

Financial services risk insights

New umbrella entity framework – Understanding
the challenges in the journey

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Background

The Reserve Bank of India (RBI) released **Framework for Authorisation of Pan-India Umbrella Entity for Retail Payments** on 18 August 2020. The objective of the guideline is to define the framework for entities interested to get into the business across eligibility, capital requirements, scope of services that the new proposed entity may be involved in and governance requirements. The guideline additionally provides a perspective on how the new umbrella entity (NUE) can opt to be a for-profit entity. According to the guidelines, the capital requirement for the business is INR 500 crore, with a requirement that the net worth shall never fall below INR 300 crore and that the applicant shall evidence availability of INR 50 crore at the time of making an application. While this initiative by the RBI represents a great opportunity, it also poses challenges, which could limit opportunity. This document is aimed at elucidating these challenges for potential business aspirants.



Challenges for NUE aspirant



The key competition for the aspirant would be the incumbent, National Payments Corporation of India (NPCI). It would be worthwhile to note that there are certain products, such as the National Financial Switch (NFS) and Cheque Truncation System (CTS), which have been moved from the RBI to the NPCI. These products offer significant advantage to the NPCI over prospective players entering the space. While due credit is given to the NPCI for innovations around RuPay, IMPS and UPI, availability of the legacy RBI innovations to NPCI skews the landscape against new aspirants. This is one of the biggest entry barriers that the aspirants need to take cognisance of.



While the India Stack initiative is focused on developing a unique digital infrastructure for the country to facilitate an environment of presence-less, paperless and cashless delivery, the reality is that internet is still patchy in the hinterlands, where majority of the population resides. Any innovation that relies heavily on availability of a strong digital infrastructure may not necessarily increase the pie. While the initiative will push up per capita digital payments, it cannot be said with certainty that it will help aspirants achieve break even. It would be the innovations around offline payment services that would be pathbreaking, given the current scale of digital infrastructure in the country.



The NPCI has used its proprietary standards for innovation. Therefore, while insistence on interoperability by the regulator is a positive move for Indian consumers, experts believe it is easier said than achieved. Development of common standards to facilitate interoperability across products and platforms would be imperative. Working with industry associations will be critical for new aspirants.



The success of any industry depends on the policy stability offered by the government and the regulator. While the issues around merchant discount rate (MDR) still haunt the industry, it would be imperative to increase the advocacy strength of the existing industry associations through the right support. An analysis of the policy responses over the past decade reveals that erratic responses are more an aberration than a norm and right advocacy can help drive the point across to government and regulators alike.



Traditionally, digital payments have followed e-commerce. However, real opportunity persists in places where e-commerce is yet to foray into. Offering traditional trade and commerce players an opportunity to digitise payments would open up several avenues. Consider the example of the USA, the UK and Singapore where travel payments (bus or train) are digitised using travel cards. Replication of this model, wherein digital payments are considered to offer independent opportunities rather than being dependent on e-commerce, is an area that banking aspirants must explore. It might be imperative for a banking aspirant to have the right mix of e-commerce skills in leadership teams.





Digital adoption is one of the weaker stories in the country. A key metric to drive this point is the use of cash on delivery option by e-commerce customers in Tier II and Tier III cities. Doing away with the practice of using physical cash is not an easy journey and the assumptions that may be used in business models need to take note of this reality. Aggressive assumptions will only help achieve revenue on paper. Balancing the assumption of a rise in per capita digital transactions and adding previously unserved customers is an important aspect to be achieved, especially when we expect technology costs to be high given the interoperability expectations.



Although it may be far fetched but a set of thinkers believe that complexity of tax code often results in non-compliance, which is a challenge. Hence, simplification of the tax code may play a big role in increasing digital adoption, especially amongst the MSME businesses. In summary, India has a complex tax regime and one of the side effects of simplification may be increased digital adoption.



While the RBI has stated an NUE can be for-profit, competition in the industry will force all the players to include the current incumbent to adopt the for-profit model to ensure sustainability as well as growth.



Cross border remittances are another aspect that have not been addressed by the current incumbent and an NUE aspirant may look at it as option. However, attention needs to be given to the cost of compliance on account of the Foreign Exchange Management Act (FEMA), 2000 requirements and the inherent money-laundering risks associated with the business.



Participation in the clearing and settlement activities of the financial services system is another area of service made available to an NUE. This is a domain where an NUE aspirant with a banking background can bring significant synergies, given its understanding and experience of this ecosystem.

Conclusion

The opportunity that NUE presents to the financial services ecosystem is huge and the aspirants should make an honest attempt in developing a workable business plan, else this initiative may just go down the same path that the payment bank initiative went through.

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RBI notification dated 10 August 2020 – Framework for
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