁷ 13. Role of Board of Directors, Rationalisation of Branch Authorization Policy – Revised Guidelines, RBI Notification, May 18, 2017. Available at: <https://rbidocs.rbi.org.in/rdocs/notification/PDFs/NOTI3062319C9C94C33494794C2B5271CF92878.PDF>

⁵⁸ Immediate Payment Service (IMPS) transactions could not be analysed as bank/bank-group wise split in data was not available

⁵⁹ Fino PB had 11,18,167 cards outstanding, whereas Paytm PB had 5,98,44,872 cards outstanding at the end of March 2020.

⁶⁰ Average number of transactions per card for Fino PB and Paytm PB is 0.51 and 0.08 respectively. Calculated as (Number of transactions at ATM + number of transactions at POS)/ Number of outstanding debit cards, from Bankwise ATM/POS/Card Statistics, RBI Data – March 2020, RBI Data. Retrieved from: <https://www.rbi.org.in/Scripts/ATMView.aspx>

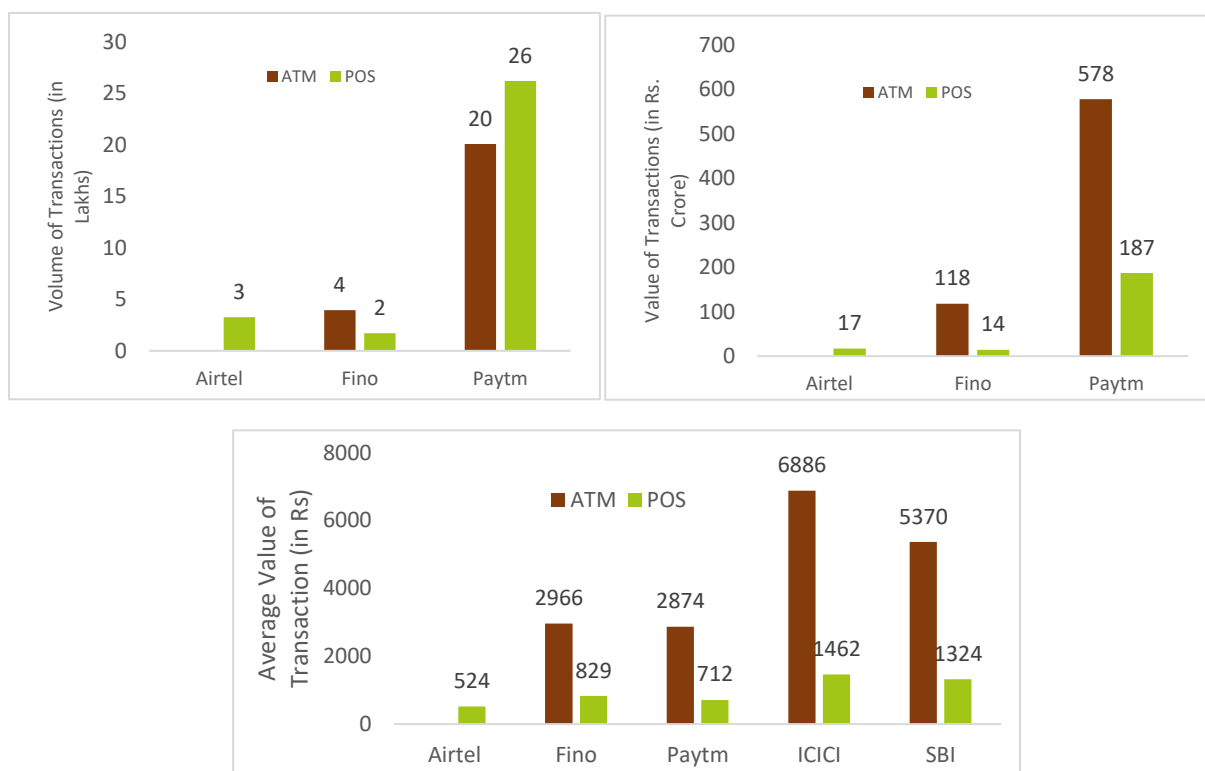


Figure 9: Volumes, Total Value and Average Value of ATM/POS Transactions via PB Debit Cards - March 2020

Source: RBI Data⁶¹

Figure 10 shows that, for the financial year ending March 2020, the numbers for POS transactions (transactions at all POS terminals done using debit cards issued by PBs) of the three full-scale PBs (not counting IPPB which had zero POS transactions) are better than that of 10 SFBs. At the same time, the average POS transaction value for PBs and SFBs is Rs. 699 and Rs. 1253 respectively. This shows that PBs are well ahead of SFBs in leveraging its own card transactions at POS terminals and, true to form, are enabling the high-volume lower-value transactions model better than SFBs.

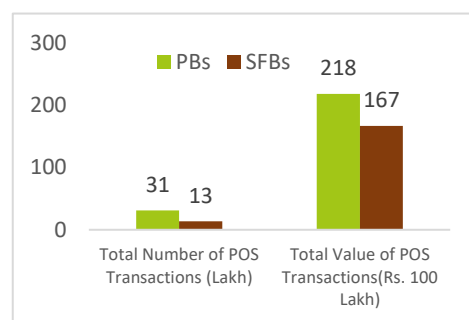


Figure 10: Comparison of POS Transactions of PBs and SFBs

3.2.2 Digital Transactions

Most transactions in the country are still cash-based⁶², despite a momentary drop in the use of cash during the period following demonetization. Since then, there has been a slow and steady increase in digital payments. In the four-year period between 2015 and 2019, the annual growth rate in the volume of retail electronic payment transactions has been over 50%⁶³. The most important modes of transactions of retail digital payments based on volume, are credit cards, debit cards, NEFT, RTGS, Immediate Payment Service (IMPS), PPIs and Unified Payments Interface (UPI).

⁶¹ Bankwise ATM/POS/Card Statistics, RBI Data – March 2020, RBI Data. Retrieved from: <https://www.rbi.org.in/Scripts/ATMView.aspx>

⁶² The ratio of Cash in Circulation (CIC) to GDP is taken as a proxy to assess whether cash is prevalent in an economy. 2018-19 saw this ratio at a high of 11.2%, indicating that cash is highly preferred as a payment instrument. Source: 'Assessment of the progress of digitisation from cash to electronic', RBI Publication – Feb 24, 2020. Available at: <https://www.rbi.org.in/Scripts/PublicationsView.aspx?id=19417>

⁶³ 'Benchmarking India's Payment Systems', RBI Publication – 4 June 2019. Available at: <https://www.rbi.org.in/Scripts/PublicationReportDetails.aspx?UrlPage=&ID=923>

We see from the charts below (in Figure 13) that in three years of operations, PBs have grown tremendously and are servicing large volumes of transactions. Especially, regarding mobile transactions (those individual and corporate payments initiated, processed and authorised using a mobile device), the larger PBs have been outperforming most of the SCBs. Paytm PB alone in March 2020 serviced 8.18 Cr mobile transactions. Only four other banks (State Bank of India, Axis Bank HDFC Bank and ICICI Bank) had a greater number of transactions than Paytm PB in the same month. Compared to SFBs too, PBs performed better with a higher average volume of mobile transactions⁶⁴. Even in terms of total value of all transactions, Paytm PB outperformed 96% of all SCBs, with about Rs. 6613 Crores worth of mobile transactions being performed in March 2020.

Compared to 20 SCBs with the highest value of mobile transactions in March 2020, Paytm PB had the lowest value of average mobile transaction value⁶⁵ (see Figure 11). The low-ticket size of Paytm PB's average transaction despite its high performance (in terms of volumes) clearly points to an operating model different from full-service banks. However, this may simply be due to its payments model and not really a testament to fulfilling the objective of serving the underserved. IPPB too stands out with its high value of average mobile transaction, despite having both low totals of both volume and value of transactions, suggesting a model focusing away from underserved/rural customers.

