Technology Law Analysis

December 07, 2017

REVAMPED PREPAID PAYMENT INSTRUMENT LAW FOCUSES ON KYC, INTEROPERABILITY, CONSUMER PROTECTION AND DATA SECURITY

- Existing entities to comply by December 31, 2017
- Stricter eligibility requirements: net worth, financial regulator NOC, 'fit and proper' status
- Detailed KYC required for semi-closed and open PPIs over INR 10,000 (approx. USD 155)
- Detailed information security and consumer protection guidelines prescribed
- Focus on introducing interoperability amongst e-wallets and between e-wallets and banks

INTRODUCTION

The Reserve Bank of India ("**RBI**") recently issued a new *Master Direction on Issuance and Operation of Prepaid Payments Instruments*[1] ("**Master Direction**"). Given that the Master Direction was effective from the day of its release, existing issuers of prepaid payment instruments ("**PPIs**") have been given time to comply with the new rules on or before December 31, 2017. The Master Direction supersedes previous RBI guidelines dealing with the issuance and operation of PPIs.[2]

The Master Direction follows from a public consultation process that the RBI had conducted earlier this year where in March, 2017, it had released the draft form of the *Master Direction on Issuance and Operation of Prepaid Payments Instruments* ("**Draft Direction**"), inviting comments from stakeholders and the general public. *Nishith Desai Associates had also submitted its comments on the Draft Direction.*

In this hotline, we discuss the significant changes introduced by the RBI in the Master Direction.

ELIGIBILITY AND AUTHORIZATION PROCESS

i. Net worth: Previously, PPI issuers were required to have a minimum paid-up capital requirement of INR 5,00,00,000 (approx. USD 776,500) and a separate minimum positive net worth requirement of INR 1,00,00,000 (approx. USD 155,000). Now an all-inclusive definition of 'net worth' has been added with a single requirement of a minimum positive net worth of INR 5,00,00,000 (approx. USD 776,500) on day one, with a requirement that PPI issuers must achieve a minimum positive net worth of INR 15,00,00,000 (approx. USD 2,329,500) within 3 years of receiving the PPI authorization.[3] Existing PPI issuers must achieve this target as on March 31, 2020.
ii. Financial regulator NOC: Both banks and non-banks regulated by any "financial sector regulator" and seeking authorization under the Master Direction must submit a No Objection Certificate (NOC) from their respective regulator as part of the application for authorization. This is a new requirement.
iii. 'Fit and proper' status: The RBI has extended the fit and proper criteria (which typically applies to banks and NBFCs) to entities applying for authorization under the Master Direction. Therefore, RBI will now "*check the 'fit and proper' status of the applicant and management by obtaining inputs from other regulators, government departments, etc., as deemed fit.*"
iv. In-principle approval: Under the earlier regime, the approval of an application resulted in a full-fledged Certificate of Authorization. Now, the Master Direction creates the concept of a six-month in-principle approval. The RBI will first issue the in-principle approval, and it may thereafter impose additional conditions or withdraw the approval if "adverse features" come to light. If the eligibility conditions continue to hold good for the six-month period, a Certificate of Authorization will be issued.
v. No automatic approval for banks: Previously, banks and NBFCs did not need separate RBI approval to issue PPIs. Now, any entity, including a bank that wishes to issue a PPI must receive specific approval in this connection from the RBI.

1. TYPES OF PPIS

The rules relating to each type of PPI have been made more detailed, and each type of PPI is now regulated in a more distinct fashion.

