

RBI deliberates rationalization of MDR on cards, PPIs and UPI

The RBI has released a discussion paper, calling for suggestions by Oct 3, 2022, on revisiting the charges on different payment systems. Based on the potential suggestions, we believe the Regulator should likely resolve the ongoing conundrum, mainly on rationalization of the otherwise higher MDR on Cards, PPIs and UPI by the year end. Key highlights:

- **Discussion paper seeks to revisit payment charges across payment instruments/modes; would this possibly get the ball rolling for reduction in MDR?** The RBI in its discussion paper seeks to review existing charges (MDR) on the entire gamut of payment systems (incl. RTGS, IMPS, NEFT, Debit/Credit Cards, UPI, PPIs) and surcharge/convenience fees being levied by payment service providers/merchants. RBI has underlined that the charges for payment services should be reasonable and competitively determined for users, while providing an optimal revenue stream for intermediaries to profitably sustain operations and attract new investments for the public good. The Regulator has sought public views on 40 specific questions with regard to charges & levies in payment systems by 3 October. Key questions: if charges should be regulated (e.g. for Debit Card)/remain market-driven; the MDR be waived or reduced; if there should be flat charges/MDR, or based on transaction value/merchant T/o; MDR be regulated or interchanged on credit cards.
- **Will MDR on cards/wallets/PPIs be reduced and re-introduced on UPI?** RBI already regulates MDR on Debit Cards, while the govt. has mandated Zero MDR on UPI (P2M transaction is incentivized by the govt.) despite the underlying ecosystem cost of 0.25%. However, the discussion paper seeks comments, most importantly on whether to reduce MDR on credit cards/PPIs which is higher, at $\geq 2\%$. RBI agrees that Credit Card MDR should be higher than Debit Card MDR (0.8%/0.9% at the maximum), given the underlying interest cost for credit-free period and credit risk. Notably, RBI has sought views on whether Credit Card MDR should be similar to the Debit Card MDR (0.9%) + avg interest cost for, say 30 days, based on the rate for a few large banks (assuming 5% CoF, say 0.4% for 30 days/0.6% for 45 days) which can be reset at the beginning of an FY. We believe there needs to be a mark-up for credit risk + customer engagement cost; thus, the final MDR comes to 1.2-2% v/s $\geq 2\%$ now. MDR on PPIs (ex BNPL) could be similar to the Debit Card MDR, but for the different cost dynamics for non-banks and the issuing/loading cost. RBI has also discussed de-linking the cost of transactions (to be charged to merchant) and cost of free credit period + credit risk premia (to be charged to the customer). However, RBI admits that such a mechanism is not prevalent anywhere in the world and may reduce credit card usage, thus defeating the RBI's purpose of increasing digital payment acceptance. RBI also seeks comments on whether MDR be re-introduced on UPI transactions (regulated/mkt-determined) or if it should continue with the current govt. subvention scheme (for P2M transactions).
- **Should there be a flat fee or % based on transaction value, and whether to regulate surcharge/convenience fees?** Many payment instruments/modes, like NEFT, RTGS and IMPS, operate on the flat fee structure as they do not involve fund transfer cost (borne by RBI). RBI believes that debit card transactions too are similar to such payment systems and so, seeks to determine whether Debit Card transactions should also attract a flat fee on each/bulk transaction, instead of the current regime of value-based charges (MDR as % of value). We believe this logic is applicable for Rupay Debit Cards where network support is provided by RBI, but not for other debit cards operating on international networks (Visa/Mastercard). However, a flat fee charge could also be applied on UPI. RBI has also raised concerns on Surcharge being charged by merchants on credit card transactions, while such a charge on Debit Card is not allowed by the RBI. Some merchants also charge a convenience fee (e.g. online travel/movie ticketing platforms like IRCTC, bookmyshow, etc), which leads to increase in the overall cost of transaction. RBI accepts that the convenience fee should be levied, given the underlying cost related to platforms, but questions whether such charges should be regulated and if so, then by whom.
- **Our view:** We believe the discussion paper has once again raised the possibility of regulating/reducing MDR or interchange fees on cards/PPIs/wallets which could hurt the profitability of card/wallet companies (mainly HDFCB, SBIC, ICICI, Axis, RBL, Paytm). That said, the formula suggested by RBI should keep MDR at $>1.2-2\%$ v/s $\geq 2\%$ now. Our rough workings suggest that a 10bps reduction in MDR/interchange fee could shave off card-business RoA by at least 50bps. That said, RBI has not expounded on the current high APR (annual percentage rate) @40%, charged by Credit Card/BNPL players, except for passing on the interest rate variability benefit on the credit fee period assumed for determining MDR. Some countries have started regulating APR or have a variable APR mechanism and so the possibility of a similar structure cannot be ruled out in the mid-to-long run in India either. Our quick discussions with card players suggest that RBI may either leave MDR on Credit Cards/Wallets being determined by the market or may nudge players to slightly bring down the interchange fees. That said, re-introduction of MDR on UPI should partly offset the impact of fee reduction in cards for banks/wallets for fintechs, but not for non-bank card companies (like SBIC), unless they engage in UPI transactions.

