Payment System - Emerging Challenges and Opportunities

by G PADMANABHAN

General Observation on Payment System

- Disruption is now the catch word
- Technology is enabling the disruption
- Disruption has now become an essential feature in payment and settlement system
- Disruption has phenomenally succeeded in improving the scale, convenience, security and accessibility
- Success means scale, customer convenience and lower cost
- Should take care of security as well as sustained confidence of the users in the system
- Path breaking changes technology has brought in banking and remittance/retail payments
- Sharp changes in adoption of technology by market participants do throw up challenges to both regulator and the customers
- Regulators need to carefully balance the measures to ensure game goes in a fair manner, fair to all stakeholders, including the customers
- Regulators are born to worry; when things happen too quickly and too fast, they worry; and when things don't happen also they worry
- Payment system throws dynamic challenges and regulators need to act with agility

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Is India ahead or a laggard in the payment space?

- India has achieved phenomenal growth, momentum, innovation and success in the payment and settlement space
- The infrastructure in the payment and settlement system has seen remarkable progress, be it capital market, Govt securities market, payment of sovereign dues (all forms of taxes etc., be it State or Central Govt), forex market, and money market. Specifically, the availability, accessibility, security and cost of transactions have come down significantly with the improved infrastructure
- All operations have become global across all asset classes and locational geography has been relegated to the virtual English dictionary
- Even in real estate transactions today, DVP is possible i.e. on registration of transfer of the property, immediate RTGS transfer takes place and at a much less cost than before
- India is the first country to introduce ISO 20022 standards in the RTGS implementation
- What is largely unstated is the silent revolution that is continuously taking place in the retail payment space
- Measure of success today is the digital options and access that a customer gets to exercise while making a payment
- The statistics speaks for itself –
    - Between FY 2012 & 2015, NEFT volumes increased five fold
    - Immediate Mobile Payment System of NPCI increased from 0 to 221 million
    - Prepaid cards went up from 31m to 740m
- Now, the Unified Payment Interface (UPI) has been introduced. This is the next gen revolution in retail payment space where the confidential banking details of

customers are not revealed, masked by the virtual payment address (VPA) but remittance or transfers seamlessly flow through the system

- In Mr. Nanden Nilekani's words, UPI is the WhatsApp moment of Indian Banking
- UPI is going to dramatically change the face of retail payment space
- In any which way we look, India's uptake in technology, infrastructure, security and convenience is on the dot and par with the best of standards
- But this kind of spurt brings its own challenges. How do we right size the system requirement when the y-o-y growth suddenly witnesses 150%. Sizing of the software and scaling to meet ever growing volumes complying with all the rules in procurements (the PSBs face this challenge and they are disadvantaged vis-à-vis the private sector competitors)
- Cyber security is the next biggest challenge
- The real achievement is when the front desk operator can conveniently handle all the customer requirements as he is the face of the bank
- Today most of the markets are stabilized, thanks to Dr. Rajan for what he did and thanks to Fed Reserve for not doing what it should have
- As we speak here, three committees are simultaneously working on the payment system challenges – one in the Govt, one at the RBI and one by the industry stakeholders to handle the disruptions that are happening due to the tech revolution

This leads us to the next question –

Do payments need traditional banks?

- We are slowly reaching a stage where P to P, B to B and B to C can happen outside the banking system
- It can happen faster, cheaper and safer including overseas remittances
- Today, non-banks are taking over payment space

- Non-banks did not get in to payment systems earlier because for a long time it was thought that the financial inclusion means opening bank accounts, receive and make payments through those accounts. But today we are seeing different types of solutions
- It has now been realized that the same objective could be achieved by unbundling all these and develop different tactics by handling them separately
- So, the experiment has started with payment banks and small banks as a separate category of banks which are distinctly different from traditional universal banks
- Everyone is talking as though the payment banks are competitors to the banks. I do not think so. As how the MFIs and other NBFCs have become sort of collaborators in financial intermediation, payment banks can also emerge as the collaborators in the system

Do payments need a central bank?

- Now, payment happens almost on the same day, debit preceding credit with credits hitting the accounts immediately. This has taken away the credit and settlement risk

- In many countries the retail payment space is not supervised by the central banks except for the consumer protection

- Is it time for India also to move in that direction?

- The distributed ledgers are enormously efficient technology

- But then it got bad name because there was always a chance that this kind of system, like Bitcoins, can be abused by terror money, mafia and other illegal money

- But the real advantage is that the distributed system operates from a central point from where the ledgers branch off and the debits and credits can happen simultaneously. There is no need for a clearing system, much less credit and settlement risk margins

- Under such system is there any need for a central bank to supervised the payment and settlement system except for consumer protection

- This would also encourage innovation in payment system bring in further disruption with positive improvements and improve quality of payment space

This leads us to next question

Is success a matter of agility or existing scale in modern payment landscape?

- Banks have enormous resources to day, be infrastructure, HR, finances etc. but then why are they not agile
- Four banks participated on day one in the Bharat Bill Payment System. Tow were private sector banks and two were cooperative banks and no public sector banks (PSBs), and it is the PSBs which hold more than three-fourths of the banking assets
- Bill payment system is going to be a game changer as it happened in Brazil ad Saudi Arabia and now happening in India. For such an important event, only private participants and no PSBs.
- Competition goes with agility. Without being agile and competitive, banks cannot survive dynamically changing payment system space
- For PSBs, process of selection of resources itself is completely different and challenging which their competitors need not face this and hence are extremely quick to react to changing dynamics.
- Or is it that the PSBs can be given freedom of choice in selecting resources so that they can also be agile and be first movers.

This leads us to next question

Security Vs Convenience - Collaborate or compete?

- Financial world, security and convenience are both must. For the sake of security if the basic transaction processing becomes difficult, then it would affect the mass banking and making digital economy less vibrant. But for the sake of convenience we cannot also forsake the security. Less secure payment space would drive away the digital money

- Even as of today, one has to remember lot of passwords, user-ids, codes and keep juggling between multiple devices, multiple accounts etc.
- Is security vs convenience like Hobson's choice? Not really
- This calls for innovation in the payment system so that both coexist simultaneously
- A case in point is UPI. It is an enormous leap in finance, very secure and maintains confidentiality of accounts etc., This sort of innovation needs to be sustained to attract even less informed public to adopt to digital options

Should regulations move away from product based to risk based?

- As we discussed earlier, world over the central banks are moving away from regulating the retail payment systems except for customer protection
- Is it then time for India also need to move to that scenario?
- Till date, the peer to peer regulation has not yet been released by the Reserve Bank
- Is it time for RBI to move away from product based supervision to risk based supervision
- This can be done by RBI declaring what can be done and what cannot be done, put in place key parameters that have to be fulfilled, protect customer interest and leave it to the stakeholders a level playing field
- Let innovation, technology and entrepreneurial risk rule the market

Thank You