i. Closed System PPIs: These PPIs are issued by an entity for facilitating the purchase of goods and services from that entity only (and not from third parties). There are no major changes specific to closed system PPIs.
ii. Semi-Closed System PPIs: These PPIs are used for the purchase of goods and services from designated third parties which have a specific contract with the issuer, either directly or through a payment aggregator or payment gateway, to accept the PPIs as payment instruments. The earlier categories have been revised as below:

    a) *Semi-Closed PPIs up to INR 10,000 (approx. USD 155)*: These can be issued with “minimum details” of the customer, including the mobile number verified with One Time Pin (OTP) and a self-declaration with the name and unique identification number of any officially valid document.[4]

    b) *Semi-Closed PPIs up to INR 1,00,000 (approx. USD 1,550)*: For this category of semi-closed PPIs, full KYC requirements are applicable i.e., the same level of KYC as required for opening a bank account. There is a monthly funds transfer limit of Rupees 10,000 (approx. USD 155), barring exceptions. More detailed norms are prescribed than under the earlier rules, such as the ability to transfer funds ‘back to source’ and the facility of pre-registered beneficiaries.

iii. Open System PPIs: These are PPIs that can be used at any merchant for purchase of goods and services, and also can be used for cash withdrawal. It has been clarified in the Master Direction that only banks can issue open system PPIs. Under the earlier regime, non-banks could issue such PPIs. The rules regarding this category have also been made more detailed, and largely resemble the rules for the second category of semi-closed PPIs, including the rules on ‘back to source’ and pre-registered beneficiaries as mentioned above.

2. OTHER INSTRUMENTS

The Master Direction has done away with many different categories of PPIs that were in existence and has provided that in addition to the above, PPI issuers can only issue PPIs of the following two categories:

i. Gift instruments: (Maximum value of INR 10,000 (approx. USD 155)). This is effectively a one-time gift card which is provided by several merchants to use on their website / own store. Such instruments cannot be made reloadable.
ii. PPIs for Mass Transit Systems (PPI-MTS): These are semi-closed PPIs issued by mass transit system operators after authorization to issue and operate such PPIs. Typically, this kind of PPI is used for availing of public transportation facilities as well as paying toll for private vehicles. Such PPIs should be reloadable and the maximum value outstanding such PPIs cannot exceed INR 3,000 (approx. USD 45) at any point. No cash-outs, refunds or fund transfers are allowed for this type of PPI.

Another addition worth noting is that cross-border outward transactions have now been permitted under the Master Direction. KYC-compliant reloadable semi-closed and open system PPIs (INR denominated) issued by authorised banks are permitted to be used in cross-border outward transactions. This will be only for permissible current account transactions under the Foreign Exchange Management Act, 1999 i.e., purchase of goods and services, and not for cross-border outward fund transfer or for remittances under the Liberalised Remittance Scheme.

3. INTEROPERABILITY

The Master Direction provides for interoperability amongst PPIs[5] and essentially prescribes that interoperability should be enabled in phases. In the first phase, PPI issuers (both banks and non-bank entities) should make all KYC compliant PPIs issued in the form of wallets interoperable amongst themselves through the Unified Payments Interface (“**UPI**”)[6] within 6 months from the date of issue of the PPI Direction. In subsequent phases, interoperability should be enabled between wallets and bank accounts through UPI.

4. CONVERSION OF EXISTING PPIS

PPI issuers would need to give PPI holders the option to convert the existing semi-closed and open system PPIs issued to them into various types of PPIs based on KYC requirements, and after conducting applicable due diligence, on or before December 31, 2017. In cases where such conversion is not opted for by PPI holders, such PPIs should be mandatorily converted into minimal KYC PPIs.

5. OTHER IMPORTANT PROVISIONS

i. Validity & Redemption: All PPIs issued in India should have a minimum validity of 1 year from

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the date of last loading / re-loading of the PPI. PPIs with no financial transaction for a consecutive period of 1 year should be reported to RBI and be made inactive. Re-activation would entail a due diligence by the PPI issuer.

ii. Refunds: Like the case was earlier, refunds, in cases of failed / returned / rejected / cancelled transactions, are required to be made to the PPI from which the initial payment was debited. Pertinently, the RBI had earlier this year released a circular pertaining to customer protection and limiting the liability of customers in unauthorized electronic banking transactions.[7] Click here for our update and analysis on this circular.

iii. Security & Audit

PPI issuers should put in place a Board-approved information security policy for the security and safety of the PPIs covering critical areas of concern like login security issues, authentication of successive payment transactions, and additional factor of authentication as required for debit cards. Detailed regulations for the same have now been prescribed.

