Enhancing Financial Innovation & Access

Payment Service Banks: Identifying lessons for the Nigerian market

Key Findings

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A. Background

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Background

About EFInA

- Enhancing Financial Innovation & Access (EFInA) is a financial sector development organization that promotes financial inclusion in Nigeria.
- EFInA's vision is to be the leader in facilitating the emergence of an all-inclusive and growth-promoting financial system. EFInA adopts a holistic approach to impact the market at three levels – micro, meso and macro levels.

Payment Service Bank study

- The study sought to understand the analyse the readiness of the Nigerian financial ecosystem for the implementation of Payment Service Banks (PSBs) in comparison to India's experience and to draw insights on the circumstances that may impact the implementation of payment service banks.
- It aimed to draw lessons and define critical strategies for all stakeholders in the financial sector and to drive the transformation of the financial sector through the introduction of the payment service banks model.

Approach & Methodology

- The study was conducted through desk research and analysis of the PSBs' ecosystem in Nigeria with a focus on the macro, meso, and micro layers. It was complemented by stakeholder interviews with representatives from Banks, Mobile Network Operators, Fintechs, Switches, Mobile Money Operators and Regulators.
- The research was complemented with a comparative study on PSB implementation in India and the challenges and successes that have been experienced.
- Findings of the research were used to define key lessons learnt and define the way forward for ecosystem stakeholders for the successful implementation of payment service banks.

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B. Overview and analysis of the Nigerian ecosystem for Payment Service Banks: A contextual analysis

Overview of the Nigerian financial ecosystem

Aspect	Findings
Financial inclusion	• Clear national commitment towards financial inclusion. However, inclusion efforts suffer from a singular focus by stakeholders towards only rural or marginalized populations. • Inclusion of urban populations will be key to champion inclusion of rural populations.
Infrastructure	• Inadequate physical and ICT infrastructure limits shift to digital delivery channels due to cost implications particularly in rural or marginalized areas. • System reliability will be key to drive customer trust in digital financial services.
Regulatory frameworks	• Formulation of regulations reactive and directed towards limiting dominance of some sector players. • Inadequate and complex regulations lead to confusion and impact stakeholder compliance.
Identity systems	• Highly fragmented ID systems with multiple ID documents that are not comprehensive in use. • Need for a widely accepted ID document to enable financial inclusion.
Competitive landscape	• Sector players operate in 'silos' that present challenges in growing reach and access. • Collaboration and partnerships among sector players key to enhance the business case for financial inclusion efforts.
Distribution networks	• Ineffective agent network management. • Weak agent and customer value propositions lead to high rates of inactivity among agents.
Products and services	• The financial needs of the mass market are not addressed adequately, as existing products are either unaffordable or inappropriate for their unique financial management needs.
Users	• The target market features low-income, cash heavy, low-literacy individuals residing in geographically inaccessible areas characterized by inadequate physical and ICT infrastructure.

C. Understanding the PSB model

Objectives of PSBs

- The key objective for the introduction of PSBs in Nigeria is to enhance financial inclusion in rural areas.

- PSBs are expected to increase access to deposit products, payments, and remittance services to small businesses, low-income households, and other entities through high-volume, low-value transactions in a secured technology-driven environment.

- CBN has set up key guidelines for the implementation of PSBs to drive financial inclusion. These are to:
    - Utilise mobile and digital channels to enhance financial inclusion and stimulate economic growth at the last mile
    - Facilitate high-volume, low-value transactions in remittances, micro-savings, and withdrawals (deposit and remittances)
    - Establish expansive distribution networks that make use of agents, ATMs, and other digital channels
    - Have 25% presence in rural areas
    - Establish customer service and support centres

- PSBs fill the gap between a full-scale commercial bank with its high cost of transactions, and the limited role that mobile money instruments play in facilitating payments. The key to viability lies in keeping costs low and aiming at economies of scale through digital modes.

- PSBs in Nigeria will need to differentiate themselves from other traditional banks and offer attractive value propositions to the underserved and unserved low-income customers.

