MicroSave India Focus Note 83

Financial Inclusion through E/M-Banking: The Regulatory Landscape in India

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Incremental Changes in Regulations

Over the years, the financial and banking sector in India has been opened up slowly, but substantially, with a view to promoting financial inclusion. The Reserve Bank of India (RBI) has prescribed regulatory and policy changes in line with the evolving domestic market conditions, changes in the world economy and customer needs.

The period from 1949 to 1966 saw the evolution of RBI as its roles and responsibilities were defined. These related to the licensing of banks, branch expansion, liquidity of banks, management and methods of working, and mergers among others.

The period from 1967-1990 was of consolidation with focus on using the scarce resources of the banking system for the purpose of planned development. Fourteen banks were nationalised and the concept of the 'priority sector'[1] was articulated and introduced. Between 1990 and 2008, the Government experimented with new models to improve financial access for the poorest segment through the active involvement of NABARD.[2] In 2005, the RBI directed the banks to offer a basic banking 'no frills account' with low or zero balances and minimum charges on transactions and other services to expand the outreach to low income groups. In 2006, the RBI permitted banks to use the services of certain entities as Business Correspondent (BCs) and Business Facilitators (BFs) to provide financial and banking services. This was accompanied by certain guidelines for the appointment and management of BCs.[3] The guidelines were updated periodically to accommodate customer needs and to address operational challenges faced by banks and BCs. In 2008, the RBI announced the guidelines for mobile banking transactions.[4]

Recent Developments

In recent years, the government's focus has been on enhancing financial inclusion by providing easy access to banking services for the low income/ unbanked/ under banked segments. This is in order to ensure more equitable distribution of the fruits of economic growth. Between April and November 2009, the RBI increased the maximum distance permitted between the place of business of a BC and the link bank branch from 15 to 30 kilometres. It also allowed banks to charge 'reasonable' fee from customers for using services through BCs.

In 2010, the RBI further expanded and liberalised the BC model by permitting "for profit" companies to serve as BCs.[5] It subsequently also allowed urban cooperative banks to use the services of BCs. Other significant steps towards enhancement of financial inclusion are: setting up the target of making banking services available to all villages with a population of 2,000 by March 2012; mandatory opening of 25% of new branches in unbanked rural areas and simplified KYC for "small accounts".

Regulations on M-banking

Only banks (licensed, supervised and with physical presence) that have core banking solutions can offer mobile banking services. These services are restricted to customers of banks and debit/credit card holders. Only Indian Rupee based domestic services can be provided; cross border transfers are not allowed. The most important regulatory relaxation is that banks may use the services of BCs to extend mobile banking facilities to their customers.

The initial transaction limit set by RBI for mobile banking transactions was Rs.2,500 per transaction with a daily limit of Rs.5,000 per customer. These were later raised to Rs.10,000 and Rs.50,000 respectively.[6] Transactions up to Rs.5,000 can be facilitated by banks without end to end encryption, which practically means that customers with low-end handsets can also avail the services, but with limits on transaction value.

Banks have been entrusted with the responsibility of ensuring security of all transactions and with customer protection issues.

Some regulations that are relevant to mobile banking in India, but are beyond the scope of this note are:

- Information Technology Act, 2000;
- Risks and controls in computers and telecommunications, February 1998;

[1] http://rbidocs.rbi.org.in/rdocs/notification/PDFs/107MRC050711.pdf
[2] National Bank for Rural and Agricultural Development was established in 1982 by an Act of Parliament of India. More details about NABARD can be seen at www.nabard.org
[3] http://rbidocs.rbi.org.in/rdocs/notification/PDFs/68417.pdf
[4] http://rbidocs.rbi.org.in/rdocs/PressRelease/PDFs/87064.pdf
[5] http://rbidocs.rbi.org.in/rdocs/Notification/PDFs/CPC28092010.pdf
[6] http://rbidocs.rbi.org.in/rdocs/notification/PDFs/MGR241209.pdf

- Guidelines on managing risks and code of conduct in outsourcing of financial services by banks, November 2006;
- Issuance and operation of pre-paid instruments in India, 2009 (amended 2010);
- Banking ombudsman scheme, 2006 (amended May 2007); and
- Consumer Protection Act, 1986.