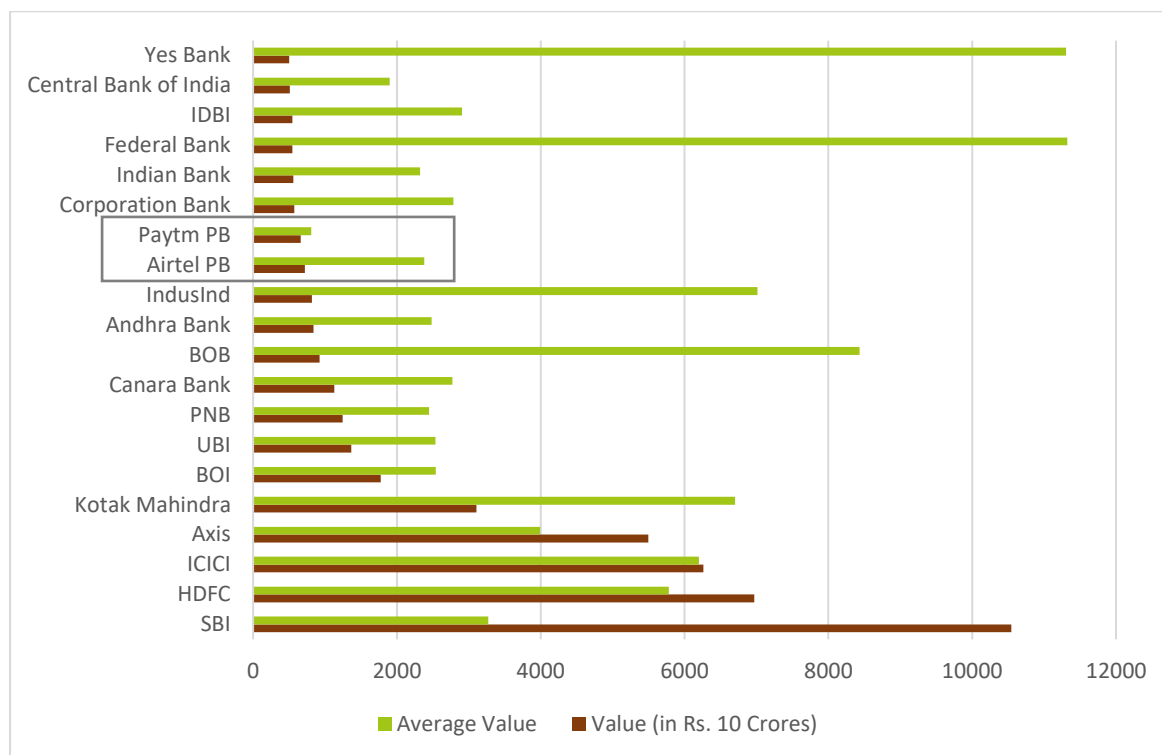


Figure 11: Average Mobile Transaction Value of Banks with Highest Value of Mobile Transactions - March 2020

⁶⁴ The average number of mobile transactions in March 2020 per bank for SFBs and PBs was 3.9 lakhs and 1.93 crores respectively, whereas for SCBs (excluding SFBs and PBs) the value was 36.4 lakhs. Bankwise volumes in ECS/NEFT/RTGS/Mobile Transactions – March, RBI Data. Available at: <https://www.rbi.org.in/Scripts/NEFTView.aspx>

⁶⁵ Paytm's average mobile transaction value for March 2020 was around Rs. 807. The average value of mobile transactions for the SCBs with the top 20 most valued transactions was around Rs. 4495 in the same period.

With NEFT transactions, the PBs’ average value of transaction for March 2020, was significantly lower than that for SFBs and all SCBs and has been decreasing steadily since their commencement. For Real Time Gross Settlement (RTGS)⁶⁶ transactions, the average transactional value of PBs was lower than that of SCBs (excluding PBs and SFBs) but higher than that of SFBs. However, the PBs’ high average is driven largely by Paytm PB, specifically its outward RTGS transactions. The high values and volumes of RTGS transactions could suggest Paytm’s strategy for onboarding business account holders by having zero transactional charges⁶⁷. In terms of volumes of NEFT and RTGS of payments banks, we see that the space is occupied by mostly the top three PBs – Paytm PB, Airtel PB and Fino PB. In terms of value of transactions, we see that Paytm PB has outperformed other PBs by a large margin. This is indeed good news for the bank because these numbers have a positive effect on its profitability.

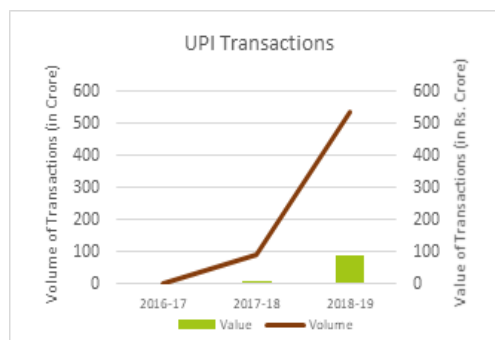


Figure 12: Volume and Value of UPI Transactions

Source: RBI Annual Report 2019

The analysis of the performance of PBs in terms of digital transactions is constrained by the unavailability of bank level data of different modes of transactions beyond NEFT and RTGS. NEFT and RTGS transactions alone do not provide a full picture of the retail digital payments space as they comprise a small portion (about 8% as of May 2020) of the total number of retail transactions. A comprehensive understanding of the transactions space can be gained by including the bank-wise/bank-group wise data of UPI transactions whose volumes have rapidly grown over the years (See Figure 11), to occupy a 48% share of the volume of total payments⁶⁸. The PBs specifically, see relatively greater usage of this channel with the share of their UPI channel in inward and outward remittances of PBs being 74.3% and 69.7% respectively⁶⁹. Considering both inward and outward remittances, PBs occupy 18% of the total UPI transactions in 2018-19. Therefore, the UPI channel plays an important role in fulfilling the PBs’ goal of enabling transactions. However, due to lack of disaggregated data on transactional volumes, it remains to be seen how many of these transactions can be attributed to the underserved populations, given that serving them remains the primary objective of the PB model as envisaged by RBI.

⁶⁶ The RTGS mode of fund transfer is for large value transactions of Rs. 2 lakh or above per transfer. It is to be noted here that the RBI’s PB licensing guidelines specify in ‘Scope of activities’ that the Rs. 1 lakh restriction on PB deposits is on End of Day (EOD) balance, i.e., a greater amount can be remitted through the account as long as the balance by EOD is less than the regulatory limit. This explains how PB customers undertake RTGS transactions.

⁶⁷ Terms and Conditions, Paytm Payments Bank. Retrieved from: <https://www.paytmbank.com/Terms&Conditions>. Accessed on 16th July 2020.

⁶⁸ Table No. 43, Payment System Indicators, Payments Systems, Financial Sector, Statistics. RBI Database on Indian Economy. Retrieved from: <https://dbie.rbi.org.in/DBIE/dbie.rbi?site=statistics>

⁶⁹ Table IV.35: Remittances through Payments Banks during 2018-19, Report on Trend and Progress of Banking in India. Retrieved from: <https://rbidocs.rbi.org.in/rdocs/Publications/PDFs/ORTP241219FL760D9F69321B47988DE44D68D9217A7E.PDF>



Figure 13 - Bank-wise Digital Transactions of PBs – April 2020
Source: RBI DBIE

In summary, we see that PBs have a network of over 13 lakh touchpoints in total. In contrast to other bank groups, PBs’ touchpoints are largely of the non-branch type. While a large proportion of the total touchpoints is contributed by Airtel PB’s wide network of retailers, other PBs too bring in unique elements such as depth of touchpoints provided by IPPB’s geographic spread of post-offices enabled as touchpoints across districts and population groups and its usage of postmen/women as agents, diversity provided by Fino’s partnerships, and lean operations provided by Paytm’s KYC points. PBs are utilizing this spread of touchpoints to serve the unbanked regions as well as to enable large volumes of transactions, including high-value RTGS transactions. The transaction-focussed PB accounts can therefore complement the deposit-focussed accounts that other bank groups provide. Over time, one can expect PBs to continue developing their network through partnerships, including acting as BCs to full-service banks, and strengthening of their own infrastructure to occupy a considerable share of the payments space. However, such a realisation of the payment bank model depends to a considerable extent on the competition faced by model, which we examine in the following section.

4. The Competitive Landscape for PBs

In this section, we shall take a brief look at the competitive space for PBs with respect to the two primary banking functions they offer, namely deposits and payments.

4.1 The Case of SCBs as Competitors

Deposits in PBs serve as a store of funds that can be easily accessed, and through which quick transactions can be facilitated. Additionally, the deposits are expected to act as small savings accounts for the underserved population. This is very similar to the functionality of wallets (for those who can access them easily). While wallets cannot pay interest, the interest rates offered on the PBs' savings accounts are between 2.75% to 3% (Table 4) and averaging at 2.875%. These rates are close to that of SCBs (excluding SFBs). The average interest rate offered by select SCBs is 3.53% (see Annexure 2). In contrast, we see that the SFBs which are also raising deposits for the first time, have priced their savings account interest rates higher (see Annexure 2), with an average of 4.88% interest rate for savings accounts with deposit amounts less than Rs.1 lakh.

Savings Account Interest Rate p.a	
Airtel PB	3.00%
IPPB	2.75%
Paytm PB	3.00%
Fino PB	2.75%

Table 4- PBs' interest rates on savings Accounts – May 2020 (less than Rs. 1 lakh amount)

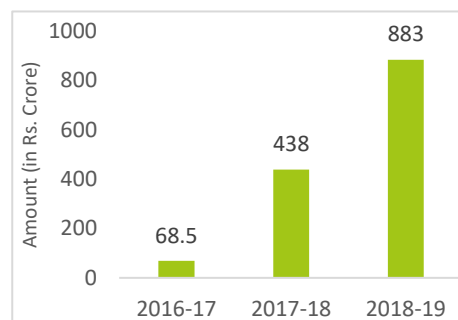


Figure 14: Total Deposits with PBs
Source: Report on Trend and Progress of Banking in India, 2018-19.

Similarly, two new full-service banks, IDFC First Bank and Bandhan Bank, have also priced their savings account interest rates at 6% and 4% per annum, in order to widen the depositor base⁷⁰. Shown in Figure 14 is the total amount of deposits with PBs over the last three financial years. The average annual growth of the deposits in this period is 321%. The high growth rate may be attributed to a low base effect, given that fewer PBs were operational at the beginning of this period⁷¹.

