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DIGITAL PAYMENTS POST DEMONETIZATION: CHANGES IN POLICY AND PRACTICES

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ABSTRACT

On November 8, 2016, the Union government of India announced the withdrawal of old currency notes of high value denomination with effect from midnight. As a consequence, 1,000 rupee and 500 rupee notes were made redundant and the government rolled out the biggest ever currency swap programme in the world over the next few weeks in a revolutionary bid to cripple the black money market and to disengage the hawala (cash) payment system that remained unaccounted by the tax authorities. The government also claimed it was cracking down on the terror network, which is widely believed to be funded by the parallel economy thriving on a hawala/black money racket. It's been eight months since the demonetization was introduced in the country and old currency notes exchanged. While it is still debatable if the massive de-circulation of notes has had its desirable impact in rooting out black money from the Indian eco-system, there are visible upswings in many sectors, particularly the banking sector, where notable forward traction has been achieved compared to previously recorded progress.

The following paper attempts to bring out how the disruption in the money market due to the massive exercise of demonetization brought about changes in behavioral and policy level practices vis-à-vis payments processed in a market economy. It underlines the relative shift, both in the customer mindset and the banking industry, with the help of available data sets sourced from authenticated publications, newspapers and RBI releases. The paper refines its derivatives in two broad classifications that align with the overall impact of demonetization on cash as a mode of transaction: Part I attempts to map the shift in the behavioral pattern of the end user in making transactions post November 8, 2016. Part II highlights the changes in policy outline and initiatives rolled out by the Union government, the RBI and its affiliate banking network in wake of the economic squeeze that had set in after November 8, cash sweep.

***KEYWORDS**: Demonetization, Hawala, Banking Sector, Economic Squeeze, End-User Behaviour.*

Introduction

Part I- Changes in end-user behaviour

- **Surge in Digital Transactions**

If there is one common denominator to the whole of demonetization exercise in its outreach to reduce cash flow in economy, it has been a consistent surge in digital transactions. In the months since the massive currency swap was executed, there has been a change in the practice of the end user where a record spike in digital payments has been observed and reported. A presentation made by the finance ministry before *the Parliamentary Standing Committee on Finance on Demonetization & Transformation towards Digital Economy* in July this year claims the spur in digital transactions unleashed by the demonetization of old high-value currency notes has sustained over the months. According to report

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presented in May this year, digital transactions increased by an overall 23 percent to 27.5 million*. The presentation made before the standing committee clocks a period of inference between November 2016, when the transactions made online were worth 22.4 million, and that of May, 2017.

This data set can be employed to make reasonable assessment, even though not conclusive, considering the period in coverage is spread over a course of 6 months. Yet, it helps aggregate the impact of the union government move on the cash transactions since demonetization. The presentation also implies that the customer preferences have shown a marked shift towards adopting technology-based payment models that have been a proverbial tough nut to crack for the banking institutions in India due to lack of awareness and low penetration levels of banking services and tech infrastructure outside of the cities. The 23 percent jump in online transactions as pointed out before the parliamentary standing committee includes a 7 per cent spike in use of cards. That's a low bar compared to the overall average jump in non-cash sales and purchases during the said period. The low incremental value to card-based transaction system need not necessarily validate the argument that plastic money is still not a preferred mode of transaction for the customer. We have to take into account the penetration of bank accounts in the small towns and predominantly rural areas and understand if their service ecosystem includes provisioning of plastic money as a standard, which otherwise is aggressively practiced in the cities.

The other variable that has to be factored in before attributing reasons for the low growth in card transactions is the availability of the Point of Sales (PoS) machines. Point of Sales (PoS) machines or PoS machines are an essential requisite for card-based payments at a physical merchant store. Lesser than average jump in card-based transactions could also be a result of lesser Point of Sales (PoS), machines with merchant outlets. The availability of secure and high-speed Internet connection would also impact card usage. The data has to be, therefore, optimized for acquiring values corresponding top these sub-sets before a conclusive result can be drawn for lower card usage. A separate study is required to assess these factors. This data, however, is a conclusive proof that a significant portion of the jump in digital payments has been because of other active modes of payment including that of payment banking and direct bank-to-bank transfers.

- **What Triggered this Behavioral Change?**

A two-pronged approach worked towards mobilizing the digital convergence plan in the banking sector. The first is a direct derivative of the union government's decision to withdraw old bills from the market with immediate effect. The result saw a mopping up of 85 per cent of the cash in circulation (CIC) and consequently, drying up of physical cash, an idea which the end user has been used to for transacting business. An estimated Rs15.5 lakh crores value of currency bills were wiped out from the market resulting in a severe cash crunch leading up to the issuance of new bills*. The weekly data on status of currency in circulation in pre and post-demonetized India shows the revealing gap in availability of currency. According to RBI data*, the value of currency in circulation (CIC) in the first week of November, and before demonetization was announced, was over 17.74 lakh crores rupees. The figures for CIC as in first week of January, after two months of withdrawal of old currency notes, stood at 8.73 lakh crores rupees*. The weekly data on "money supply" released by the RBI in January second week tells us how the money supply was reduced to just half in a span of just two months. With cash drying up and queues outside Automatic Teller Machines (ATM) and banks not thinning out in the first few months, people had little option, but to move to plastic money. The segment of customers who were issued card linked to their account by their bank, found use of it in everyday transactions.

