White Paper on Impediments & the Way Forward

On Proposed Extension of PA/ PG Guidelines to Offline Payment Aggregators

CHASE INDIA

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Preface

As the world enters the era of the techade, the Government of India envisions transforming the country into a digitally empowered society and a knowledge economy. It is making much lauded efforts in this space by launching a multitude of policies across sectors, for building digital infrastructure, improving e-governance, and enhancing citizen capabilities. Tech-enabled solutions are going to be the bedrock of governance in the future, with government services being available to all at a click. One of the core focus areas in this regard is comprehensive digital financial inclusion, including people living in the remotest regions of the country. While dedicating 75 Digital Banking Units in 75 districts of the country, Hon'ble Prime Minister Shri. Narendra Modi highlighted that fintech is at the heart of India's policies and efforts, and that it will form the basis of financial revolution.

This revolution has been aided by several government initiatives like Startup India, Digital India, India Stack, Account Aggregators, Peer to Peer (P2P) lending platforms, and 24x7 digital payment systems. The Reserve Bank of India (RBI) has also fostered innovation in fintech by setting up the Reserve Bank Innovation Hub (RBIH), and introducing programmes like the Regulatory Sandbox framework, and a Global Hackathon titled 'Harbinger 2021' to make retail payments more innovative.

Retail payments garnered special attention from the RBI due to their ability to improve financial inclusion in India and widespread customer adoption. By formulating guidelines for online payment aggregators, the RBI ensured smooth growth in the digital payment system through operational uniformity.

Growth of Digital Payments in India

UPI currently constitutes well over 40% of all digital transactions taking place in India. It has given a tremendous boost to small businesses and street vendors as it enables fast and secure bank-to-bank transactions even for small amounts. As per UPI data released by the National Payments Corporation of India (NPCI) for September 2022, 14.12% of person to merchant transactions were for amounts ranging between INR 0-500, while 17.06% transactions were between INR 500-2000. In all, a whopping total value of INR 79,331.66 crore in UPI was dealt with by small business owners in September 2022. This has been achieved by the conducive policy and regulatory environment provided by the government and the RBI.

For instance, UPI payments account for over 65% of all payments on RazorPay. Paytm reached a new milestone in offline payments in September 2022, by adding 3.5 million devices at merchant stores across the country in the last year. BharatPe expanded its footprint to 400 towns and cities by providing their UPI QR to tier 2,3 and 4 towns.

These statistics reflect the eager adoption of UPI payments by big as well as small merchants in India. Interoperable QR codes, simplified merchant onboarding and quick payment processing has helped PAs successfully penetrate low ticket business owners like rickshaw pullers, hawkers, and street vendors operating in urban and rural areas of the country. This makes them a key contributor to Hon'ble Prime Minister Shri. Narendra Modi's vision of improving financial inclusion in India by digitally enabling small business owners.

Payment Aggregator Regulation in India

On 17th March 2020, the RBI issued guidelines on regulation of payment aggregators (PAs) and payment gateways (PGs) in India, stating that PAs and PGs are intermediaries playing an important function in facilitating payment in the online space (“PA/PG Guidelines”). These guidelines are inter alia applicable to PAs, including the domestic leg of import and export related payments facilitated by PAs, but not to cash on delivery e-commerce models. On 30th September 2022, through a press release issued by the RBI on “Statement on Developmental and Regulatory Policies”, the RBI extended these guidelines to offline PAs (keeping in view the similar nature of activities undertaken by online and offline PAs) who handle proximity/ face-to-face transactions to bring synergy in regulations covering activities and operations of PAs, apart from convergence on standards of data collection and storage. The RBI clarified that detailed instructions in this regard would be issued separately.

Challenges and Way Forward in Extending PA/PG Regulations on Offline PAs.

While the endeavour to bring in synergy in card data storage and technological standards is a welcome move, offline PAs (specifically those involved in payment aggregation & settlement for offline transactions undertaken through UPI/POS/QR) may face the following challenges in the event the online PA/PG Guidelines are extended as is to these offline PAs:

A. Extension of RBI’s Master Direction - Know Your Customer (KYC) Direction, 2016 (“KYC Directions”) to Offline PAs

As per the extant PA/PG Guidelines, KYC guidelines issued by the Department of Regulation, RBI, under the KYC Directions norms shall apply mutatis mutandis to all entities. This requirement is now proposed to be extended to offline PAs as well. In this context, offline PAs that primarily deal with low-ticket/low-income value business owners like street vendors, rickshaw pullers, auto drivers, hawkers, retailers etc. (who operate their businesses from their personal accounts) may be expected to comply with ‘Customer Due Diligence (CDD) procedure in case of individuals’ under Chapter 6 of the KYC Directions. However, KYC verification of small business owners/retailers/merchants by either visiting them physically or via V-CIP may turn out to be a challenging task for offline PAs.