The high individual shares of deposits of Paytm PB and Airtel PB, as seen below in Figure 15, could be due to these banks leveraging their already existing clientele of their respective parent companies – One97 Communications and Bharti Airtel respectively. Paytm's existing wallets which were earlier issued by the parent, One97 Communications, were automatically transferred ownership to Paytm PB⁷². In a 9-month period, starting March 2018, Paytm PB's deposits grew by a factor of about 3.5. Further, according to a blog post by the bank, by April 2019, they had over Rs. 500 crores in deposits. But more details about where this growth came from could not be ascertained. Fino PB was the only bank to have its deposits decline between March and December 2018, the reason behind this remains unclear. More recent statistics on deposits were not available in the public domain.

⁷⁰ The average of the interest rates offered by the ten SFBs as of May 2020 for balances less than Rs. 1 lakh is 4.88%.

⁷¹ The number of operational PBs in FYs 2016-17, 2017-18 and 2018-19 are two, five and seven. Paytm, Fino and ABIPB began operations in FY 2016-17. Jio and NSDL began operations in FY 2017-18.

⁷²(2017, Jan), Paytm to transfer wallet business to payments bank. *Economic Times*. Retrieved from: <https://economictimes.indiatimes.com/small-biz/startups/paytm-to-transfer-wallet-business-to-payments-bank/articleshow/56462457.cms>

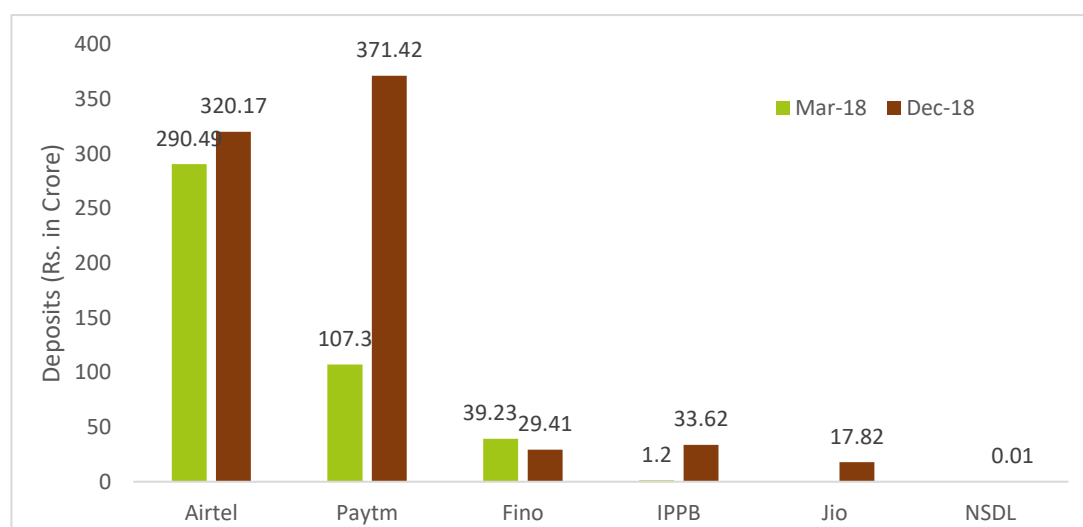


Figure 15: Growth of Individual Deposits of PBs
Source: BloombergQuint⁷³

For depositors having equal access to both PBs and full-service banks, the savings account of PBs do not present themselves as an attractive option as a place to park money in order to earn interest. The PBs might not be able to viably reduce interest rates further as they operate on tight margins due to the regulatory requirement of placing 75% of deposits in risk-free but low-return SLR investments. Therefore, the PBs' business model is not favourable to fulfilling the objective of providing small savings accounts to the underserved. Currently data from RBI is not available on the number of accounts and deposit balances in these accounts for PBs. However, given the high number of transactions against the total deposit amounts held at PBs compared to that of SFBs or select SCBs (Annexure 3), it can be concluded that the users of PB accounts have employed them not as a store of value but as a checking account for undertaking payment transactions with a formal bank. The transaction-focused PB accounts can therefore exist alongside the deposit-focused accounts of full-service banks.

4.2 The Case of Pre-Paid Instruments as Competitors

Pre-Paid Instruments, specifically those in the form of wallets are functionally equivalent to PBs' savings accounts, and the wallets offered by SCBs and non-banks are strong competitors to the PB model. The additional permissions that PBs have, as a result of becoming a bank, are to operate CICO touchpoints and to offer interest on deposits. The licensing guidelines for PBs granted eligibility for existing non-bank PPIs to be promoters. Additionally, existing PPI license holders were also given the option for conversion into PBs. In fact, 17 of the 41 applicants to Payments Bank licenses were existing (or associated entities of existing) PPI license holders⁷⁴.

The CCFS report had recommended that the existing and new PPI applicants be required to apply for a PB license or become a BC⁷⁵. Deviating from this recommendation, RBI guidelines did not

⁷³ Palepu A.R., (2019, May), Exclusive: It's A Two-Horse Race Among India's Payments Banks. *BloombergQuint*. Retrieved from: <https://www.bloombergquint.com/bq-blue-exclusive/exclusive-its-a-two-horse-race-among-indias-payments-banks>

⁷⁴ RBI releases Names of Applicants of Small Finance Banks and Payments Banks, Feb 04, 2015, RBI Press Releases. Retrieved from: https://www.rbi.org.in/scripts/BS_PressReleaseDisplay.aspx?prid=33164;

Certificates of Authorisation issued by the Reserve Bank of India under the Payment and Settlement Systems Act, 2007 for Setting up and Operating Payment System in India, April 30, 2020, RBI Occasional Publications. Available at: <https://m.rbi.org.in/Scripts/PublicationsView.aspx?id=12043>

⁷⁵ 3.9, Recommendation regarding Payments and Savings, Committee on Comprehensive Financial Services for Small Businesses and Low-Income Households Report, p78. Available at: <https://rbidocs.rbi.org.in/rdocs/PublicationReport/Pdfs/CFS070114RFL.pdf>

make it mandatory for existing PPI issuers to convert to either a PB or become a BC, and allowed them to continue as PPI issuers. The following subsections discuss how these PPI issuers have proven themselves to be tough competitors to PBs and to the payments bank model itself.

4.2.1 Transactions

The digital payments space has seen significant changes due to the moderately high growth in usage of PPIs and UPI as payment channels. While PPI is a wallet provider, whether it be closed system, semi-closed or open-system wallets, UPI is an immediate real-time payments system provided by the National Payments Corporation of India (NPCI).

We see from Figure 16 that the use of PPIs saw a tremendous increase⁷⁶ from late-2016 onwards, especially due to the immediate push post demonetization. While the post-demonetization growth rates have been on a decline, the share of PPI volumes to total retail payments has been increasing at an average annual growth of 44% between FY 2013-14 and FY 2018-19⁷⁷.

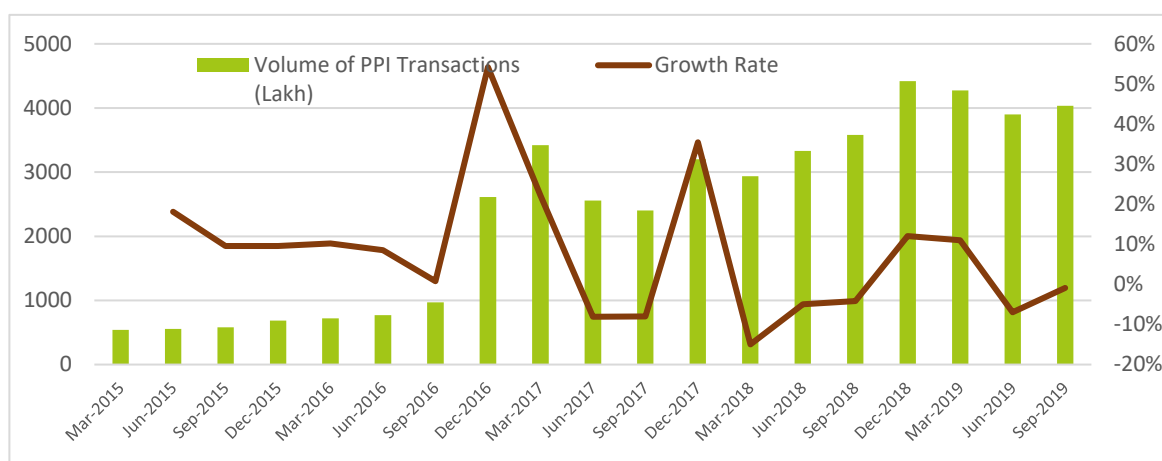


Figure 16: Volume of PPI Transactions
Source: RBI DBIE

Non-PB PPI issuers (both bank and non-bank) enabled close to 436 Crore PPI transactions in the financial year 2018-19⁷⁸. In comparison, the total number of remittances enabled through PBs in the same period is 137 Crore⁷⁹. While the present picture shows us that, in terms of total volumes, the non-PB PPIs are dominating the transactions space, it cannot be concluded whether PPIs have been adopted in semi-rural and rural regions of the country where cash-out services become the key competitive advantage for PBs.

