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Analysing developments impacting business

CREDIT LINES ON UPI - THE NEXT STEP TOWARDS DIGITAL FINANCIAL INCLUSION

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Introduction

The Reserve Bank of India (RBI) through its directive dated 4 September 2023 (Directive) allowed pre-sanctioned credit line of a bank to be used as a funding account for enabling payments through the Unified Payments Interface (UPI). The existing funding accounts in UPI ecosystem are savings and overdraft accounts, prepaid payment instruments and RuPay credit cards.

The RBI earlier through its press release dated 6 April 2023 (Press Release) had indicated that it would permit inclusion of credit rails as funding accounts for making UPI payments.

Background

The UPI ecosystem facilitates an architecture framework and a set of standard Application Programming Interface specifications to facilitate online payments. It is a mobile first platform where instructions can be given by the customers to its banks for initiating payments and recovering funds. The UPI ecosystem is facilitated by National Payments Corporation of India (NPCI), a not-for-profit consortium of banks authorised by the RBI for operation of retail payments and settlement systems in India. NPCI is the owner, network operator, service provider, and coordinator of the UPI ecosystem.

UPI was launched on 11 April 2016 with an initial participation of 21 member banks. The UPI ecosystem currently has more than 484 members. In 2018, the NPCI introduced new features in UPI through UPI 2.0 such as linking overdraft accounts to UPI payments and setting up mandates for recurring payments. The overdraft facility faced limited adoption by banks mainly due to levying an interchange fee of 1.5% on the acquiring banks which resulted in a higher merchant discount rate in comparison to debit cards.

Further, in June 2022, the RBI had permitted RuPay credit card to be used for making payments through UPI. RuPay has been focused on domestic payments, providing cost-effective transactions and building widespread acceptance within India.

It may also be relevant to note that last year, the RBI had explicitly disallowed linking credit lines to prepaid payment instruments such as wallets and prepaid cards, which had become a successful business model for fintech companies offering short-term credit to their customers through buy-now-pay-later models.

Key summary of the directive

1. The Directive allows only pre-sanctioned credit lines offered by Scheduled Commercial Banks to be linked to the UPI rails. The Directive has not allowed Non-Banking Financial Institutions to offer this functionality yet.
2. In order for the banks to introduce credit lines on the UPI platform, they would be required to obtain explicit consent from the individual customer prior to enabling this option.
3. Banks have been given the flexibility to stipulate the terms and conditions of such credit line offerings (such as rate of interest, credit limit, period of credit, etc.) as per its board approved policy.
4. The Directive enables Banks to offer all types of credit facilities through UPI including credit cards (which were only restricted to RuPay credit cards prior to the issuance of the Directive).

Comment

The Directive holds significant implications for India's financial landscape. As emphasized in both the Directive and its preceding Press Release, the regulatory intent is to reduce the customer acquisition costs for banks. The Directive also allows instruments like credit cards, debit card equated monthly installments (EMIs), zero cost EMI cards to be accessible through the UPI interface.

This development aligns seamlessly with the overarching goals of the Indian Government and the RBI, which have been focused on increasing financial inclusion and enabling access to formal credit. This was recently reiterated at the 'G20 Summit' hosted by India, where India's Digital Public Infrastructure (DPI) was acknowledged as the driving force behind India's financial accessibility ambitions in a domestic and global context. DPI is the foundational framework of digital technologies and services established by the Indian Government to empower citizens and enable digital interactions across various domains.

The low penetration of credit cards in India has led to many customer segments being underserved. The addition of pre-approved credit limits to UPI would lead to introduction of customized, cost effective financial products for the underserved segment of India ensuring real time payments and settlements.

Further, integrating credit lines into UPI simplifies financial transactions, making managing finances more accessible and user-friendly and driving innovation in financial services. The Directive would also promote healthy competition among banks, benefiting consumers with better pricing options and services.

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