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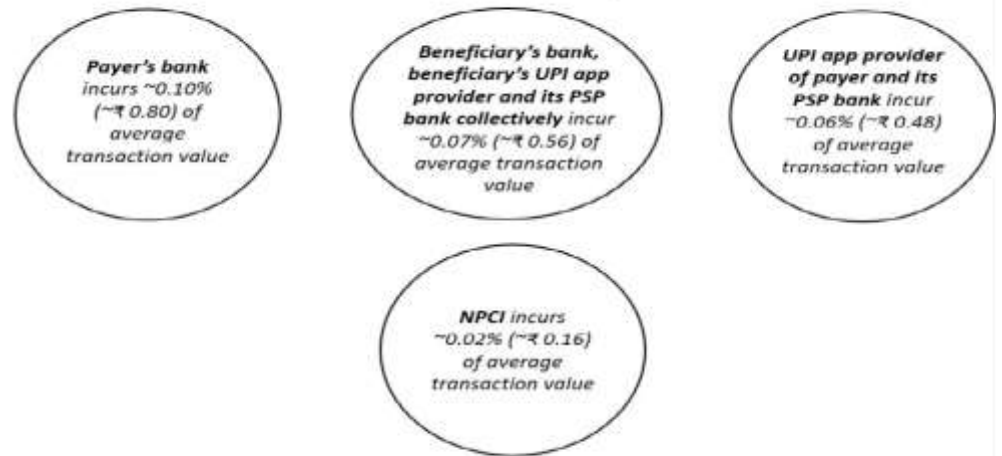
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Story in charts

Exhibit 1: Approximate cost incurred by stakeholders in processing a UPI P2M transaction

This box depicts ~ cost incurred by different stakeholders in a UPI-P2M transaction with average transaction value ~ ₹ 800/-



Collectively, the stakeholders incur ~ ₹ 2/- for processing a UPI-P2M transaction with average transaction value ~ ₹ 800/-.

Note: Costs mentioned above reflect approximate figures. They do not reflect cost incurred in giving incentives to users for increasing the use of digital payments.

Source: RBI, Emkay Research

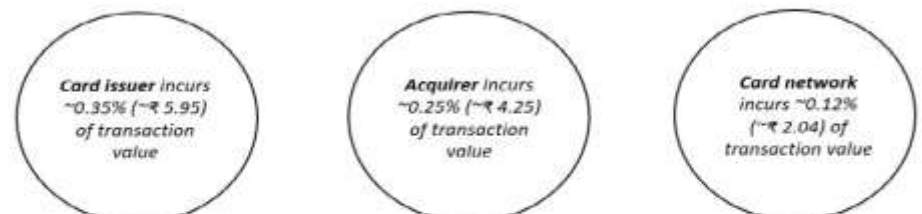
Exhibit 2: Current MDR regime for Debit Card transactions

Sr no	Merchant Category	Maximum MDR for debit card transactions (as a % of transaction value)	
		Physical PoS infrastructure (including online card transactions)	Quick Response (QR) code-based card acceptance infrastructure
1	Small merchants (with turnover up to ₹ 20 lakh during the previous financial year)	Not exceeding 0.40% (MDR cap of ₹ 200 per transaction)	Not exceeding 0.30% (MDR cap of ₹ 200 per transaction)
2	Other merchants (with turnover above ₹ 20 lakh during the previous financial year)	Not exceeding 0.90% (MDR cap of ₹ 1,000 per transaction)	Not exceeding 0.80% (MDR cap of ₹ 1,000 per transaction)