⁷⁶ The period between September 2016 and Feb 2017 saw a 188% increase in the volume of PPI transactions. Table No. 43, Payment System Indicators, Financial Sector, Statistics, RBI DBIE. Available at: <https://dbie.rbi.org.in/DBIE/dbie.rbi?site=statistics>. Post September 2019, a change in data reporting formats has made more recent data uncomparable with that in Figure 16.

⁷⁷ Calculated from Table IX.1: Payment System Indicators – Annual Turnover, IX. Payment and Settlement Systems and Information Technology, RBI Annual Report 2018-19, RBI Publications. Available at: <https://m.rbi.org.in/Scripts/AnnualReportPublications.aspx?Id=1264>

⁷⁸ Month-wise PPI volumes taken from April 2018 to March 2019 from Table No. 43, Payment System Indicators, Payments Systems, Financial Sector, Statistics. RBI Database on Indian Economy. Retrieved from: <https://dbie.rbi.org.in/DBIE/dbie.rbi?site=statistics>

⁷⁹ Remittances calculated as a sum of inward and outward remittances of the channels: NEFT, RTGS, IMPS, UPI, E-Wallets, POS, ATM and Others. Source: Table IV.35 Remittances through Payments Banks during 2018-19, Report on Trends and Progress of Banking in India 2018-19. Available at: <https://rbidocs.rbi.org.in/rdocs/Publications/PDFs/ORTP241219FL760D9F69321B47988DE44D68D9217A7E.PDF>

However, regulatory changes in March 2020⁸⁰ allow users to withdraw cash of up to Rs. 1000 per day in Tier 1 and 2 locations, and up to Rs. 2000 per day in Tier 3 and above locations, at merchant locations using UPI, therefore enabling even PPI issuers to offer cash-out solutions, albeit to a limited extent. As we shall see in the following subsection, this is one of the several regulatory changes which has considerably altered the competitive environment for PPIs, and consequently for PBs as well.

4.2.2 Regulatory Space of PPIs

The PPI regulatory space saw several ups and downs. RBI frequently updated the operational guidelines with developments and advances in the PPI sector. The earlier regulations allowed PPIs to operate a limited version (limits placed on transaction amount, outstanding balance, loading amount) requiring no KYC, only minimum customer details which include OTP verified mobile number and other self-declared details such as name and address⁸¹. Later, the revised RBI regulations allowed the users of full-KYC compliant PPIs higher limits on transaction, outstanding and reloading amounts⁸².

The Aadhaar Act, 2016 provided PPI issuers a revolutionary way of processing KYC, electronic KYC (e-KYC), which allowed them to access KYC data with the Unique Identification Authority of India (UIDAI) by using the unique Aadhaar number of an individual. The PPI issuers of full-KYC versions could have leveraged the Aadhaar infrastructure which had burgeoned in coverage by 2017 with 97% of the population claimed to have been mapped to unique Aadhaar numbers⁸³. However, in September 2018, financial service providers suffered a huge setback when the use of Aadhaar for KYC was disallowed. The PPIs had to not only shift to manual KYC for fresh onboarding of customers but also had to redo the KYC for the existing customers who had Aadhaar KYC⁸⁴. According to Paytm, this exercise was estimated to cost between Rs. 260 to Rs. 270 per person⁸⁵. A subsequent ruling pronounced that only *banks* could do Aadhaar KYC with consent from the consumers⁸⁶. This move now gives the payments banks a slight edge over the PPIs.

⁸⁰ Introduction of cash withdrawal services at merchant location using UPI, 16th March 2020, NPCI Circular. Retrieved from: <https://www.medianama.com/wp-content/uploads/UPI-OC-83-Introduction-of-Cash-Withdrawal-Services-at-Merchant-Location....pdf>

⁸¹ 7. Categories of Pre-paid Payment Instruments, Master Circular – Policy Guidelines on Issuance and Operation of Pre-paid Payment Instruments in India – July 2016, RBI Notifications. Retrieved from: <https://rbidocs.rbi.org.in/rdocs/notification/PDFs/16MC9102DB7D5FE742CCB5D0715A77F6666E.PDF>

⁸² Those semi-closed PPIs which are not converted to being full-KYC within 24 months of date of issue of the PPI shall not be allowed to further credit into the PPIs. However, the user of such PPIs will be allowed to use the balance in the PPI. Additionally, those semi-closed PPIs with balance loaded only from bank accounts are allowed to operate by taking only the minimum details of the user. In both these cases, the monthly outstanding amount is limited to only Rs. 10,000 (in contrast, the limit for full-KYC PPIs is Rs. 1,00,000) and the transactions too are restricted only to the purchase of goods and services and not funds transfer.

⁸³ Global Findex Report 2017, World Bank. Available at: https://globalfindex.worldbank.org/sites/globalfindex/files/2018-04/2017%20Findex%20full%20report_0.pdf

⁸⁴ Alternatively, a 'minimum KYC' can be done using OTP sent to registered mobile number and a digital ID recognized by the Revenue department to continue operating the wallet. This would be valid for a limited period. However, such a KYC would convert the PPI to a 'semi-closed PPI' and no fresh loading onto the instrument is allowed. Additionally, there are more stringent restrictions on the maximum allowed balance and transaction amount. Transactions using the existing balance are allowed.

Semi-closed System PPIs are those PPIs are used for purchase of goods and services, including financial services, remittance facilities, etc., at a group of clearly identified merchant locations / establishments which have a specific contract with the issuer (or contract through a payment aggregator / payment gateway) to accept the PPIs as payment instruments. These instruments do not permit cash withdrawal, irrespective of whether they are issued by banks or non-banks.

⁸⁵ Bhakta. P., (2019, June). Retain minimum KYC rule: Paytm. *Economic Times*. Retrieved from: <https://economictimes.indiatimes.com/small-biz/startups/newsbuzz/retain-minimum-kyc-rule-paytm/articleshow/69734035.cms?from=mdr>

⁸⁶ Banks are allowed to perform e-authentication by RBI, per direction 6(d)(i) of RBI Master Direction - Know Your Customer (KYC) Direction, 2016, accessible at <https://rbidocs.rbi.org.in/rdocs/notification/PDFs/MD18KYCF6E92C82E1E1419D87323E3869BC9F13.PDF>

Another potential advantage for PBs is that those whose promoter is an MNO company can use their existing KYC, subject to customer consent, for opening PB accounts if it is of the same quality as mandated by RBI.

However, the PPIs still enjoy considerable regulatory leeway and competitive advantage especially since interoperability between the PPIs (both within and across the categories) was allowed⁸⁷. As defined by RBI, interoperability is ‘the ability of customers to use a set of payment instruments seamlessly with other users within the segment’⁸⁸. Interoperability of PPIs was envisaged to be enabled in phases, the first being interoperability across those KYC-compliant PPIs issued (by both and non-bank entities) in the form of wallets, enabled through UPI. The subsequent phase would be interoperability enabled between wallets and bank accounts through UPI. Similarly, interoperability across PPIs issued in the form of cards is envisaged through affiliation with authorized card networks, with the cards that are EMV Chip and PIN compliant.

Therefore, the changes brought about by UPI, i.e., allowing cash-out at merchant locations through PPI providers upto Rs. 2000, along with interoperability among wallets and between wallets and bank accounts, has levelled the competitive field to a significant extent. It has brought the full-KYC-compliant PPIs at par with PBs whose only major advantage continues to be their large existing physical retail-facing networks from which to do cash-out. This advantage comes in exchange for complying with the higher levels of micro-prudential regulatory requirements (such as capital adequacy and leverage ratio) and being subject to RBI’s supervisory scrutiny.

5. Challenges

This section talks about the challenges that PBs have faced till now regarding regulatory compliances, the ambiguity over the same and the concerns over profitability.

5.1 Lack of Regulatory Clarity and Violations in Institutional Conduct

PBs have been subjected to supervisory strictures and penalties by the RBI and other authorities. While some of these instances are a clear care of fraudulent behaviour by unscrupulous agents, other instances pertain to institutional negligence when it came to conduct of its agents manning their touchpoints. Some of these conduct violations are not peculiar to only PBs as there have been several cases of misconduct and fraudulent transactions in accounts of other banks too.

In December 2017, UIDAI placed a ban on Airtel PB from using Aadhar e-KYC to register new customers. RBI also imposed a penalty of Rs. 5 Crore on Airtel PB in March 2018 for violation of KYC norms and operating guidelines. It was reported that the bank had been opening accounts without clear consent from its customers. Later in July 2018, the bank was given approval from both UIDAI and RBI to resume onboarding of new customers and to use Aadhar e-KYC for verification⁸⁹.

⁸⁷ Section 18 – Interoperability, Master Direction on Issuance and Operation of Prepaid Payment Instruments, RBI Master Directions. Available at: https://www.rbi.org.in/Scripts/BS_ViewMasDirections.aspx?id=11142

⁸⁸ Prepaid Payment Instruments (PPIs) – Operational Guidelines for Interoperability, October 16, 2018, RBI Notifications. Retrieved from: <https://www.rbi.org.in/SCRIPTS/NotificationUser.aspx?id=11393&Mode=0>

⁸⁹ Press Trust of India. (2018, March). RBI slaps Rs 5 crore penalty on Airtel Payments Bank for violation of norms. *Economic Times*. Retrieved from:

<https://economictimes.indiatimes.com/industry/banking/finance/banking/rbi-slaps-rs-5-crore-penalty-on-airtel-payments-bank-for-violation-of-norms/articleshow/63235308.cms> Press Trust of India. (2018, July).