At present, offline PAs operate as payment intermediaries and are not required to re-conduct KYC of merchants onboarded if the KYC due diligence has already been carried out by banks. To this effect, even the clarification issued by the RBI in its Guidelines on Regulation of Payment Aggregators and Payment Gateways dated 31st March 2021 (“2021 PA/PG Guidelines”) in paragraph 4.2 states that there would not be a requirement to carry out the entire KYC process where the merchant already has a bank account which is being used for transaction settlement purposes. Hence, mandating a re-KYC may become cumbersome for offline PAs in case of merchant onboarding as it may increase customer hassle, and would also significantly increase operational and logistical costs.

Additionally, offline PAs generally onboard merchants whose KYC verification is already conducted/completed by banks with whom such merchants maintain their accounts (where such offline PAs settle funds due to merchants). Further, additional due diligence is undertaken by offline PAs at the time of onboarding as per the KYC policies of the acquiring member bank for availing UPI/POS/QR services.

Further, physical KYC may cost around INR 250-300 per customer and may take two to five working days to be completed. Incurring this cost may force offline PAs to bear this cost themselves which could drive them out of business. Alternatively, this cost may have to be passed on to the merchants, disincentivising them from accepting digital payments altogether.

Moreover, while offline PAs have the option of conducting OTP-based e-KYC, the current limits/ restrictions prescribed under paragraph 17 of the KYC Directions along with a 1-year validity period and ultimate requirement to complete the CDD procedure makes it a cumbersome process. This is particularly true for small business owners, who for example, may not be able to practically comply with the requirement to maintain an aggregate credit limit of INR 2 lakh per financial year, given the nature of their businesses.

Lastly, it is apposite to note that the underlying principles for digitisation of payment channels and methods throughout the country have been to ensure financial inclusion through all levels of society and to ensure that transformation through digitisation in the payments space reaches the remotest areas of the country. In line with this stated goal and to reduce redundancies caused due to conducting re-KYC of merchants who have already undergone requisite and full KYC conducted by the banks, it is suggested that:

- *Offline PAs should not have to conduct full KYC process of merchants onboarded either for POS or UPI/ QR or any other offline payment channels where KYC has already been conducted by banks;*
- *For additional due diligence and verification, offline PAs may conduct minimum KYC in line with their merchant on-boarding policies.*

B. Relaxation in Certain Baseline Technology-Related Recommendations

Annexure 2 of the extant PA/PG Guidelines prescribes baseline technology recommendations for PAs. While these recommendations are optional for PGs, they have been made mandatory for PAs. Such technology recommendations include PA-DSS/PCI-DSS compliance obligations, enterprise data dictionary recommendations, cyber crisis management plans, enterprise information model recommendations, CERT-In reporting and cyber incidents-based requirements, recommendations for IT Governance policies and Information Security Policy.

In this regard, by way of an example, extending compliance with Payment Card Industry-Data Security Standard (PCI-DSS) and Payment Application Data Security Standard (PA-DSS) may not work, as:

- The process of onboarding merchants and types of merchants onboarded by online PAs are distinct from those pertaining to offline PAs.

- The nature of transactions is also different in the case of online PAs as such transactions are primarily done through the application/ website which captures the payment details/ data of the end customers and are therefore susceptible to data breaches which require governance/ monitoring under existing PCI-DSS/ PA-DSS frameworks. However, in the context of offline transactions, since the merchants are merely beneficiaries of the transactions undertaken with their customers through UPI/ POS/ QR mode, there does not arise a need to extend the compliance framework stated under PCI-DSS/ PA-DSS to merchants.
- Stringent technology-related recommendations may hamper innovation in the sphere and result in obsoletion of existing technology levels. Therefore, it is suggested that the RBI may provide generic indications in terms of recommendations commensurate with developments in the sector.

Considering that these recommendations have been formulated from a payment website/ application perspective through which payments would be made in non-face-to-face mode, it is submitted that these technology recommendations should be reviewed from the perspective of offline PAs and adequate clarifications be issued on applicability/ non-applicability of relevant technology recommendations.