Current Scenario

The RBI has given banks a clear lead against non-banks, particularly mobile network operators, by allowing only banks to offer mobile banking services. Though non-banks can offer pre paid instruments and mobile wallets,[7] the up-take of such instruments has been slow. The major limitation of pre-paid instruments offered by non-banks is that the customers cannot convert the value loaded on to such instruments or m-wallets into cash. This restriction is significant because of the importance of cash in the Indian economy, where the value of bank notes and coins in circulation as a percentage of narrow money is 60.07% (2009-10) compared to other emerging economies such as South Africa (18.51%), China (18.83%) and Mexico (39.14%).[8]

Mobile banking in India has, so far, remained confined to the upper and middle class, and is yet to make a significant difference in the financial inclusion space. Recently the National Payments Corporation of India (NPCI) was incorporated in December 2008 to offer Inter-Bank Mobile Payment Service (IMPS) among other services. The service allows users to transfer money from their bank account to any other bank account, in same or another participating bank. The system is completely interoperable, i.e., it works on all mobile networks and between all participating banks. Subject to its limitations, this service is likely to induce improvements in mobile banking usage.

What Does the Future Hold?

The potential to link banking services to the most widely used gadget by all sections of the society is huge. The number of mobile subscribers in India is more than 860 million or 72% of the population, whereas the proportion of the banked population is only around 50%.

From the customers' perspective, mobile banking complemented by the BC channel offers a mix of benefits and risks. It offers convenience of making transactions at BC outlets, usually near to the place of work or residence of customers; and few transactions such funds transfer, balance enquiry, bill payments etc. can be initiated by customers without the need to go to BC outlet or bank branch. The factor of 'trust' is crucial and is perhaps the most important criteria for the relationship between a bank and its customers. Customers will usually trust the bank that offers the mobile banking service; but banks will have to build robust systems and safeguards so that the same customers also trust the person (BC) and the technology they are dealing with.[9] The level of trust grows with each successful transaction. Whenever a failure takes place, either due to failure of technology or a service denial by the agent, it will need more time and effort to regain the trust.

The model will be bank-led in the foreseeable future, and non-banks/mobile network operators are unlikely to be allowed to offer full-fledged financial services. The latter can, at best, join hands with banks and act as their BCs. NBFCs have been kept out of the list of entities that can be appointed as BCs, and this too is most likely to continue because of the perceived conflict of interest between NBFCs and banks. Institutional BCs will be preferred by banks over individuals as BCs, to facilitate monitoring and management.[10]

Conclusion

It is not restrictive regulations that are at the core of slow off take of mobile banking services (especially for the low income segments), but the absence of a strong value proposition for the customer. In addition, most banks and BCs are still struggling with the basics of their business models, and thus have not been able to scale up operations. Though there are some contentious issues (such as viability of the BC channel and KYC norms) that are cited as reasons for slow uptake of the services, the RBI has already permitted charging the customers and relaxed KYC norms for the unbanked.

Over the years, RBI has clearly shown its intention to open up and relax regulations when the industry shows signs of stability and a promise to grow. It is for the banks to harness the potential of BCs and BFs to the fullest extent possible under the existing regulatory framework and then ask for more concessions or guidance from the RBI where these are necessary.

The next set of enabling regulations could be around interoperability between BCs of different banks; and around differential pricing based on geography, difficulty or ease of accessibility and similar factors. Such a pricing mechanism will provide banks the impetus to work towards making a strong business case for BCs and agents, and not to shy away from remote or difficult locations.

[7] http://rbidocs.rbi.org.in/rdocs/notification/PDFs/ADP0401110.pdf
[8] "Banking, Electronic Payments and the Road Ahead", H. R. Khan, RBI Bulletin, September 13, 2011
[9] See *MicroSave* India Focus Note 66, "What Do Clients Want in E/M-banking Agents?"
[10] See *MicroSave* India Focus Note 76 Individual or Institutional BCs: The Client's Perspective and 77 Individual or Institutional BCs: The Bank's Perspective