RBI GUIDELINES FOR THE INTEROPERABILITY OF PREPAID PAYMENT INSTRUMENTS:

A BOOST FOR DIGITAL WALLETS?

1. INTRODUCTION

On October 16, 2018, the Reserve Bank of India (the "**RBI**") issued guidelines (the "**Guidelines**") for the interoperability of know-your-customer ("**KYC**") compliant prepaid payment instruments ("**PPIs**")[1]. These Guidelines were widely anticipated ever since the RBI had issued the Master Directions on Issuance and Operations of Prepaid Payment Instruments[2] (the "**Master Direction on PPIs**") in 2017, which, among others, had introduced *interoperability* among payment instruments such as wallets with other wallets and bank accounts.

Interoperability essentially means the technical compatibility that enables a payment system to be used in conjunction with other payment systems. In the context of wallets, it refers to the ability of individuals holding a wallet issued by a particular issuer to undertake peer-to-peer payment transactions with individuals holding a wallet issued by a different issuer.

In this context, the demonetization of India's currency in November 2016, along with the push towards adopting digital payments has boosted the use of digital wallets in India. This news alert highlights the key takeaways from the Guidelines and its potential effect on the rapidly growing digital wallets space in India.

2. ANALYSIS

The Master Direction on PPIs had envisaged interoperability of PPIs in multiple phases. In the first phase, both bank and non-bank entities, which had issued PPIs ("**PPI Issuers**") were required to make all KYC-compliant PPIs issued in the form of wallets *interoperable* amongst themselves through the Unified Payment Interface ("**UPI**") within 6 months from the date of the directions. In subsequent phases, *interoperability* was to be established between wallets and bank accounts using UPI, and PPIs issued in the forms of cards.

UPI is essentially a payment system developed by the National Payments Corporation of India ("**NPCI**"), that allows instantaneous fund routing and merchant payments.

In keeping with the Master Direction on PPIs, the Guidelines have combined these phases and have provided a road map for implementation of the *interoperability* of wallets.

[1] Available at https://rbi.org.in/Scripts/NotificationUser.aspx?Id=11393&Mode=0.

[2] Available at https://www.rbi.org.in/Scripts/BS_ViewMasDirections.aspx?id=11142.

2.1 Manner of implementing interoperability

The first step for any PPI Issuer is to ensure that they have a board approved policy for achieving *interoperability*.

Companies issuing PPIs in the form of wallets are required to enable *interoperability* through the UPI infrastructure. The Guidelines state that PPI Issuers (*for wallets*) shall adhere to all the requirements of UPI including the relevant membership type and criteria, merchant on-boarding requirements, technical requirements, governance, certifications and audit requirements. Further, they shall also follow the relevant UPI guidelines for reconciliation of positions (the settlement of dues between *different* wallets and banks). PPI Issuers shall also follow the dispute resolution and customer grievance redressal mechanisms as prescribed by UPI. Further, PPI Issuers are required to facilitate all the basic and standard features of interoperability of UPI.

2.2 Types of wallets covered

The Master Direction on PPIs allowed PPI Issuers to issue *semi-closed* PPIs to users who have provided certain minimum identification details but have not completed the full KYC process prescribed by the RBI. However, such users are not allowed to load more than INR 10,000 a month or maintain a balance above INR 10,000 at any point of time. Further, the total amount debited from such accounts, are limited to INR 10,000 a month. Funds transfer from such PPIs to bank accounts and other PPIs is not permitted. Importantly, these PPIs were required to be KYC compliant within 12 months from the date of issue of the PPI.

The Master Direction on PPIs also allowed a PPI Issuer to issue a PPI with a higher balance of up to INR 1,00,000 after completing the KYC of the concerned user. The fund transfer limit is INR 1,00,000 per month for *pre-registered beneficiaries* and INR 10,000 per month for all other cases.

Both the Master Direction on PPIs and the Guidelines mandate PPIs Issuers to enable *interoperability* only among the accounts of those users for whom KYC compliance has been undertaken. This means that those users for whom the KYC process has not been completed will not be permitted to transfer funds to other wallets or bank accounts.

2.3 Settlement Mechanism

The Guidelines state that a non-bank PPI Issuer shall participate through a sponsor bank for the purpose of settlement, for which they will have to adhere to the requirements of the sponsor bank arrangements in UPI and the requirements of the NPCI. This will necessitate a PPI Issuer to enter into arrangements with a sponsor bank, which will increase the cost of doing business for wallet transactions.

2.4 Offline transactions

The Guidelines allows non-bank PPI Issuers to participate in the **99# USSD* service provided by NPCI. This essentially allows individuals with a mobile connection to transact and obtain certain information even without accessing internet.

2.5 Key membership criteria and requirements for UPI

The UPI Procedural Guidelines[3] specify a number of requirements to be satisfied by an entity to participate in UPI as a payment systems provider (a "**PSP**"). Some of the key requirements for a PPI Issuer are mentioned below.

(a) Type of Entity

Currently, a PSP should be an entity regulated by the RBI under the Banking Regulation Act, 1949 and be authorized by the RBI to provide mobile banking services for it to become a member and participate in UPI.

A non-bank entity operating as a PPI Issuer is not regulated under the Banking Regulation Act, 1949. A number of guidelines are framed in the context of banks operating as a PSP to provide mobile banking services. In light of the Guidelines expressly requiring *interoperability* through UPI, the UPI Procedures Guidelines ought to be revised to allow non-bank PPI Issuers to participate in the UPI infrastructure.