Comparison of PSB models in Nigeria and India

Requirement	Nigeria	India
Application fee	NGN 500,000 (USD 1,375)	Not applicable
Minimum capital requirements	• NGN 5 billion (USD 13.75 million) • The minimum Capital Adequacy Ratio (qualifying capital/total risk-weighted assets) for PSBs shall be 10% or as may be prescribed by the CBN from time-to-time	• INR 1 billion (USD 14 million) • Maintain a minimum capital adequacy ratio of 15% of its risk-weighted assets (RWAs) on a continuous basis
Licensing fee	• NGN 2 million (USD 5,500) • Change of name fee NGN 1 million (USD 2,750)	• Not applicable
Permissible activities	• Deposits and withdrawals covered by the deposit insurance scheme • Payments and remittances including cross-border inbound remittances • Issue debit and prepaid cards (no credit cards) • Electronic wallets • Invest in Federal Government of Nigeria (FGN) and Central Bank of Nigeria (CBN) securities • Render financial advisory services • Sale of foreign currencies realised from inbound cross-border personal remittances to authorised foreign exchange dealers	• Accept demand deposits: Maximum balance INR 100,000 (USD 1,426) by the end of the day from resident Indian customers only (No deposits by non-resident Indians) • Issue ATM and debit cards (No credit cards) • Allow walk-in customers as per KYC norms, simplified KYC/AML/CFT norms for small accounts and digitisation of other traditionally manual processes • Allowed to participate in Real-Time Gross Settlement (RTGS), National Electronic Funds Transfer (NEFT), and Immediate payment Service (IMPS) payments channels • Allowed non-risk sharing services like distribution of mutual funds, insurance, pension products, among others
Non-permissible activities	• Issue any form of loans, advances or guarantees • Accept foreign currency deposits or deal in foreign exchange markets, or both; insurance underwriting • Accept any closed-scheme electronic value (such as airtime) as a form of deposit or payment	• Deposits of more than INR 100,000 (USD 1,400) • Fixed or recurring deposits • Grant loans and issue credit cards • Trade in the foreign exchange market • Insurance underwriting

Payments Banks in India – Case study of Airtel & Paytm PBs

Airtel Payment Bank

- Launched in January 2017
- Bharti Airtel is the parent organisation
- Operates as an MNO

- ***Strengths***
  - First-mover advantage, leading telecom player, high brand recognition
  - JV partnership with Kotak Mahindra Bank
  - The existing telecom customer base of Airtel stands at 304.9m

- ***Status***
  - Resumed operations in July 2018 after being barred by RBI (in Jan 2018) from adding new customers to its existing customer base of more than 10m
  - Created a network of more than 250,000 banking access points across 29 states with a customer base of 30m
  - Entered into a strategic partnership with Hindustan Petroleum Corporation Limited (HPCL) as fuel stations will act as banking points
  - The bank suffered a loss of INR 338.8 crore (USD 47.5 million) in the financial year 2018-19

- ***Future Plans***
  - Scale its network to 0.6m banking points
  - Plans to make banking services available at all the 5m touch-points

Paytm Payment Bank

- Launched in November 2017
- One97 Communications is the parent organisation
- Operates a E-commerce, payments & digital wallets platform

- ***Strengths***
  - The existing wallet customer base of 300 million
  - 7 million offline merchant bases
  - As an online utility payments service provider, it is available in 3,000 cities and towns

- ***Status***
  - 180 million Paytm payments bank accounts created
  - Paytm was banned from adding new customers in July 2018 due to lapses in e-KYC procedures. The ban was lifted in January 2019
  - Launched 3,000 "Paytm ka ATM" outlets
  - Paytm Payments Bank reported a profit of INR 190 million (USD 2.6M) for the fiscal year 2018-19 and is the first payments bank to become profitable

- ***Future Plans***
  - Build their corporate customer base by offering incentives
  - Roll out on-demand fixed deposits and other products through partnerships
  - Achieve the target of 500 million accounts by 2020 and set up more than 1 million banking outlets by the end of 2018

Key insights on PSBs

Perception of PSBs

- The concept of PSBs draws conflicting opinions from stakeholders on their potential impact in the financial services ecosystem.
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- While most incumbents do not perceive the entry of PSBs as a threat, the market forces will definitely experience a shift PSBs are perceived to have the financial muscle, agility, and technological capabilities to advance financial inclusion.

Market acceptability

- The biggest concern is the acceptability of PSBs in the market due to brand unfamiliarity. PSBs may additionally face pricing challenges, as financial markets in Nigeria have incumbents that compete purely on lower prices, which may not be sustainable.

- However, with the right strategies, PSBs –primarily telcos – may capitalise on their ability to offer connectivity services to offset the costs incurred

Working together is key

- Competition and collaboration among stakeholders in the Nigerian industry is necessary and inevitable with the introduction of PSBs.

- Industry participants should critically review how they would approach the market and benefit most from these new entrants.. It would be wise to explore the ability to work together to achieve the financial inclusion objectives that have been difficult to achieve this far.

Potential to advance inclusion

- PSBs hold great potential to advance financial inclusion through the inherent strengths of potential players: large amounts of capital, strong brand presence, technological advancement, market presence, effective marketing and communication strategies, and ability to scale.