C. Limited Number of Escrow Accounts

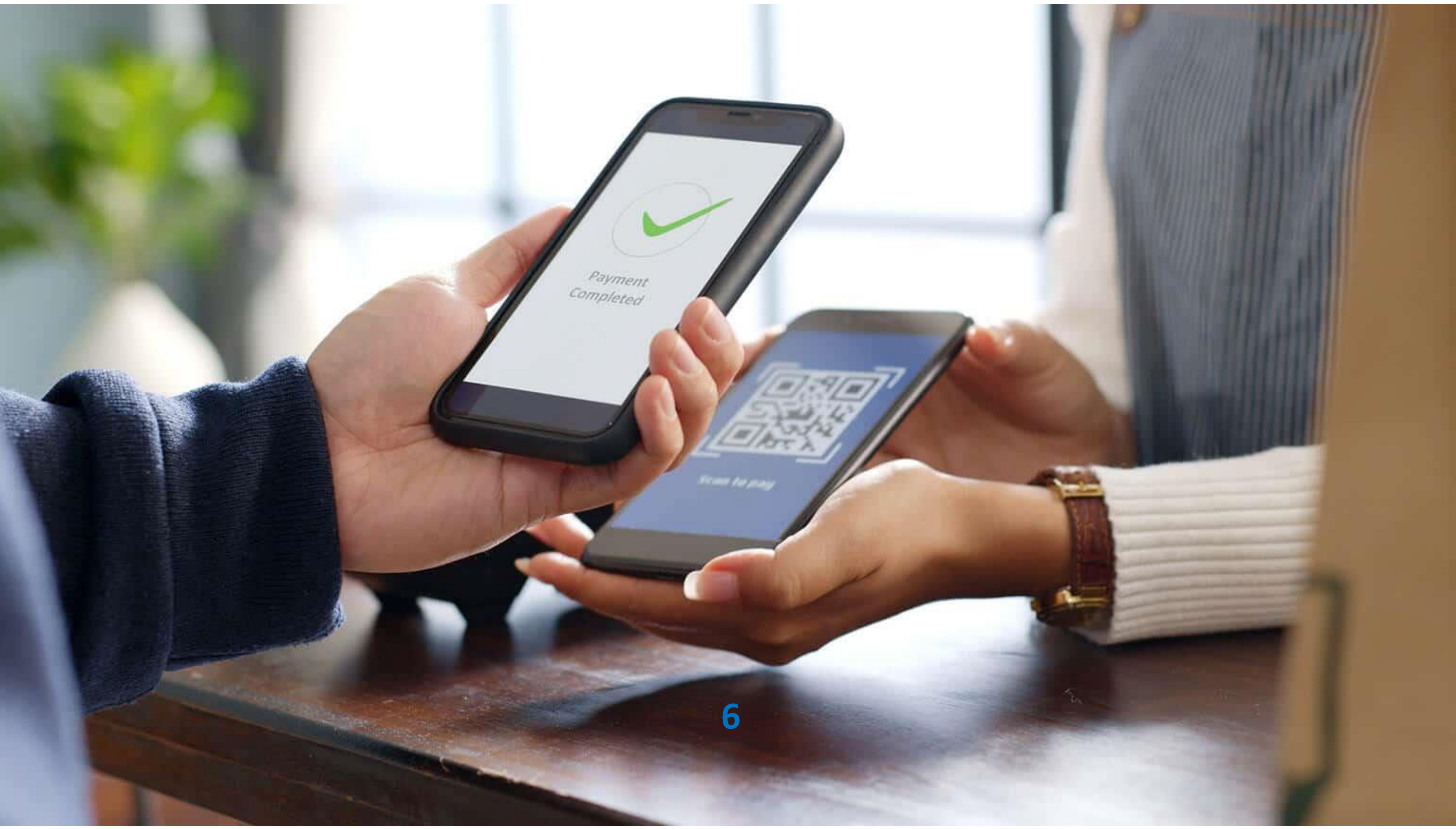
- Under the extant PA/PG Guidelines, non-bank online PAs are allowed to maintain one escrow account with any scheduled commercial bank and are further, at their discretion, allowed to maintain an additional escrow account with a different scheduled commercial bank.
- In the current offline digital payments space, UPI currently constitutes well over 40% of all digital transactions taking place in India. It has given a tremendous boost to small business and street vendors as it enables fast and secure bank-to-bank transactions even for small amounts. As per UPI data released by the NPCI for September 2022, 14.12% of person to merchant transactions were for amounts ranging between INR 0-500, While 17.06% transactions were between INR 500-

2000. In all, a whopping total value of INR 79,331.66 crore in UPI was dealt with by small business owners in September 2022. QR Codes have played a big role in making acceptance of digital payments easier. Currently, QR Code payments are accepted by over 30 million merchants in the country, a substantial jump from 2.5 million merchants five years ago. In terms of POS, as of June 2022, the total number of POS terminals deployed by merchant acquiring banks was 6.59 million; it increased by 43% in Q2 2022 as compared to Q2 2021.

- In this regard, since the volume of transactions is large and very frequent, reliance on just one/two escrow account(s) will not be able to support the technological and infrastructure requirements of the offline PA ecosystem. This may affect the seamless operation of the payments and settlements ecosystem and may further affect the business continuity along with normal banking operations.
- *Accordingly, it is suggested that offline PAs should have the flexibility to maintain and operate multiple PA escrow accounts, including permission to carry out inter-escrow transfers without any restriction; permission to open and maintain multiple escrow accounts with the acquiring bank(s) that such offline PAs may partner with in relation to offline UPI/POS/QR payments, etc., to ensure optimum up-time, seamless operations, business continuity, reduction in technical glitches and efficiency of payment flows. Consolidated monitoring of all such escrow accounts can be undertaken by offline PAs, to ensure effective supervision.*

Conclusion

With this short report, we hereby put forth our suggestions and industry recommendations on the concerns that arise from extending PA/PG guidelines to offline PAs. We aim to help the RBI develop a regulatory framework required for offline PAs and thereby work towards implementing effective financial inclusion across all income groups. This will allow us to not only contribute to the government's vision of making India a leader in digital finance but also revolutionise social welfare.



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CHASE INDIA

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