Furthermore, PPI issuers should, in addition to reporting to RBI and CERT-In, establish a mechanism for monitoring, handling and follow-up of cyber security incidents and cyber security breaches. Non-banking entities issuing PPIs should submit a systems audit report including security audit conducted by a CERT-IN empaneled auditor, within 2 months of the close of the financial year.[8]

Given that the Central Government recently appointed a committee to propose a new, horizontally applicable data protection framework for India, PPI issuers will have to be mindful of the requirements under both regimes. In the event of any conflict between the two, the stricter standard will likely need to be followed.

CONCLUSION

The Master Direction significantly increases the compliance burden on PPI issuers on various fronts: data security, KYC, audits, disclosures and grievance redressal. Some commentators have questioned whether the PPI regime will result in e-wallets losing their edge over traditional financial offerings.[9] This is because many of the new requirements resemble those required for banks and NBFCs.

However, given the increase in the use of PPIs in India, consumer protection concerns seem to warrant increased regulation. The RBI November 2017 Bulletin disclosed that as of September 2017, PPI volumes stood at 240.29 million (as opposed to 97.07 million in September 2016), and PPI values stood at INR 109.77 billion (as opposed to INR 56.28 billion in September 2016).[10] Mr. R. Gandhi, former RBI deputy governor, was recently quoted as saying, "*if you don't insist on the same type of terms for banks and wallets, then there is clear arbitrage, and it is tantamount to picking a winner. If RBI doesn't lay terms of security and KYC, then wallets will be at a clear advantage*."[11] This statement appears to echo the rationale behind the revamped rules in the Master Direction.

We see the Master Direction as a welcome move. By facilitating a level playing field, it pushes for a regulated environment where there is uniformity and certainty. By increasing entry barriers and compliance requirements, the RBI is seeking to protect consumer interests and prevent systemic risk, considering the increased funds at stake. The move to promote interoperability amongst PPIs and bank accounts may also go a long way in promoting a cashless and digital economy in India by facilitating payments between PPIs and other PPIs and between PPIs and bank accounts.

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You can direct your queries or comments to the authors

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[1] Circular dated October 11, 2017. Available at https://rbi.org.in/Scripts/NotificationUser.aspx?Id=11142&Mode=0. Last accessed: December 5, 2017.

[2] Tables 1 and 2 of the Master Direction set out the circulars which have been fully and partly repealed. Significantly, the *Policy Guidelines on Issuance and Operation of Pre-Paid Payment Instruments in India, 2009*, as amended and consolidated from time to time, stands repealed.

[3] If the PPI issuer is a bank, they would need to meet the necessary capital requirements applicable to banks.

[4] This category of PPI now cannot be used for purposes other than the purchase of goods and services. Therefore, unlike earlier, peer-to-peer payments would not be permitted unless they are for such purchases.

[5] The Master Direction states that separate operational guidelines will be issued on interoperability.

[6] See http://cashlessindia.gov.in/upi.html. Last accessed: December 5, 2017.

[7] Circular on *Customer Protection – Limiting Liability of Customers in Unauthorized Electronic Banking*

Transactions, dated July 6, 2017. Available at: https://rbi.org.in/Scripts/BS_CircularIndexDisplay.aspx?Id=11040. Last accessed: December 5, 2017.

[8] Note: Banks will continue to be regulated by the *RBI Circular on Cyber Security Framework in Banks*, dated June 2, 2016.

[9] See https://the-ken.com/rbi-kicked-off-shark-fight-wallet-users/#. Last accessed: December 5, 2017.

[10] https://rbidocs.rbi.org.in/rdocs/Bulletin/PDFs/RBIBNOV17ABB2DE5EA76F428980F42BE602988E90.PDF Last accessed: December 5, 2017.

[11] https://the-ken.com/rbi-kicked-off-shark-fight-wallet-users/#. Last accessed: December 5, 2017.