- While these characteristics are not uniform among all potential PSB applicants, these are evident among telcos that have so far taken the lead in applications for the license.

D. Operationalization of Payment Service Banks

Key business challenges

Business viability and acceptability

- Challenges gaining acceptability in the market as a new entrant in the market.
- Difficult to achieve sustainability due to the high start-up requirements and the consequent high cost to scale operations.
- Restrictions on lending undermine the opportunity for PSBs to offer an attractive value proposition for their customers and agent networks.

Regulatory restrictions

- Bureaucratic processes complicate the application and approval processes and may discourage aspiring applicants.
- Revenue generation activities are limited but PSBs must subscribe to the strict conditions set for Deposit Money Banks (DMBs).
- The restrictions on lending curtail systemic risk but limit the participation of PSBs in the market.

Capital requirements

- Start up capital of of NGN 5 billion and a licensing fee of NGN 2.5 million may be challenging to acquire particularly for smaller players exacerbating the start up costs.
- Requirement of 25% presence in rural areas requires heavy financial investment to ensure reliable system uptime especially with inadequate physical and digital infrastructure.

Key operational constraints (1/2)

Optimization of distribution networks

- Creation of attractive agent and customer value propositions with limited service portfolio is limited. Diverse product offerings and concerted efforts to create customer awareness on agent services are necessary to enhance the agent value proposition.
- High investment into agent network management necessary to support high value low value transactions. Agent training and effective customer and agent support structures will be critical to ensure the sustainability of agents.

Customer value proposition

- PSBs may struggle to offer an attractive customer value proposition. The design of products that subscribe to the mental models of the customer is particularly challenging due to the profile of the target segments.
- A diverse serving offering that moves beyond cash-in and cash-out should be developed to achieve sustainability and scale.

Regulatory compliance

- Compliance with the KYC guidelines of traditional banks may be challenging for players like telecom operators, for whom the KYC requirements are less stringent. KYC requirements for banks go a step further — they need additional customer documentation and a Bank Verification Number (BVN).
- Differentiated mainstream traditional bank regulations, as compared to PSB regulations, may create gaps and loopholes that could be manipulated by the players.

Key operational constraints (2/2)

Digital shift of transactions	• PSBs must create a positive customer experience for the use of mobiles and PoS machines through the design of user-friendly interfaces for the end-user. • To optimize reach, PSBs must capitalise on mobile ownership levels and design delivery channels that are easily accessible, affordable, and available to the end-user.
Human capital resourcing	• PSBs lack traditional banking experience and may struggle to take strategic decisions without the right mix of human resources. PSBs must invest in acquiring the right set of skills to steer the growth of payments banks.

Key stakeholder concerns revolve around clarity of regulations

1. Multiplicity of regulations that govern agent network operations; the mobile money regulatory framework, guidelines for super-agent operations, and the agent banking regulations. Sector players expressed the need for universal regulation on agent network operations for various providers.
2. Lack of clarification on pricing and tariff guides for PSBs. Potential PSBs are not clear on how existing deposit bank regulations apply to PSB operations. For these players, the lack of clarity on regulation brought in gaps that inhibit their ability to adequately develop tariff structures.
3. Lack of clarity on the KYC requirements for PSB operations. Potential players are not clear on whether they would be required to use BVN or basic KYC currently required for registration of mobile SIM cards.
4. The focus of the regulator to prevent monopolies of non-bank player. This has inadvertently hindered the optimisation of capacities of other players, such as telcos. Such players may be better placed to advance financial inclusion through small-value transactions in high volumes.
5. Limited clarity around the ability of PSBs to offer loan facilities directly or indirectly through partnerships with other sector players, such as banks or fintechs.
6. Regulations for PSBs fail to address stakeholder concerns with the branding of subsidiary companies formed to operate as PSBs. Telcos, in particular, are not sure if they are allowed to conduct PSB business under the same name as the originating company.
7. Regulations do not clearly stipulate the nature of distribution points that PSBs should implement. Potential PSBs were unclear on whether they have the mandate to implement ATMs, branches, or agent networks to advance the distribution network.

