

New Master Directions on Prepaid Payment Instruments

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On 27 August 2021, the Reserve Bank of India (RBI) notified a new set of Master Directions on Prepaid Payment Instruments (PPI Directions) under the Payment and Settlement Systems Act, 2007.

The PPI Directions regulate the issuance and operation of certain types of Prepaid Payment Instruments (PPIs) in India. PPIs are payment instruments that facilitate purchase of goods and services, financial services, remittance facilities, etc., against the value stored therein.

The PPI Directions consolidate the erstwhile Master Direction on Issuance and Operation of Prepaid Payment Instruments dated 11 October 2017 (2017 PPI MD) and subsequent circulars issued by the RBI in respect of different aspects relating to PPIs. This update highlights some of the key changes introduced in the PPI regime by the PPI Directions and briefly analyses their potential impact.

The RBI has simplified the regime for prepaid payment instruments with a view to enhance seamless adoption of such instruments for digital payments. In this update, we discuss some of the major changes brought by the new regime and its potential implications.

1 Classification of PPIs

The 2017 PPI MD regulated two categories of PPIs:

- a. Open PPI – They could only be issued by authorised banks for use at any merchant establishment, and from which cash withdrawals were permitted;

- b. Semi-closed PPIs - They could be issued by both authorised banks and non-bank entities for use only at a group of clearly identified merchant locations which have a specific contract with the relevant PPI issuer, from which cash withdrawals were not permitted.

Semi-closed PPIs, in turn, were mainly of two types - (i) PPIs issued by accepting minimum details of PPI holders, of value up to INR 10,000 (**Minimum Detail PPIs**) and (ii) PPIs issued after completing KYC of PPI holders, of value up to INR 100,000 (**Full KYC Semi-closed PPIs**). However, on 19 May 2021, the RBI issued a notification titled '*Prepaid Payment Instruments (PPIs) – (i) Mandating Interoperability; (ii) Increasing the Limit to ₹2 lakh for Full-KYC PPIs; and (iii) Permitting Cash Withdrawal from Full-KYC PPIs of Non-Bank PPI Issuers*' (**May 2021 Circular**) which permitted cash withdrawal from Full KYC Semi-closed PPIs and increased the limit from INR 100,000 to INR 200,000.

The PPI Directions consolidate these changes and simplify the classification of regulated PPIs as '**Small PPIs**' and '**Full KYC PPIs**'. Small PPIs are like Minimum Detail PPIs whereas open PPIs and Full KYC Semi-closed PPIs are subsumed under Full KYC PPIs.

Full KYC PPIs permit fund transfers back to the source account or PPI holders' bank account and allow cash withdrawals, subject to specified fund transfer limits and monthly overall limits. However, there are no limits on the total number of debits and credits in a month for Full KYC PPIs, as clarified through the FAQs on PPIs dated 20 September 2021. Unlike open PPIs under the erstwhile directions, Full KYC PPIs may be issued by non-bank entities and not just banks. This move is likely to encourage more non-bank entities to enter the PPI space. Further, in a significant deviation from the erstwhile directions, Full KYC PPIs can be used at any merchant establishment and the requirement to identify a specific group of merchants has been removed. This could increase customer convenience and aid in improving adoption of PPIs as a payment method across a wide number of merchants.

Small PPIs are further classified into Small PPIs with and without cash loading facility. Small PPIs with cash loading facility must be converted to Full KYC PPIs within 24 months from the date of issuance, failing which no further credit will be allowed in the Small PPI. However, the PPI holder will be permitted to use the balance available in the non-converted Small PPI.

The PPI Directions also provide that Video Based Customer Verification Process can be used to open Full KYC PPIs or to convert Small PPIs to Full KYC PPIs.

The PPI Directions exclude Closed System PPIs from the ambit of RBI regulation. Closed System PPIs are defined as PPIs which are issued by an entity for facilitating purchase of goods and services from that entity only, and do not permit cash withdrawals.