(b) Audit

Another requirement is that PSPs are required to provide an audit report for its application to enable the wallet (and its data center) by an auditor equivalent to a Certified Information Systems Auditor. Further audits are required to be conducted on an annual basis.

The NPCI may also audit the UPI related systems used by a member PSP as and when considered necessary. This may be undertaken either directly or through an external agency.

(c) Fees

There is also a minor switching fee levied on each transaction undertaken through UPI. While this is a very low cost per transaction, it increases the transactional costs for wallets which undertake a large number of transactions.

(d) Maximum number of transactions

The maximum number of peer-to-peer transactions that a user may undertake in a 24-hour period through UPI is limited to 10. This will curtail the number of transactions that a wallet user may undertake with other wallet users.

(e) Onboarding

Presently, the customer onboarding process under the UPI Procedural Guidelines requires linking the application to the customer or user's bank account. There is a lack of clarity on whether this means that wallets need to be linked to bank accounts to use UPI.

(f) Mergers and amalgamations

The UPI Procedural Guidelines states that the NPCI may terminate the UPI membership of a member PSP if: "*the member bank is amalgamated or merged with another member bank*". This could

[3] Available at https://www.npci.org.in/sites/default/files/UPI-PG-RBI_Final.pdf.

create difficulties for PPI Issuers, especially since the RBI does not have stringent conditions for mergers or amalgamations of PPI Issuers, as it does for banking companies.

(g) **Authentication process**

All financial transactions mandatorily require a *two-factor* authentication process. In the context of UPI, the first level of authentication is completed with the linking of the user's mobile number. The second level of authentication is complete by entering the M-PIN set by the user in the UPI framework.

3. INDUSLAW VIEW

The Guidelines should be seen as part of the Indian Government's recent push towards increasing digital transactions and enabling free two-way transfer of funds across wallets, issued by different PPI Issuers. In comparison to the earlier guidelines on domestic money transfer[4], where an individual could only transfer funds to other wallets issued by the same PPI Issuer, this unlocks the potential for increasing the number of digital transactions. This should increase the speed, frequency and convenience of digital transactions, though the UPI limit of 10 peer-to-peer transactions in a 24-hour period may restrict the full realization of this benefit.

The downside is the increased cost of compliance for PPI Issuers which will need to be incurred for implementing the UPI technology requirements, offering the required features of UPI, undertaking audits and other transactional costs.

It is possible that some of this additional cost will be passed on to the user. For instance, any fees which are required to be paid to the sponsor bank could be passed on to the user, especially since the Master Direction on PPIs allow the PPI Issuer to debit, from the escrow account where the users' funds are held, payments made to a sponsor bank for processing fund transfer instructions. Similarly, the switching fee may also be charged to the user. It remains to be seen whether the *potential* for transaction growth will enable the development of this sector despite these downsides.

Further clarity is required on the interpretation of certain parts of the UPI Procedural Guidelines in relation to non-bank entities as PPI Issuers. As stated earlier, a number of requirements are specific to banks and cannot be mirrored for PPI Issuers. Clarification on the membership criteria for PPI Issuers is necessary.

The Guidelines seem to suggest that it is up to PPI Issuers to determine whether they want to allow *interoperability*. However, the Master Direction on PPIs seem to suggest that i*nteroperability* of PPIs is an objective of the RBI and hence a mandatory obligation for PPI Issuers. This aspect needs to be clarified.

It should be noted that there are no timelines provided for implementation. The Master Direction on PPIs had stated that interoperability between wallets had to be enabled within 6 months. This could not be complied with until now since the RBI had not issued operational guidelines. Therefore, one interpretation could be that it is to be enabled within 6 months from the Guidelines. However, considering the dependency on NPCI to modify their UPI related guidelines and circulars to enable this, a longer time frame may be necessary.

[4] Available at https://www.rbi.org.in/Scripts/NotificationUser.aspx?Id=6750&Mode=0 . Please note that this was repealed by the Master Directions on PPIs.

Further clarity is required on the manner in which PPI Issuers can comply with the maximum monetary cap imposed on transactions using PPIs. As stated earlier, there is a *monthly* limit as well as an *overall* limit on the amount that can be added to or used from a wallet. Complying with this becomes difficult when transactions are initiated from one wallet to another. For instance, if a transfer of INR 10,000 is initiated from wallet A to wallet B, but wallet B already has a balance of INR 95,000, then it is not clear if this transaction can be undertaken.

The Guidelines are not clear on the manner in which *interoperability* is to be achieved between wallets and banks through UPI. Though it does state that it seeks to enable all phases of *interoperability*, specific directions have not been provided for linking with bank accounts.

Another potential issue could be the two-factor authentication process required by UPI. One of the main advantages of wallets is the seamless payment to merchants. The requirement to enter an M-PIN to authenticate *each* transaction makes it inconvenient for users and it could affect businesses relying on automatic deduction from wallets.

Despite the above, the Guidelines seem to be a progressive move designed to benefit non-banking entities operating as PPI Issuers, giving more credibility in the market to digital wallets. It allows PPI Issuers to issue UPI handles and allows wallet users to pay to any other wallet through UPI. The Guidelines are therefore likely to increase user confidence and should help non-bank entities tap into a customer base that is not presently holding a wallet issued by them.

However, following the recent decision by the Supreme Court, the success of the Guidelines depends largely on the Government or the RBI prescribing efficient alternatives to the *Aadhaar* based e-KYC authentication, considering that interoperability is only available for *fully* KYC compliant wallets.

Authors: Namita Viswanath | Savithran Ramesh

Sector: Government & Regulatory | Financial Services | Technology, Media & Telecommunications

Date: October 30, 2018

DISCLAIMER