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The second factor authentication rule is relaxed in India

In 2009 the Reserve Bank of India ('RBI') put into place a requirement for banks to implement an 'additional factor of authentication' ('AFA') based on information that is not visible on the credit/debit cards used in card not present ('CNP') transactions; typically this is delivered to consumers via internet passwords, for instance. Now the AFA Rule is set to be relaxed, with the RBI notifying the industry on 6 December 2016 that transactions of a certain value can be made without following the AFA Rule. Aaron Kamath and Vaibhav Parikh of Nishith Desai Associates discuss the background to the RBI's latest move and how it fits into the wider push by the Indian Government towards the use of digital payments in the country.

Landscape of card transactions in India

India has seen a surge in the number of credit and debit card cards used in transactions in the last few years. For instance, in the month of October 2016, the number of debit card transactions at point of sale ('POS') terminals stood at 140,586,967, with an aggregate value of INR 219,412.84 million (approx. \$3.2 billion), and the number of credit card transactions at POS terminals stood at 88,864,901 with an aggregate value of INR 299,424.01 million (approx. \$4.4 billion)¹. As of 2015, debit card transactions had climbed 36.5% of the compound annual growth rate ('CAGR') over the previous five years, while credit card payments had grown at a CAGR of 21.3%².

Surge in card transactions post-demonetisation

While there may be various reasons that may be attributed to the slow adoption of digital payments in India (such as low internet penetration and the challenges in ensuring use of banking facilities by all), the Government of India has been taking significant steps and has launched several initiatives to promote the transition to digital payments. This includes the recent step taken by the Government of India to demonetise

existing INR 500 (approx. \$7.5) and INR 1,000 (approx. \$15) denominations of currency in lieu of fresh INR 500 and INR 2,000 (approx. \$30) notes being circulated. The usage of credit and debit cards for transactions worth less than INR 500 (approx. \$7.5) has increased by 65% since the demonetisation announcement by the Government, with debit card usage increasing by 70% and credit card usage increasing by 40%³.

The Central Bank's mandate on additional security for online card payments

In 2009, India's central bank, the RBI, had directed⁴ banks to mandatorily put in place an 'additional factor of authentication' ('AFA') based on information that is not visible on the credit/debit cards used in card not present ('CNP') transactions. This 'second factor' authentication, as it is commonly known to the public, is based on information known or available to the cardholder but which is not printed on the card. Since this mandate by the RBI, banks have implemented the AFA requirement primarily through one time passwords being immediately sent to the users' registered mobile number, or through the use of internet passwords. This mandate by the RBI is applicable

It is clear that India has followed certain other countries in relaxing its AFA requirement.

1. ATM & Card Statistics for October 2016 released by the Reserve Bank of India; available at: <https://rbi.org.in/scripts/ATMView.aspx?atmid=67>
2. Payment industry to witness multifold growth, dated 29 October 2015, available at: <http://www.thehindu.com/business/Industry/payment-industry-to-witness-multifold-growth/article7814959.ece>
3. Credit/debit card usage surges on demonetisation, dated 23 November 2016, available at: <http://www.thehindubusinessline.com/money-and-banking/creditdebit-card-usage-surges-on-demonetisation/article9341080.ece>
4. Vide Notification RBI/2008-09/387 dated 18 February 2009; 'Credit/Debit Card transactions - Security Issues and Risk Mitigation Measures,' available at: <https://www.rbi.org.in/scripts/NotificationUser.aspx?id=4844&Mode=0>, along with other circulars and notifications.
5. Vide Notification RBI/2011-12/145 dated 4 August 2011, 'Security Issues and Risk mitigation measures related to Card Not Present (CNP) transactions,' available at: <https://www.rbi.org.in/scripts/NotificationUser.aspx?id=6657&Mode=0>
6. Vide Notification RBI/2016-17/172 dated 6 December 2016; 'Card Not Present transactions - Relaxation in Additional Factor of Authentication for payments up to 2000 - for card network provided authentication solutions'; available at: <https://www.rbi.org.in/Scripts/NotificationUser.aspx?id=10766&Mode=0>
7. Government to waive service tax on card transactions of up to Rs 2,000, dated 8 December 2016, available at: <http://economictimes.indiatimes.com/wealth/personal-finance-news/government-to-waive-service-tax-on-card-transactions-up-to-rs-2000/articleshow/55870033.cms>