2 Interoperability

The May 2021 Circular mandated interoperability for holders of Full KYC Semi-closed PPI through authorised card networks, such as Visa or Mastercard, for PPIs in the form of cards, and through the Unified Payment Interface (**UPI**) for PPIs in the form of wallets by 31 March 2022. Interoperability was also made mandatory for the acceptance side. PPIs for mass transit (**PPI-MT**) were exempt from the requirement while gift instrument PPI issuers had the option to offer interoperability. These changes have been carried over to the PPI Directions with respect to Full KYC PPIs.

The PPI Directions provide further clarity on the measures to be adopted to achieve interoperability and require the National Payment Corporation of India (**NPCI**), which operates the UPI, and authorised card

networks to facilitate participation of PPI issuers in UPI and card payment systems, respectively. The PPI Directions further specify that to enable interoperability through card networks, PPI issuers can participate as members or associate members of card networks with settlements handled directly or through sponsor banks. For achieving interoperability through UPI, the PPI Directions stipulate that PPI issuers must act as Payment System Providers and manage settlements through sponsor banks. However, they may onboard only their own customers to UPI and not customers of any bank or other non-bank PPI issuers. Customers can authenticate the transaction through their wallet credentials and do not need to separately authenticate the transaction for UPI. Reconciliation of transactions, customer grievance redressal and dispute resolution for interoperable PPIs will be governed by the rules and regulations of NPCI and the card networks.

Interoperability is a welcome feature for consumers since the acceptability of PPIs will no longer be tied to the merchant and PPI holder having contracts with the same PPI issuer. However, implementing the interoperability requirements may come with additional operational and compliance costs for PPI issuers.

3 Authentication

The 2017 PPI MD required PPIs in the form of cards to have additional factor of authentication (**AFA**) as required for debit cards. For wallets, AFA was only required at the time of loading (based on the instrument used for loading). The May 2021 Circular made the AFA requirement applicable to cash withdrawals from wallets (with PIN as an alternative). The PPI Directions extend the requirement further to all wallet transactions and provide that all wallet transactions require two factor authentication (**2FA**) for validation. However, 2FA/AFA is not mandatory for gift PPIs and PPI-MTs.

While measures like AFA and 2FA are introduced to enhance the security of PPI transactions, payment system providers often argue that they reduce the ease of transacting for PPI holders and may dampen customer enthusiasm for adoption of PPIs as a preferred payment method. However, for many years now credit/debit cards, internet/mobile banking and UPI have been subject to OTP or some other form of AFA and consumers can be expected to be reasonably familiar with such measures.

4 Gift PPI

The 2017 PPI MD allowed issuance of gift PPIs (not exceeding INR 10,000) by banks and non-banks. However, they did not permit cash out or refund for gift PPIs. While the PPI Directions also contain the same restriction, they allow funds to be transferred back to the source account (i.e. the account from where the gift PPI was loaded) after receiving consent from the PPI holder.

5 Other key changes

- a. Certificates of Authorisation (**COA**) for issuing and operating PPIs, which were previously issued only for a period of 5 years, will now be issued on a perpetual basis, subject to certain conditions, in accordance with the RBI notification titled '*Authorisation of entities for operating a Payment System under the Payment and Settlement Systems Act, 2007 (PSS Act) – Introduction of Cooling Period*' dated 4 December 2020.
- b. A one year cooling off period has been introduced for any entity applying for COA if (i) its previous application for COA was rejected, (ii) its COA was revoked, voluntarily surrendered, or not renewed, or (iii) it is an entity set up by promoters involved in any of the above, in accordance with the RBI notification of 4 December 2020.

6 Conclusion

The PPI Directions manifest the RBI's efforts to simplify the regime for issuers and customers through measures such as interoperability. This will likely allow customers to have a seamless payment experience free from the constraints of the underlying payment system. The PPI Directions bring further clarity on implementation of interoperability and recognise the role of NPCI and the authorised card networks in achieving this objective. However, it is likely to increase compliance costs for PPI issuers in the immediate future.

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