LPG Subsidy fiasco: Airtel Payments Bank gets RBI, UIDAI nod to resume taking new customers. *Business Standard*.

Retrieved from:

https://www.business-standard.com/article/pti-stories/lpg-subsidy-fiasco-airtel-payments-bank-gets-rbi-uidai-nod-to-resume-taking-new-customers-118071200338_1.html

Like Airtel PB, Paytm PB was also banned from allowing creation of new accounts in June 2018. RBI had concerns about the process followed by Paytm PB for acquiring new customers as well its conformity to the KYC norms. RBI also ordered Paytm PB to shift its operations to a facility separate from its parent (One97 Communications Ltd.) citing security concerns about customer data⁹⁰. Paytm PB account holders have also faced numerous instances of cyber fraud⁹¹. The bank had submitted a list of 3,500 phone numbers to Telecom Regulatory Authority of India (TRAI) to address the issue in addition to filing an FIR against the criminals with the cyber cell⁹². In January 2019, RBI gave a nod to Paytm PB to re-start registering new account holders and resume using KYC for the wallet as well as for the PB⁹³.

Fino PB was also asked to pause on enrolling new customers by the RBI in May 2018 on grounds of violating the operating guidelines. Fino PB was reported to be taking on more than the stipulated Rs. 1,00,000 as deposits. In November 2018, RBI imposed a fine of Rs. 1 crore on the bank for going against the order and taking on new customers⁹⁴.

Additionally, there is a lack of clarity when it comes to certain regulations. For example, it is unclear if BCs can undertake KYC on behalf of entities regulated by RBI, including instantaneous Customer Due Diligence (CDD) process, such as those based on biometric e-KYC. In case of the latter, it is also unclear if there is a need for the bank's employee to manually verify the completed CDD for it to be valid for the purposes of opening an account⁹⁵. While this ambiguity is present for other banking groups too, it particularly affects PBs since their businesses are largely dependent on agent networks.

5.2 Profitability Concerns

Concerns have been raised in public discourse regarding the profitability of the PB model. Two out of the 11 PBs that had received licenses from RBI had shut shop due to profitability concerns. Vodafone Idea had written off Rs. 580 Crores⁹⁶ in the first quarter of 2018-19 for the closure of payments bank.

⁹⁰ Raj,A. and Verma,S., (2018,August). RBI tells Paytm Payments Bank to stop adding new customers with immediate effect. *LiveMint*. Retrieved from:

<https://www.livemint.com/Companies/IEa62oFHkxyja4b36qWr0J/RBI-tells-Paytm-Payments-Bank-to-stop-adding-new-customers-w.html>

⁹¹ Alawadhi,N., (2020, January). Paytm Payments Bank submits list of 3,500 fraud phone numbers to Trai. *Business Standard*. Retrieved from: https://www.business-standard.com/article/companies/paytm-payments-bank-submits-list-of-3-500-fraud-phone-numbers-to-trai-120012401636_1.html

⁹² Customers were asked to install a mobile phone, or a desktop app and the PIN generated was used to gain access to the customer's device. Their accounts were then emptied through a series of transactions. Fraudsters also fooled account holders through SMS, claiming that the account will be closed if KYC details were not shared.

⁹³(2019, January). Account opening restarts at Paytm Payments Bank after RBI nod. *LiveMint*. Retrieved from: <https://www.livemint.com/Companies/jeMrVo3Lx3uEnLzqMQGfkl/Account-opening-restarts-at-Paytm-Payments-Bank-after-RBI-no.html>

⁹⁴Alawadhi,N., (2020, January). Paytm Payments Bank submits list of 3,500 fraud phone numbers to Trai. *Business Standard*. Retrieved from: https://www.business-standard.com/article/companies/paytm-payments-bank-submits-list-of-3-500-fraud-phone-numbers-to-trai-120012401636_1.html

⁹⁵ For more detail, refer to "A closer look at Payments Banks' violations", George. D., Chugh. B, Srinivas.M., Dvara Research. Available at: <https://www.dvara.com/blog/2018/08/31/a-closer-look-at-recent-payments-banks-violations/>

⁹⁶Press Trust of India. (2019, July). Voda Idea to close m-pesa biz, writes off ₹210 cr for payments bank closure. *LiveMint*. Retrieved from: <https://www.livemint.com/industry/telecom/voda-idea-to-close-m-pesa-biz-writes-off-rs-210-cr-for-payments-bank-closure-1564421551275.html>

In 2017-18, ABIPB reported losses of Rs. 24 crores⁹⁷. ABIPB was the only PB to surrender their license after commencing operations.

Given the costing and revenue structure of the PBs (See Annexure 5), that PBs have limited scope for improving their profitability given their current sources of revenue and the corresponding costs. Apart from this, as newly functioning banks, their operational expenditure is very high. As on March 2019, the percentage of operational expenditure of all PBs to their total expenditure was a steep 98%⁹⁸. In comparison, the same figure stands at around 23% for all SCBs. In order to ensure long-term viability, the PBs would need to pursue adjacent revenue sources in addition to its primary sources (deposits and payments), as elaborated earlier.

Currently, PBs are in a delicate circumstance that they need to offer a cost advantage to attract customers, whilst also trying to keep their costs down so as to maintain a profitability margin that would enable them to be viable in the long run. As newly operational banks, it is important that the PBs build a repeat customer base if they are to go beyond their basic functions of payments and deposits. Further, in order to be financially viable, they would need to focus on adopting the platform model which by itself would need scale to succeed⁹⁹.

6. Conclusion

The key differentiator of PBs is that they would leverage their large existing real-sector retail networks to provide payments and deposit services to those clientele/areas which were previously unviable to serve by existing full-service banks. With only a few years into operations, PBs have displayed competencies in areas such as onboarding customers and touchpoints to enable high volumes of transactions. However, the promise of the PBs is yet to be fully achieved and there is huge unmet potential. IPPB is well positioned to make considerable advancements in the matter of financial inclusion by capitalizing on its existing large human resources and physical infrastructure. The biggest promise is held by MNOs who have many factors to their advantage: their large network of retail stores manned by agents already well-versed in cash management, the possibility of using existing telecom KYC¹⁰⁰ and thus lowering costs, a ready brand recall among the MNOs' already existing customer base and possibly experience with operating in a highly-competitive field with long gestation periods. In the coming years, Jio PB, formed through a joint venture between Reliance Industries and State Bank of India, is likely to emerge as a strong player in the PB space. Jio can leverage both the advantages of having an MNO promoter as well as a large, well-established payment bank license within its group of companies. Another example of the potential of partnerships is displayed by Fino PB working with BPCL. Using petrol pumps as BC outlets may allow the bank to leverage the value of being associated with an existing big brand and also serve segments of the underserved population such as migrant labourers. In the future, more partnerships can be built by PBs to provide services such as insurance and investments, and loan origination for banks as BCs.

⁹⁷ Press Trust of India. (2019, July) Aditya Birla Idea Payments Bank to close operations. *Economic Times*. Retrieved from : <https://economictimes.indiatimes.com/industry/banking/finance/aditya-birla-idea-payments-bank-to-close-operations/articleshow/70309018.cms?from=mdr>

⁹⁸ Calculated using the formula Operating Expenses/ Expenditure with data from Table IV.4 and Table VI.33, Report on Trend and Progress of Banking in India – 2018-19, RBI Publications. Retrieved from: <https://rbidocs.rbi.org.in/rdocs/Publications/PDFs/ORTP241219FL760D9F69321B47988DE44D68D9217A7E.PDF>

⁹⁹ Ghosh.I., Ranade.A., (2020, April). Can Payments Banks Succeed? A Trilemma and a Possible Solution. *EPW*. Vol. 55, Issue No.15. Retrieved from: <https://www.epw.in/journal/2020/15/special-articles/can-payments-banks-succeed.html>

¹⁰⁰ 8.KYC Requirements, Operating Guidelines for Payments Banks, October 6, 2016, RBI Notifications. Retrieved from: <https://www.rbi.org.in/scripts/NotificationUser.aspx?Mode=0&Id=10635>

We have seen from the discussion so far that PBs have positioned themselves as large agent-banking players whilst the concerns over the profitability of the PB model still hold. Further adding fuel to the fire is the RBI providing a way for PBs to convert to SFBs¹⁰¹, which is seen by many as RBI's admission of the failure of the PB model. Considering that there have been many changes in the financial sector space since the CCFS recommendation for setting up of payments banks, it remains to be seen how PBs would emerge successful given their limited functionality and strong competition from other players such as PPIs (whose position has been strengthened due to favourable regulatory changes) in the function of payments, which was to be PBs' core competence. However, a few PBs still continue to operate, many claiming to be close to breaking even. Moreover, it may be argued that the profitability of even one PB can be seen as a proof of concept of the PB model.