to all credit and debit cards issued in India and where the merchant is based in India. Further, this mandate is applicable to all recurring transactions contemplated between merchants and cardholders. In fact, the RBI further specified that the card issuing bank would be liable to reimburse any losses incurred by a customer arising out of a transaction effected without the AFA⁵.

Recent relaxation of the AFA Rule

The RBI, on 6 December 2016, issued a notification⁶ through which the AFA requirement for CNP transactions up to INR 2,000 (approx. \$30) could be relaxed by banks and authorised card networks, at the option of the customer ('Notification'). Authorised card networks and card issuing banks may choose to relax the AFA requirement for customers upon receiving their consent. Lower transaction limits may be set by the customer in opting out of the AFA requirements. Further, as the Notification specifies that the AFA relaxation will be applicable to CNP transactions of up to INR 2,000 per transaction, it appears from the language of the Notification that if a merchant and customer split a payment to be made into separate tranches (either paid at different times during the same day or over a few days), each payment tranche may be considered to be a separate transaction. If such payment tranches are of a value of INR 2,000 or less, such transactions may be carried out without the AFA requirement. Hence, bigger value transactions could be split into smaller payment tranches to avail of this facility. However, we await further clarity and guidelines from the RBI on such finer points.

Customers opting for this facility would need to go through a one-time

registration process with the issuing bank. Further, the Notification provides that banks and authorised card networks should bear the full liability in the event of a security breach or a compromise in the authorised card network. In facilitating and giving customers an option to opt out of the AFA requirements, banks and authorised card networks would be required to:

1. Conduct 'velocity' checks to ascertain the value and frequency of transactions in which the AFA requirement is not carried out;
2. Educate and make customers aware that it is optional for them to opt out of the AFA requirement and that they are free to use other forms of AFA requirements (although the RBI has not specified other forms of AFA requirements that may be adopted);
3. Educate and make customers aware of the mechanism and risk involved in opting out of the AFA requirements; and
4. Indicate the maximum liability of the customer in the event of them opting out of the AFA requirements.

Impact

It is clear that India has followed certain other countries in relaxing its AFA requirement. Certain developed countries have, over the years, taken steps to relax such procedural hurdles faced by customers in making CNP transactions. It is, however, commendable that the RBI has, without going into too much detail, maintained that customer awareness and security infrastructure are paramount.

The primary impact of this Notification is that customers availing of this facility will only need to use their login credentials to avail of the facility and will not need

to re-enter their card details for every transaction on a merchant website and also go through an AFA by way of a one-time password or internet password.

The issuance of the Notification is a welcome step by the RBI in the wake of the demonetisation in India and should be another step forward in encouraging the adoption of digital payment methods. It is clear that the RBI has made an attempt to aid customer convenience for low value card transactions, given the current liquid cash crunch in the country. This facility is an added convenience for customers in making digital payments to e-commerce website operators, radio taxi operators, depositing money in e-wallets, and in other online transactions through their credit/debit cards. Other initiatives introduced by the Government of India to foster financial inclusion and promote digital payments include the Unified Payment Interface, National Automated Clearing House, RuPay and the Bharat Bill Payment System.

Further, as per recent media reports⁷, the Government is also contemplating waiving service tax chargeable on services by an acquiring bank in relation to settlement of an amount up to INR 2,000 through debit or credit cards, in a bid to promote digital transactions. This should be seen as a boon for merchants whom, at present, incur a ~15% service tax on service fees payable to the banks. However, it will be prudent to wait and observe the exact wording of the notification from the Indian tax authorities on this matter.

Only time will tell of the net effect of such initiatives aimed to foster financial inclusion and promote digital payments.