For the month ending July, 2017, here's what the CIC is. Total currency in circulation was Rs.15.41 lakh crores on July 28, according to the RBI. This measures up to around 86 per cent of the amount in circulation on November 4 last year, four days before demonetization was rolled out. Deputy Governor of the RBI, Viral Acharya gives ample hint that the reduced money supply shall be the new norm in the Indian market. "The currency in circulation is showing early signs of normalization," he said after a post-policy briefing of the RBI. According to the RBI data released in July last week, the currency in circulation now is about 9% of the gross domestic product (GDP) of the country, down from more than 12%. The CIC in developed countries has a variable range between 5 per cent and 8 per cent of the country's GDP, which is now within foreseeable grasp.

The second factor is an offshoot of the government decision to roll out demonetization. Where the government decided to take the bull by its horn by aggressively pushing the envelope on alternate modes of transactions, the private sector saw an enterprise in the demand for non-cash transactions and ramped up its efforts to bridge the digital divide and offer basic banking solutions to the public-at-large.

This led to a availability of choice, critical to the transition to the alternate payment systems in the economy post-demonetization. The governments' intervention through policy parameters gave a shot in the arm to the efforts of the RBI in fighting the crunch in money supply that followed the withdrawal of high value currency notes. The paper would delve into such policy measures separately. What is, however, a pertinent is to amplify the role of catalyst played by the unprecedented step-up of the online banking sector, the undeniable role of payment banks, in particular. On August 19, 2015, the Reserve Bank of India granted in-principle approval to eleven applicants to set up Payments Banks under the "Guidelines for Licensing of Payments Banks", which were issued on November 27, 2014. The eleven applicants issued these licenses were:

- Aditya Birla Nuvo Limited
- Airtel M Commerce Services Limited
- Cholamandalam Distribution Services Limited
- Department of Posts
- Fino PayTech Limited
- National Securities Depository Limited
- Reliance Industries Limited
- Dilip Shantilal Shanghvi
- Vijay Shekhar Sharma
- Tech Mahindra Limited
- Vodafone m-pesa Limited

Three of these applicants have since surrendered their licences, but that did not deter the availability of the payment banks that had just started to branch out by offering banking solutions right down to the vendor on the street.

What is a Payments Bank?

Put simply, a payments bank, unlike the regular banks, is not authorised to lend money, which is the primary source of banking business. Also, as per the RBI guidelines dictate that such banks cannot accept deposits in excess of Rs 1 lakh in an account. They are, however, free to issue passbooks and other cash transaction facilities such as issuance of debit card and setting up of ATMs. Payments banks offer online and mobile banking solutions to their customers.

Vijay Shehkhar Sharma's start-up venture Paytm has become a household name, thanks to demonetization that suck cash dry from the market for a few months before new currency notes were infused in the market again. Payment banks opened a gateway to the people at the grassroots, to the illiterate and even those in the unorganized sector and without banking instruments to join the mainstream of banking without having to step inside a bank. This was a major hindrance in taking banking to the masses, who were left out of the technology-assisted ease of doing business in the Indian banking sector. This has to be dealt with broad-based outlook within the ambit of government push to the payment banks. What payments bank like paytm, India Post and Airtel Money did was to steer the flow of digital payments at a time of restricted money supply to effect a successful transaction without the involvement of physical cash. These payments banks have since evolved and have made hay in the economy reeling under post-demonetization cash crunch. The payments banks also broke the banking divide for the low-income group and the poor. Those who had never stepped inside a bank or didn't have the requisite documents and/or cash to open an account could at the click of a button on their phone engage in a legally tenable transaction approved by the RBI. This led to a financial freedom of a large section of small-time traders, vendors and individuals to conduct secure transactions through online systems or mobile devices. The liquidity crunch that had plagued the country after demonetisation could be eased out substantially, with the help of these payments banks that offered cashless banking solutions to the man on the street.

Part II-Policy, Parameters and Digital Outline

While the currency swap programme was underway, the RBI and the union government went into an overdrive to promote cashless transactions. This involved a concentrated policy approach to help the end user embrace digital applications that would enable them to transact business. The policy shift included, launch of mainstream applications like BHIM app and amendment in existing rules and guidelines such as reducing tax on Point of Operation machines and limiting customer liability on card based transactions to offer relief to and boost confidence of the user. The following points outline how the government and banking institutions went about dovetailing their programmes to help transition into the digital and less-cash economy.

Mobile Applications

The Centre's thrust of building on mobile penetration in India to help secure transactions after demonetization saw the launch of BHIM, the most ambitious money transfer portal named after the father of Indian constitution, Bhim Rao Ambedkar. According to the National Payments Corporation of India, which maintains the app, "Bharat Interface for Money (BHIM) is an app that lets you make simple, easy and quick payment transactions using Unified Payments Interface (UPI). You can make instant bank-to-bank payments and Pay and collect money using just Mobile number or Virtual Payment Address (VPA)."