By enabling a large share of the PB transactions as well as opening up the payments space for other players - both bank and non-bank - UPI has been a source of both strength and competitive disadvantage for the PBs. Nevertheless, the primary objective of this report was not to examine the business concerns or the profitability issues of the PBs, but to evaluate whether the PBs have, even to a small degree, moved the needle on the goal of financial inclusion, particularly payments inclusion. We see that there is evidence of large aggregate numbers attributable to the PBs in case of networks, especially due to Airtel PB, or in transaction volumes, especially due to Paytm PB. The establishment of a large touchpoint network also helps the unbanked regions to gain access to payments/remittances services as well as banking services when PBs act as BCs to full-service banks.

The available evidence paints a woefully inadequate picture as we do not have data at a disaggregated customer/transaction level such as the number of deposit accounts that have been opened by those new to the formal banking space, the number of transactions that have been performed by the target population – migrant labour workforce, low income households, small businesses and other unorganized sector entities, and most importantly the use of PB touchpoints for cash-out services whether from a savings account or not.

Another key data point required is the extent of the agent network. Only if greater detail on the number of touchpoints and the areas they service is collected, would it become possible to estimate what is truly the unbanked proportion of the country. This gains more importance with the change in branch authorization policy to a more inclusive 'banking outlet' definition which acknowledges a non-branch approach to provision of financial services, more suited to the PB model. Moreover, an accurate picture of unbanked areas would direct a better banking outlet authorization policy. Therefore, until we have detailed, disaggregated data released by the RBI over the usage of these banking functions, one cannot truly assess the extent of achievement of the goal of financial inclusion, and subsequently design policies to remedy the lack of the same, by the PBs.

¹⁰¹ Guidelines for 'on tap' Licensing of Small Finance Banks in the Private Sector – Dec 05, 2019. RBI Press Releases. Available at: https://www.rbi.org.in/scripts/bs_viewcontent.aspx?id=3797

7. Annexures

Annexure 1: Comparison of Products and Services Offered by the Payments Banks

Services	Airtel PB	IPPB	Fino PB	Paytm PB
Savings Account	✓	✓	✓	✓
Current Account	✓	✓	✓	✓
Sweep Account Facility		✓	✓	✓
Debit Card	✓		✓	✓
Wallet	✓		✓	✓
Payments	✓	✓	✓	✓
Cash Management Services	✓		✓	
Insurance	✓		✓	
Doorstep Banking		✓	✓	
BC Lending			✓	

Table 5: Products and Services Offered by PBs
Source – Bank websites, as of January 2020

Annexure 2: Savings Account Interest Rates of Select SCBs, and SFBs

Ten large SCBs (five private sector and five public sector) banks have been selected in order to present a representative view of the full-service commercial banks. Below is a table depicting the interest rates, as on May 2020 (sourced from bank websites), offered by these select SCBs on their savings accounts with balances less than Rs. 1 lakh. These are compared against the interest rates of the savings account products offered by all SFBs.

Select SCBs	Interest Rate	Small Finance Banks	Interest Rate
State Bank of India	2.75%	North East SFB	5.00%
ICICI Bank	3.25%	Fincare SFB	5.50%
Punjab National Bank	3.50%	Utkarsh SFB	7.00%
HDFC Bank	3.25%	Au SFB	4.50%
Bank of Baroda	3.25%	Suryoday SFB	6.25%
IDBI Bank	3.50%	Ujjivan SFB	4.00%
Canara Bank	3.00%	ESAF SFB	4.00%
Axis Bank	3.50%	Equitas SFB	4.00%
Union Bank of India	3.25%	Capital SFB	4.00%
YES Bank	6.00%	Jana SFB	4.50%

Table 6: Savings Account Interest Rates of select SCBs and SFBs

Annexure 3: Transactional Value to Deposit balance Ratio¹⁰²

The ratio of transactional value to deposit balance is calculated for the three bank groups, namely, PBs, SFBs and SCBs (excluding PBs and SFBs). This ratio is intended to illustrate the extent to which the deposit account is used for the purpose of carrying out transactions, ie, as a checking account, rather than as a place for long-term savings.

To obtain transactional value, the value of physical (at ATMs and POS) and mobile transactions using debit cards (where the bank was the issuer) was added up to obtain a reasonably complete picture of total value of transactions emanating from debit cards (a proxy for bank accounts) without overlap of numbers across modes and channels of transactions. The data for mobile transactions excludes those transactions that were initiated through non-mobile internet-enabled platforms (such as internet banking), and those initiated at branches of banks (such as deposit and withdrawal transactions at the teller).

FY 2018-19	Deposit Balance (Rs Cr) *	Value of ATM Transactions (Rs. Cr) **	Value of POS Transactions (Rs. Cr) **	Value of Mobile Transactions (Rs. Cr) [†]	Total Value of Transactions (in Rs. Cr)	Transactional Value to Deposit Balance Ratio
PBs	661	4,082	1,897	1,40,260	1,46,239	221.41
SFBs	710	18,967	850	5,810	25,627	36.07
All SCBs (excludes PBs and SFBs)	50,72,770	32,88,246	5,90,980	28,12,257	66,91,483	1.32

Table 7: Transactional Value to Deposit Balance Ratios of different Bank Groups

* The deposit amount for SFBs and SCBs represents the amount present in current and savings accounts. In both these cases, the term deposit amount has been excluded to aid an appropriate comparison to the PBs' amount. Deposit amount is the average of values outstanding as of March 2018 and March 2019.

** The value of ATM transactions and POS transactions are those performed by the debit cards issued by the bank/bank-group at ATMs and POS respectively in the months of April 2018 to March 2019.

[†] The value of mobile transactions are of those individual and corporate payments initiated, processed and authorised using a mobile device.

¹⁰² Sources: Bankwise ATM/POS/Card Statistics, RBI Data – March 2018 to March 2019, RBI Data. Retrieved from: <https://www.rbi.org.in/Scripts/ATMView.aspx>; Bankwise volumes in ECS/NEFT/RTGS/Mobile Transactions – March 2018 to March 2019, RBI Data. Available at: <https://www.rbi.org.in/Scripts/NEFTView.aspx>; Table No.2.2, Deposits of Scheduled Commercial Banks According to Bank Group – March 2019, Basic Statistical Return (BSR)2 – Deposits with SCBs, RBI DBIE. Retrieved from: <https://dbie.rbi.org.in/DBIE/dbie.rbi?site=publications>; Table IV.32: Consolidated Balance Sheet of Payments Banks, Report on Trend and Progress of Banking in India, 2018-19. Retrieved from: <https://rbidocs.rbi.org.in/rdocs/Publications/PDFs/ORTP241219FL760D9F69321B47988DE44D68D9217A7E.PDF>

Annexure 4: Transaction Charges of Payments Banks

(i) Paytm PB¹⁰³

ATM Charges	Funds Transfers/Remittances
Other Bank Metro ATMs (Mumbai, New Delhi, Chennai, Kolkata, Bengaluru and Hyderabad)	IMPS, UPI, NEFT – No Charges
3 free every month; post that Cash withdrawal: ₹ 20/txn Mini statement, Balance check, PIN change: ₹ 8/txn	Domestic Money Transfer through Paytm Banking Point - Minimum Rs. 10 or 1% per transaction (Whichever is higher)
Other Bank Non-Metro ATMs (Other than the 6 cities mentioned above)	
5 free every month; post that Cash withdrawal: ₹ 20/txn Mini statement, Balance check, PIN change: ₹ 8/txn	
Paytm Payments Bank ATMs	
Unlimited Free Transactions using Paytm Payments Bank Debit Card	

Table 8: Transaction Charges of Paytm PB

(ii) Fino PB¹⁰⁴

Account Variant	Pratham Savings Account	Saral Salary Account	Sanchay Savings Account	Pragati Current Account
Account Feature				
CASH Deposit				
Branch	2 txns free per month, Rs.5 per 1000	2 txns free per month, Rs.5 per 1000	5 txns free per month, Rs.5 per 1000	Free
Merchant	0.6% of Transaction or Min Rs 5 whichever is higher	0.6% of Transaction or Min Rs 5 whichever is higher	0.6% of Transaction or Min Rs 5 whichever is higher	0.6% of Transaction or Min Rs 5 whichever is higher
CASH Withdrawal				
Branch	2 txns free per month, Rs.5 per 1000	2 txns free per month, Rs.5 per 1000	5 txns free per month, Rs.5 per 1000	Free
Merchant	0.6% of Transaction or Min Rs 5 whichever is higher	0.6% of Transaction or Min Rs 5 whichever is higher	0.6% of Transaction or Min Rs 5 whichever is higher	0.6% of Transaction or Min Rs 5 whichever is higher
Fund Transfer				
FINO TO FINO				
Branch	Flat Rs 5	Free	Flat Rs 5	Free
Merchant	Rs 10	Rs 10	Rs 10	Rs 10

¹⁰³ Rates & Charges, Paytm Payments Bank Website. Accessed from: <https://www.paytm.com/ratesCharges>

¹⁰⁴ Schedule of Charges, Fino Payments Bank Website. Accessed from: <https://www.fino.com/pdf/Schedule-of-charges.pdf>