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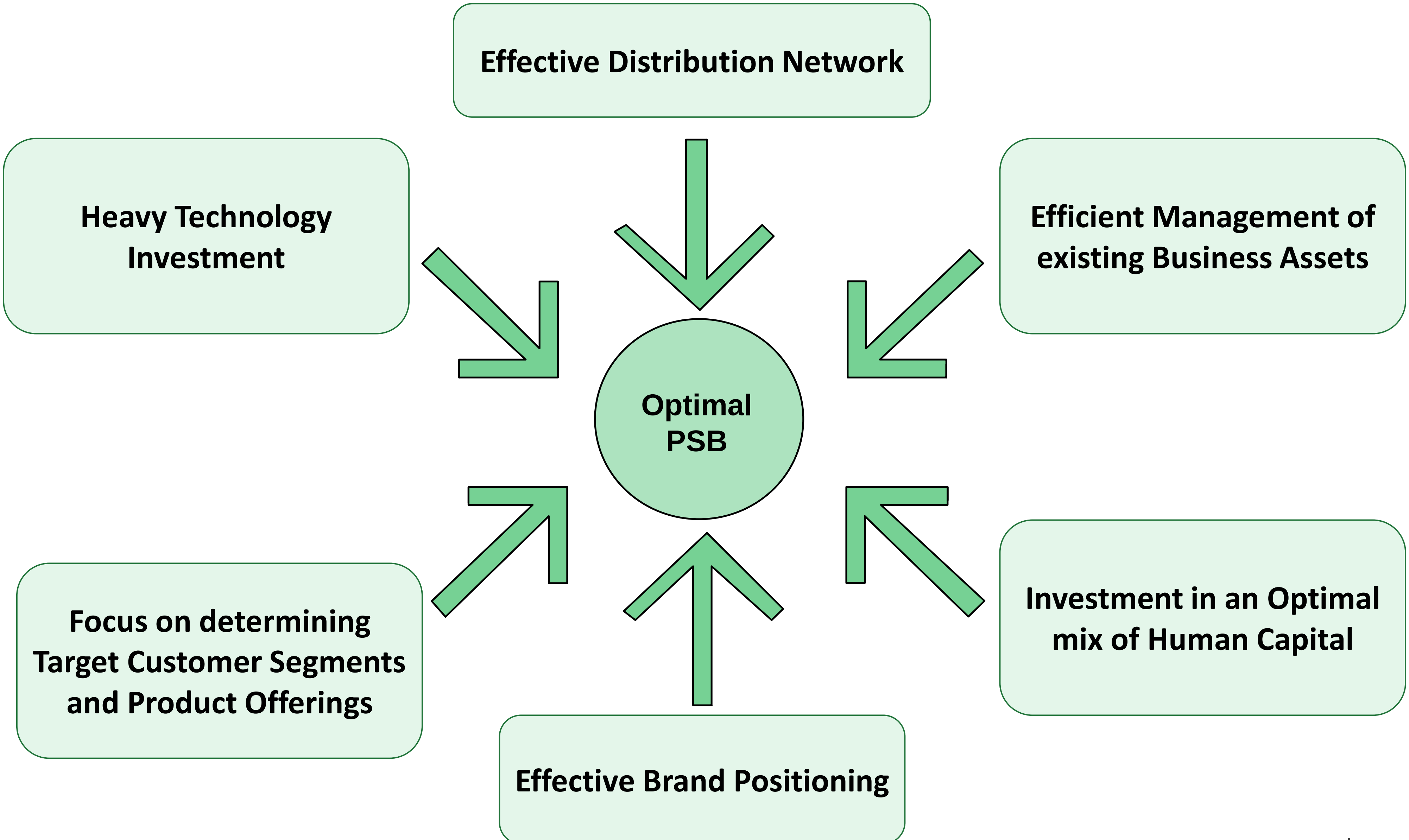
E. Defining an optimal PSB and the business case for Payment Service Banks

An Optimal PSBs should have a large capacity for capital investment, with experience in efficient management



Action points for the PSBs in Nigeria

- Define the business case for Payment Service Banks - Create more value for the customers, Develop customer-centric products to achieve sustainability and scale. Drive revenue through product integrations of existing use cases such as G2P, P2G, C2B, and B2C
- Conduct a demand-side assessment to accurately understand the needs of the mass market and to inform the design of financial products
- Grow the numbers – Focus on the specified target market, drive the volume of transactions, expand distribution network and manage agent network effectively
- Drive market acceptance through financial literacy and intensive awareness efforts
- Comply with regulations of CBN and the prudential banking norms, ensure that internal processes and technology are inline with the regulator's requirements
- Positive customer experience - Through the design of user-friendly interfaces for the end-user. PSBs must capitalise on mobile ownership across the country to design delivery channels that are easily accessible, affordable and available to the end-user
- Be competitively positioned - Developing a brand that encourages confidence and trust will be key to increase uptake and usage
- Strategic partnerships - Leverage the strengths of existing financial sector players, such as banks, micro credit lenders, Fintechs, Microinsurance companies to gain competitive advantage

THANK YOU