Source: RBI, Emkay Research

Exhibit 3: Approximate cost incurred by PSPs in processing of a typical debit card transaction (0.72%)

This box depicts ~ cost incurred by three PSPs – card issuer, acquirer and card network – in processing of a typical debit card transaction of value ₹ 1,700/- at PoS terminal / online (e-commerce)



The three PSPs – card issuer, acquirer and card network - collectively incur ₹ 12.24 for processing a debit card transaction of value ₹ 1,700/- at PoS terminal / online (e-commerce)

Note: Costs mentioned above reflect approximate figures and may vary with transactions processed using debit cards affiliated to different card networks. They do not reflect cost incurred in giving incentives to users for increasing the use of digital payments.

Source: RBI, Emkay Research

Summary of Questions in the discussion paper:

RTGS

1. Should the RBI review the policy of not levying charges on members for RTGS transactions?
2. Should the time-variable charges be re-introduced?
3. For RTGS transactions, should the RBI prescribe the charges that can be levied on customers by members, or should they be market driven?

NEFT

4. Should the RBI charge member- banks for transactions processed through NEFT?
5. Should banks be permitted to charge customers for NEFT transactions, whether initiated online or otherwise?
6. Should the RBI prescribe charges for NEFT transactions to be levied by banks on their customers, or should they be market driven?

IMPS

7. Should charges for IMPS transactions be regulated by the RBI?
8. Should the RBI fix a ceiling on charges that can be imposed in IMPS?

Debit Cards

9. Should debit card transactions be charged as normal fund transfer transactions?
10. Should MDR for debit cards be uniform across merchants (irrespective of the turnover)?
11. Should the RBI regulate the interchange for debit- card transactions?
12. Should the RBI deregulate MDR for debit card transactions and let stakeholders decide on the optimum level of MDR and interchange?
13. Should MDR for debit cards be a percentage of the transaction value or should it be a fixed amount, irrespective of the transaction value?
14. Should RuPay cards be treated differently from other debit cards affiliated with international card networks, in terms of MDR?
15. Among the two options (waiving / reducing MDR, or giving incentive to cardholders), which is more effective for increasing use of digital payments?

Credit Cards

16. Are credit card MDR charges reasonable?
17. Should the RBI regulate MDR for credit cards?
18. Instead of MDR, should the RBI regulate interchange for credit- card transactions?
19. Should the RBI regulate both, MDR and interchange for credit cards?

PPIs

20. Should the RBI regulate MDR for PPI transactions?
21. Given that no credit is extended in case of PPis, is it reasonable to charge high MDR (in sync with MDR levied on credit- card transactions) for PPI transactions?
22. Should the charges- structure for merchant payments done using PPis be akin to that of debit cards?
23. Should charges for cash withdrawal using PPis be regulated?

UPI

24. In the context of zero charges, is subsidising the costs a more effective alternative?
25. If UPI transactions are charged, should MDR for these be a percentage of transaction value or should a fixed amount, irrespective of the transaction value, be levied?
26. If charges are introduced, should these be administered (say, by the RBI) or be market-determined?

Intermediaries

27. Should intermediaries be transparent about the manner in which they levy charges?
28. Should the various charges levied by intermediaries be unbundled and charged separately?
29. Should these charges be subjected to regulation?

Surcharging

30. Are surcharges justified? Are they desirable?
31. Should merchants be allowed to levy surcharge on customers?
32. Should surcharging be regulated? If so, then by whom?

Convenience Fee

33. Should convenience fee be regulated? If so, then by whom?
34. Should such charges be the same, irrespective of the number of seats / tickets booked?
35. Should such charges be based on value of the transaction?

Other Aspects

36. Should the levy of charges for a digital payment transaction be independent of the value of the transaction?
37. Should the levy of charges for a digital payment transaction be the same, irrespective of the number of seats / tickets booked?
38. Should the levy of charges by merchants be marginal- cost -based, meaning that only the additional costs incurred by them for facilitating a digital payment transaction should be recovered from the users?
39. Should the charges for digital payment transactions be market determined – based on demand and supply – without any regulatory or sovereign intervention?
40. What further transparency could be brought in for such charges?