BHIM is unlike the payments banks and the mobile wallets popularized by Paytm, Airtel Money, which take deposits. BHIM on the other hand, is only "a facilitator", which helps transfer money between different bank accounts. The key feature of BHIM, according to the NPCI is the ability to send money using an Aadhaar number, account number, IFSC code and QR code. Other broad-based features of the application include:

- Transferring money using mobile number registered with the application
- Payment by scanning QR code just like in mobile wallets
- User can check transaction history and can report issues in transactions.
- Customer can change the bank account linked with app along with the password used to operate it.
- The application supports up to 8 regional languages ina diverse country like India. This includes: Tamil, Bengali, Malayalam, Oriya, Gujarati, Kannada, Telugu and Hindi).

BHIM application has crossed a subscriber base of 16 million in April this year. Around 4 million of these subscribers were logged in as active customers till the end of June as per NPCI. According to a Time of India report dated August 7, 2017, the government of India is planning to roll out higher cash back on transactions through BHIM on August 15. This is again a policy boost to promote digital transactions on the application and compete with similar applications and mobile wallets in the private sphere.

Tax Exemption on PoS Machines

Point of Sale machines, which are used to swipe cards for effecting a transaction, are critical to acceptability of cards making them the transaction points for cashless exchange. On February 1, 2017, Union finance minister Arun Jaitley in his budget speech announced, "To promote cashless transactions, I propose to exempt BCD (basic custom duties), excise duties, CVD (countervailing duties), SAD (special additional duty) on miniaturized card readers and mPoS micro ATMs standards for version 1.5.1, finger print readers, scanners and iris scanners." The copy of his budget speech made available by the department of economic affairs, Government of India, further states that, "Simultaneously, I propose to exempt components for manufacturing of such device so as to encourage domestic manufacturing of these items." To understand the underlying importance of this announcement, we must understand the dearth of PoS machines with traders willing to make a digital exchange. State Bank of India (SBI) Ecowrap, the research unit of India's largest bank by valuation has attributed the surge in credit card usage and the consequent demand for PoS machines to the effects of demonetization. Ina statement released by the research arm of the banking major in July this year, it said, "If demonetization had not happened, it would have taken three years more for credit and debit cards transactions on point of sales (PoS) terminals to reach the current level of Rs 70,000 crores (assuming a yearly growth rate of 25%)."

It further stated that, "We believe that increasing number of PoS terminals (post demonetization, banks have been able to set-up 11.8 lakh extra PoS terminals) and ease of doing digital transaction will increase this level further. In Hindustan Times article titled: *mobile wallets see a soaring growth post* demonetization, published on January 1, 2017, it says, "One reason for the rise of mobile wallets is the lack of point-of-sale machines in the country to swipe debit or credit cards. There are only 1.5 million of them, mostly with large shop owners." SBI Ecowrap also states that pre-paid instruments that include mobile wallets, PPI cards and paper vouchers and mobile banking, have also witnessed a spike in transactional value which has touched Rs 10,700 crores in May 2017. Compared to this transactions worth Rs. 5,100 crores were conducted through the same instruments in November 2016.

Limit on Customer Liability

Its circular dated July 6, 2017, the RBI took a major step by limiting customer liability on fraudulent transactions on cards. The circular titled, "*Customer Protection-Limiting Liability of Customers in Unauthorized Electronic Banking Transactions*" It states, "With the increased thrust on financial inclusion and customer protection and considering the recent surge in customer grievances relating to unauthorized transactions resulting in debits to their accounts/ cards, the criteria for determining the customer liability in these circumstances have been reviewed.” In a major leap of faith for the customer transacting through digital means, the central bank introduced a Zero Liability clause. According to the circular, a customer’s entitlement to zero liability shall arise where the unauthorized transaction occurs due to “Contributory fraud/ negligence/ deficiency on the part of the bank”. What is important to the entire ruling is that the sero liability stays intact irrespective of whether or not the transaction has been reported by the customer. One of the prime concerns of the customer with plastic money is the possibility of fraudulent transaction and the charges such a transaction would attract in the event such a crime is committed. The RBI has attempted to allay fears by further fool-proofing the zero liability clause in the event of a third party breach where the deficiency lies neither with the bank nor with the customer but in the system, and the customer notifies the bank within three working days of receiving the communication from the bank regarding the unauthorized transaction.

Cut in NEFT, RTGS Charges

The National Electronic Funds Transfer (NEFT) and Real Time Gross Settlement (RTGS) are one of the easiest, secure and quickest way of transferring money from one account to another through online banking applications. Last month, the State Bank of India (SBI) slashed on these two modes of transaction by up to 75%. The revised charges which have been made effective from July 15, is expected to make transactions done through bank’s internet banking and mobile banking cheaper. The bank has also waived charges for fund transfer of up to Rs1,000 through IMPS (Immediate Payment Service) to push small scale transactions online.

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