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Mobile Banking	Free	Free	Free	Free
FINO To Other Banks				
Branch	A: Up to Rs .1000: Rs 5 B: 1001-4999: Rs 10 C: 5000-9999: Rs 15 D: 10000 - 25000: Rs 20 E: 25001 and above: Rs 30	A: Up to Rs .1000: Rs 5 B: 1001-4999: Rs 10 C: 5000-9999: Rs 15 D: 10000 - 25000: Rs 20 E: 25001 and above: Rs 30	A: Up to Rs .1000: Rs 5 B: 1001-4999: Rs 10 C: 5000-9999: Rs 15 D: 10000 - 25000: Rs 20 E: 25001 and above: Rs 30	A: Up to Rs .1000: Rs 5 B: 1001-4999: Rs 10 C: 5000-9999: Rs 15 D: 10000 - 25000: Rs 20 E: 25001 and above: Rs 30
Merchant	A: Up to Rs .1000: Rs 5 B: 1001-4999: Rs 10 C: 5000-9999: Rs 15 D: 10000 - 25000: Rs 20 E: 25001 and above: Rs 30	A: Up to Rs .1000: Rs 5 B: 1001-4999: Rs 10 C: 5000-9999: Rs 15 D: 10000 - 25000: Rs 20 E: 25001 and above: Rs 30	A: Up to Rs .1000: Rs 5 B: 1001-4999: Rs 10 C: 5000-9999: Rs 15 D: 10000 - 25000: Rs 20 E: 25001 and above: Rs 30	A: Up to Rs .1000: Rs 5 B: 1001-4999: Rs 10 C: 5000-9999: Rs 15 D: 10000 - 25000: Rs 20 E: 25001 and above: Rs 30
Mobile Banking	Rs 10	Rs 5	Rs 10	Rs 5

Table 9: Transaction Charges of Fino PB

(iii) IPPB¹⁰⁵

Domestic Remittances/ Money Transfer Charges

Mode of Money Transfer	Transaction size	Charges at Access Point & Doorstep		Charges for Mobile Banking	
		Savings Account	Current Account	Savings Account	Current Account
Intra Bank (IPPB account to IPPB account)	Free	Free	Free	Free	Free
IMPS	Up to 2,000	INR 10	INR 10	INR 05	INR 05
	2,001-5,000	INR 20	INR 20	INR 05	INR 05
	Above 5,000	INR 50	INR 50	INR 10	INR 10
NEFT	Up to 10,000	INR 2.25	INR 2.25	NIL	INR 2.25
	10,001 to 1 Lakh	INR 4.75	INR 4.75	NIL	INR 4.75
	1 Lakh to 2 Lakh	INR 14.75	INR 14.75	NIL	INR 9.75
	Above 2 Lakh	INR 24.75	INR 24.75	NIL	INR 19.75
RTGS	2 Lakh to 5 Lakh	INR 24.50	INR 24.50	INR 24.50	INR 24.50
	Above 5 Lakh	INR 49.50	INR 49.50	INR 49.50	INR 49.50

Table 10: Transaction Charges of IPPB

IPPB does not have any charges on cash withdrawal or deposits from its savings accounts.

¹⁰⁵ Rates & Charges, IPPB Website. Accessed from: <https://ippbonline.com/web/ippb/rates-and-charges>

(iv) Airtel PB¹⁰⁶

Deposit Charges		Withdrawal Charges	
Deposit Amount (Rs.)	Charge (% of deposit amount)	Withdrawal Amount (Cumulative amount per month, Rs.)	Charge (% of withdrawal amount)
0 - 20,000	-	0 - 20,000	-
20,000 - 50,000	0.50%	>20,000	0.65%
>50,000	0.75%		
Fund Transfer Charges			
Type of Transfer			Charge (% of transfer amount)
Within Airtel Payments Bank (Internet banking, mobile banking and USSD)			-
From Airtel Payments Bank to another Bank (Internet banking, Mobile App & USSD) – NEFT			-
From Airtel Payments Bank to another Bank (Internet banking, Mobile App & USSD)-IMPS			1%

Table 11: Transaction Charges of Airtel PB

Domestic Remittances Charges are set as absolute amounts which differ based on the amount for remittance. Overall, most of these charges vary between 1% and 1.1% of the remittance amount.

Annexure 5: Costing and Revenue Structure of Payments Banks

The cost and revenue structure of PBs is different from full-service banks due to the former's limited functionality and differing strategy of using BCs and partners instead of branches. An overview of the items of the ensuing discussion is presented below in Table 4.

Costs	Revenue Sources
Deposits <ul style="list-style-type: none"> Interest Payment Raising Amounts 	Transactions <ul style="list-style-type: none"> Remittance charges – at branch/merchant/by self through NEFT/RTGS/IMPS/UPI to accounts/wallets of same/different bank Withdrawal/deposit – at branch/merchant/self into wallet/account
Transactions <ul style="list-style-type: none"> BC commissions 	Investments – demand deposit balances in SLR/CRR instruments
Operations <ul style="list-style-type: none"> Set up Costs – Branches/physical infrastructure, Recruiting/Training, Technological solutions Ongoing costs of personnel/administrative/technology etc 	Partnerships <ul style="list-style-type: none"> Third party products – investment/insurance, mutual funds BC commissions (from other banks) Transactions – Bill payments/DBT payments Cash management services

Table 12: Costs and Revenues of PBs

¹⁰⁶ Charges & Fees, Airtel Payments Bank Website. Accessed from: <https://www.airtel.in/bank/bank-charges> on 17th Feb, 2020

The basic sources of revenue available to all PBs are through their payments and deposits business. 75% of the PBs’ deposits are to be invested in risk-free but low-return SLR investments.

As a source of revenue, transactional charges are placed by PBs on both deposits and payments transactions, transferring money from wallets to bank accounts, PB accounts to other bank accounts and on withdrawals (both through ATMs/agents). There are also charges on agent-based banking, for items such as balance enquiry, pin change and generating mini statement, to name a few. PBs such as Fino PB and IPPB have charges for providing doorstep banking services¹⁰⁷.

There are also potential sources of revenue through the process of deposits. PBs typically charge customers on depositing money into the bank account or the wallet. These are transactional charges, the amount is usually fixed as a percentage of the transaction amount (deposit amount), which vary based on the amount that has been deposited (usually smaller deposits warrant zero charges) and whether the transaction has been done through an agent or not¹⁰⁸.

Other sources of transactional revenue for PBs through provision of basic services is charges on remittances, utility bill payments and mobile recharges, among others. (See Annexure 4 for details on charges).

Shown below are the returns from treasury bills (T-bills), one of the SLR-approved assets preferred by banks.

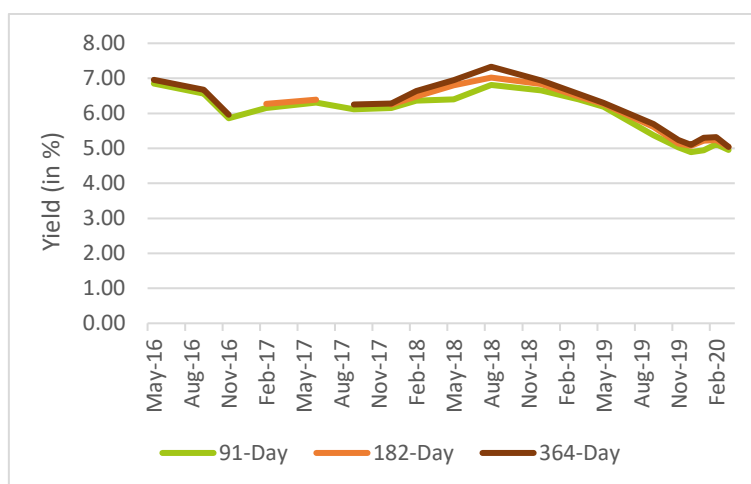


Figure 17: Tenor-wise Yields of Treasury Bills
Source: RBI Data¹⁰⁹

As we can see, the returns across the different tenors (91-day, 182-day and 364-day) have been moving closely, and approximately between 5 and 7%.

¹⁰⁷ As on May 2020, Fino PB charges 0.6% or a min of Rs.5 per doorstep transactions. IPPB used to charge Rs.25 and Rs.15 for cash-based and non-cash-based doorstep banking services, respectively. These charges are presently waived.

¹⁰⁸ For example, Fino charges Rs. 5 for those deposit transactions beyond a certain limit (two or five per month depending on the type of account) for every 1000 Rs. Deposited. Airtel charges 0.5% on the amount deposited, if it is between 20,000 and 50,000 Rs.

¹⁰⁹ Cash Reserve Ratio and Interest Rates, National Summary Data Page, RBI Publication. Retrieved from: https://www.rbi.org.in/Scripts/BS_NSDPDisplay.aspx?param=4

We see from the high operating expense ratio (operating expenses/ total income) of 1.24¹¹⁰ for the PBs in FY 2018-19¹¹¹, that the investment returns are not sufficiently high for the PBs to have good profitability margins, considering the costs undertaken in raising these deposits. It is estimated that there are differential costs based on the mode of loading cash into the wallet/ bank account; the costs are higher, in comparison to a purely digital transfer, when done through a BC, owing to the commission paid to the BCs. While agent-based banking is associated with lower costs than a typical brick-and-mortar branch-based banking, PBs still need to bear set up costs as they are still in early days of their operations. Additional cost to deposits is the interest rate paid by the PBs on these deposits (refer to Section 4.1 for details on interest rates provided by PBs).