Emkay Alpha Portfolio – BFSI-Banks



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Sector

Banks

Analyst bio

Anand Dama is a CA, CPM (ICFAI) with total 13 years of research experience, in addition to 3 years in the finance/rating industry. His team currently covers 21 banks and 15 stocks in the NBFC/Insurance space.

EAP sector portfolio

Company Name	BSE200 Weight	EAP Weight	OW/UW (%)	OW/UW (bps)	EAP Weight based on Current NAV	Change vs last published EAP (bps)
BFSI-Banks	20.05	20.05	0.0%	0	100.00	
Axis Bank	1.98	2.06	4%	8	10.28	0
AU Small Finance Bank	0.27	0.22	-19%	-5	1.11	0
Bandhan Bank	0.18	0.16	-8%	-1	0.82	0
Bank of Baroda	0.21	0.18	-16%	-3	0.90	0
Canara Bank	0.12	0.12	0%	0	0.62	0
City Union Bank	0.00	0.04	NA	4	0.21	0
DCB Bank	0.00	0.00	NA	0	0.00	0
Equitas Small Finance Bank	0.00	0.00	NA	0	0.00	0
Federal Bank	0.21	0.21	0%	0	1.04	0
HDFC Bank	6.25	6.31	1%	6	31.48	0
ICICI Bank	5.80	5.92	2%	12	29.54	0
Indian Bank	0.00	0.00	NA	0	0.00	0
Indusind Bank	0.62	0.72	15%	9	3.57	0
Karur Vysya Bank	0.00	0.06	NA	6	0.32	0
Kotak Mahindra Bank	2.29	1.97	-14%	-32	9.85	0
Punjab National Bank	0.09	0.00	-100%	-9	0.00	0
RBL Bank	0.00	0.00	NA	0	0.00	0
State Bank of India	1.91	2.03	6%	12	10.14	0
Ujjivan Small Finance Bank	0.00	0.00	NA	0	0.00	0
Union Bank of India	0.04	0.00	-100%	-4	0.00	0
Yes Bank	0.05	0.02	-59%	-3	0.10	0
Cash	0.00	0.00	NA	0	0.00	0

Source: Emkay Research

■ High Conviction/Strong Over Weight ■ High Conviction/Strong Under Weight

Sector portfolio NAV

	Base					Latest
	1-Apr-19	16-Aug-21	15-Feb-22	16-May-22	15-Jul-22	16-Aug-22
EAP - BFSI-Banks	100.0	123.9	130.6	114.9	119.9	134.9
BSE200 Neutral Weighted Portfolio (ETF)	100.0	121.2	128.0	112.8	117.6	132.2

*Performance measurement base date 1st April 2019

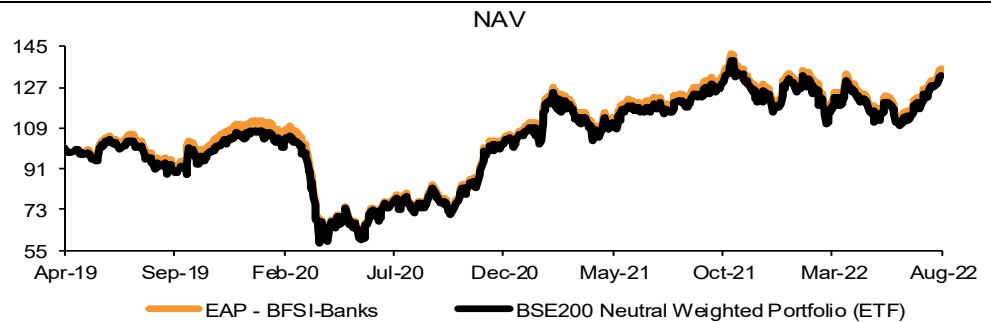
Source: Emkay Research

Price Performance (%)

	1m	3m	6m	12m
EAP - BFSI-Banks	12.5%	17.4%	3.3%	8.9%
BSE200 Neutral Weighted Portfolio (ETF)	12.4%	17.2%	3.3%	9.0%

Source: Emkay Research

NAV chart



Source: Emkay Research

Please see our model portfolio (Emkay Alpha Portfolio): [Nifty](#)

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