For transactions to be a significant revenue source, the scale of operations must be large enough to have a considerable volume of transactions. The additional revenue sources could be charging merchants for transactions, selling of third-party products such as insurance, mutual funds, providing BC services to full-service banks, providing cash management facilities, commissions on Direct Benefit Transfer (DBT) and subsidy payments, monetization of customer data to aid other lending institutions' loan origination process, help businesses understand behaviour of bottom-of-pyramid population and so on.

Annexure 6: Financial Performance of Payments Banks

With five of the 11 PBs surrendering their licenses, there have been concerns about the profitability of the PB model. The model has been facing criticism for its restriction on lending activity and the minimum SLR requirement of 75%, both of which restrict a PB's revenue generating capacity. While it might be true that six out of the seven operational PBs have been facing losses, it is important to note that most of them started operations less than 3 years ago. With Paytm being the first PB to report profits of Rs.19 Crores, things might be looking up for the PB model.

Turnover and Net worth

As shown in Figure 18, all the four PBs have seen an increase in their annual turnovers. Paytm PB's turnover grew much faster than the other PBs, at a Compounded Annual Growth Rate (CAGR) of 777%. This is consistent with its superlative performance in both deposits and transactions.

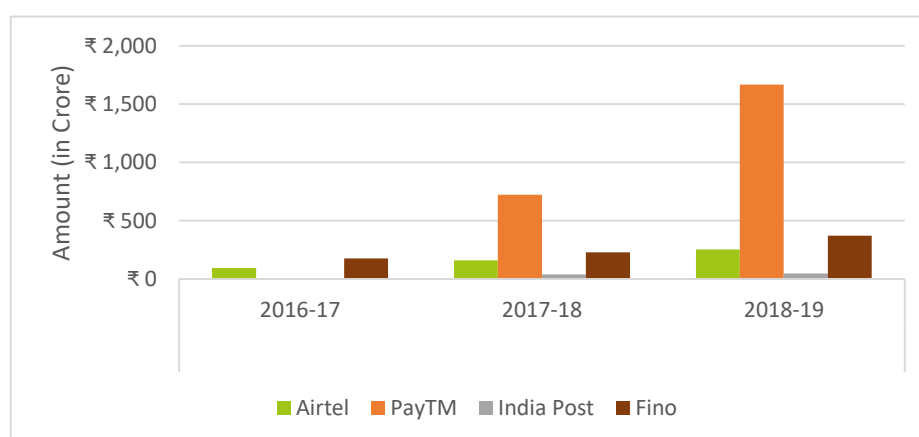


Figure 18: Turnover Figures of PBs

¹¹⁰ In comparison the operating expense ratio of SCBs on an aggregate level is 0.23. Calculated from: Table IV.4: Trends in Income and Expenditure of Scheduled Commercial Banks, Report on Trends and Progress of Banking in India 2018-19, RBI Publications. Available at:

<https://rbidocs.rbi.org.in/rdocs/Publications/PDFs/ORTP241219FL760D9F69321B47988DE44D68D9217A7E.PDF>

¹¹¹ Calculated from Table IV.33 Financial Performance of Payments Banks, Report on Trends and Progress of Banking in India 2018-19, RBI Publications. Available at:

<https://rbidocs.rbi.org.in/rdocs/Publications/PDFs/ORTP241219FL760D9F69321B47988DE44D68D9217A7E.PDF>

In terms of net worth, Paytm again tops the list with around Rs.367 Crores of net worth in the latest fiscal year 2018-19, as seen in Figure 19. Through the years, Paytm has seen several tranches of capital infusion from its founder, Vijay Shekhar Sharma, and parent company, One97 Communications¹¹².

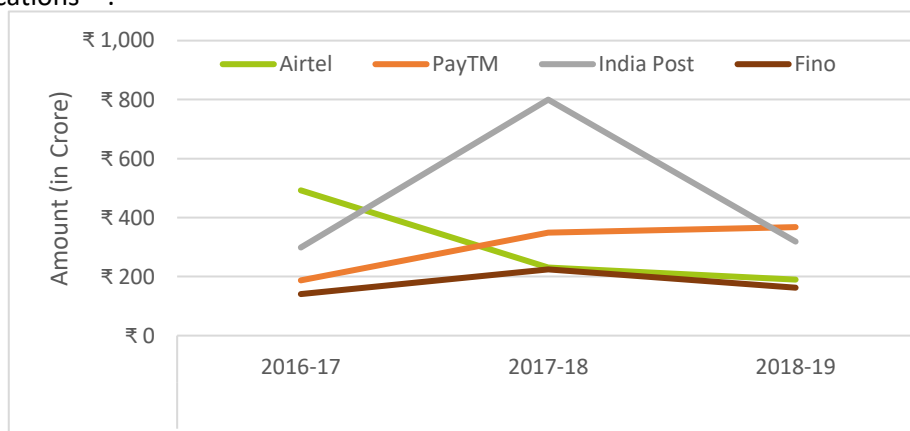


Figure 19: Networth of PBs
Source: Ministry of Corporate Affairs

IPPB shows a steep decrease in net worth after 2017-18. The reason for this could be the abnormal amount of provision for taxes in Financial Year (FY) ending 2019. However, in the previous year, IPPB was in the lead in net worth, and by a huge margin. This high net worth may be attributed to their large physical network.¹¹³

Paytm PB has been outperforming the other PBs in terms of deposits and transactions while keeping its net worth relatively low. This could be a testament to its digital strategy. Both Fino PB and Airtel PB (which had capital infusions from its parent companies) have seen their respective net worth figures decline.

Profitability

Figure 20 shows the profits/losses for FY'17 and FY'18. As mentioned earlier, Paytm turned profitable in its second year of operations. IPPB reported a profit of approximately Rs.69 Lakhs in the first year of operations but went into losses in FY'18.

¹¹² ET Bureau. (2017, November). Rs 122 crore more in Paytm Bank, thanks to One97, Vijay Shekhar Sharma. *Economic Times*. Retrieved from: <https://economictimes.indiatimes.com/small-biz/startups/newsbuzz/rs-122-crore-more-in-paytm-bank-thanks-to-one97-vijay-shekhar-sharma/articleshow/61762291.cms>

¹¹³ IPPB in the financial year 2018-19 had fixed assets to the tune of close to Rs. 294 Crores. While the actual premises (the post offices) belongs to the Department of Posts, IPPB's contribution is in terms of purchasing software and setting up fixtures and furniture.

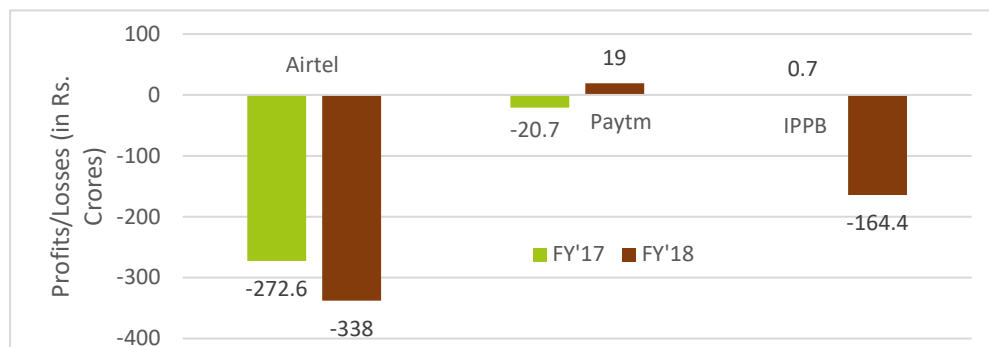


Figure 20: Profits/Losses of PBs
 Source: Annual Reports¹¹⁴/Newspaper Articles¹¹⁵

Comparing the IPPB profit and loss statements for the two financial years, we see that there has been a significantly high expense in the operating area¹¹⁶. As for Airtel PB and Paytm PB, unavailability of annual reports was a limitation in analysing the exact causes of profits/losses for these banks.

¹¹⁴ IPPB Annual Reports 2017-18 and 2018-19.

¹¹⁵ Kumar,C., (2019, August). Airtel Payment Bank loss widens to Rs 339 crore in FY19, revenue jumps 59%. *Business Today*. Retrieved from: <https://www.businesstoday.in/current/corporate/airtel-payment-bank-loss-widens-to-rs-339-crore-in-fy19/story/373765.html>

Press Trust of India. (2019, May). Paytm Payments Bank posts profit of Rs 19 crore in FY'19. *Business Today*. Retrieved from: <https://www.businesstoday.in/sectors/banks/paytm-payments-bank-profit-of-rs-19-cr-in-fy19/story/349320.html>

¹¹⁶ FY2019 saw an approximately 600% increase in operating expenses from the previous year. This was largely due to the payments and provisions made towards employees. This amount constituted 74% of the total of operating expenses. However, this expense was offset to a large extent by a large amount deferred taxes; thus, improving the profitability.