ANALYSING REGULATORY FRAMEWORK FOR SILVER EXCHANGE TRADED FUNDS, PREPAID PAYMENT INSTRUMENTS, DIGITAL BANKS, ETC

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ABSTRACT

Given the rapid emergence of new economic and financial elements globally, regulatory frameworks are crucial. This research explores three key economic concepts: Silver Exchange Traded Funds (ETFs), Prepaid Payment Instruments (PPIs), and Digital Banks. Each topic is thoroughly and clearly explained across different sections of the study. Digital banks are increasingly favored for their convenience, speed, and security. They offer numerous advantages over traditional banking, rapidly becoming the preferred choice for many individuals.

One significant benefit of digital banks is their enhanced security. They utilize sophisticated encryption methods to protect personal and financial information, making it less susceptible to breaches by hackers or cybercriminals. Additionally, digital banks often feature fraud detection systems to notify customers of any unusual activity. Another major advantage of digital banks is the ability to open an account entirely online. This removes the requirement to go to a physical branch, allowing users to complete the application process and submit necessary documents from anywhere. This is particularly beneficial for those who live remotely or have busy schedules that make visiting a bank during standard hours difficult.

The research begins by explaining the concept of Exchange Traded Funds (ETFs) to provide a foundation for understanding Silver Exchange Traded Funds. Silver ETFs are discussed in detail, followed by an overview of the regulations and guidelines established by the Securities and Exchange Board of India (SEBI). The method for calculating Net Asset Value is also covered.

Next, the research delves into Prepaid Payment Instruments (PPIs), offering a concise yet thorough explanation of the concept. Existing regulations and rules governing PPIs are discussed to ensure clarity and coherence in the research. The final section addresses Digital Banks. With the surge in global digitalization driven by 21st-century technology advancements, digital banks have emerged as a significant financial development. This section also examines the various regulations designed to govern this evolving sector.

In conclusion, the research summarizes the key points discussed throughout the work, providing a comprehensive overview of the essential aspects covered.

Keywords: Digital banks, Silver ETFs, Prepaid Payment Instruments, Financial regulations, Net Asset Value

INTRODUCTION

Before entering into the regulatory framework study of silver exchange traded funds, prepaid payment instruments, and digital banks, it is important to define what a regulatory framework is. A regulatory framework is a set of instructions, directives, and suggestions issued by an authority from time to time.[1] These frameworks on their own do not do much, as they are simply a list of rules to be followed, but are a pre-requisite for any system that is to be set up.[2]

A silver exchange traded fund is a mechanism which aids in tracking the price of silver. The Securities Exchange Board of India has come up with regulations pertaining to this, which provide for the quality of silver, its valuation and its applicability. Prepaid Payment Instruments, such as PayTM have become very widely used nowadays, especially with the need to reduce contact during transactions in the pandemic. Authorities like the Reserve Bank of India, have thus issued regulations that help in defining what a Prepaid Payment Instrument is, which of them are eligible and other newer regulations with regards to classification, security issues and interoperability. In this day and age of technology, online or digital banking has picked up speed, and due to its convenience of availing its services from even one's home, it has slowly become the norm. In India, the demonetization that took place in 2016 helped in shifting a huge portion of the population to digital banking. In order to manage this increased activity, the RBI has come up with regulations such as strict compliance standards for e-wallets like Google Pay. Moreover, a few banks are now linked to the billing system of the government to ensure close synergy between the consumer and the government's consumer agencies.

[1] Law Insider, https://www.lawinsider.com/dictionary/regulatory-framework (last visited Jan. 5, 2022).
[2] Security Sector Integrity, https://securitysectorintegrity.com/standards-and-regulations/procurement-monitoring-evaluation/ (last visited Jan. 5, 2022).

SILVER EXCHANGE TRADED FUNDS

Before we delve into the regulatory framework of Silver Exchange Traded Funds, it is imperative to understand the concept of Exchange Traded Funds or ETFs. ETFs are, simply put, funds that replicate any market index like Nifty or Sensex. An important factor about ETFs is that they can be sold and purchased like any normal stock. Since the ETFs replicate indexes, they grow or fall accordingly. Let's suppose that nifty goes up by a few points in a day, we can also expect the corresponding ETF to go up. Conversely, if the nifty index goes down, we can very well expect the ETF to go down as well. ETFs are traded like stocks in a share market.[3]

Silver Exchange Traded Funds provide for investments in silver. These silver holdings are held by the fund manager in the form of trusts. Silver is measured in ounces and not in grams when considering the ETF case. Silver ETFs act as rights of the ETF holder on whatsoever ounces of silver the ETFs represent.[4] Silver ETFs are made to replicate various silver indexes present all around the world. Silver Exchange Traded Funds can be a great source of investment in contemporary times as silver provides for a very stable market and controlled ecosystem. In the rising era of electric vehicles or EVs, silver ETF investment seems to be a fair choice. The first ETF made was the "iShares Silver Trust", regulated and controlled by the "Barclays Global Investors".[5]

In India, the Securities and Exchange Board of India (SEBI) has put down certain rules for the timely and flawless functioning of the Silver Exchange Traded Funds.[6] Amendments to the SEBI (Mutual Funds) Regulations, 1996 were introduced via a Gazette notification dated November 9, 2020. These regulations provide guidelines for managing Silver Exchange Traded Funds (ETFs), as detailed below:

1. **Investment Requirements**: At least 95% of the net assets of a silver ETF must be allocated to silver or silver-related instruments. Silver-related instruments are defined as Exchange Traded Commodity Derivatives (ETCDs) with silver as the underlying

[3] James Chen, *Exchange Traded Fund (ETF)*, Investopedia (Mar. 03, 2021), https://www.investopedia.com/terms/e/etf.asp.
[4] Lucas Downey, *Silver ETF*, Investopedia (Mar. 13, 2020), https://www.investopedia.com/terms/s/silver-etf.asp.
[5] *Ibid*.
[6] *Sebi lays down operating norms for silver exchange traded funds*, Business Standard (Nov. 25, 2021), https://www.business-standard.com/article/markets/sebi-lays-down-operating-norms-for-silver-exchange-traded-funds-121112401179_1.html.

asset. The notification outlines specific criteria for the inclusion of ETCDs as silver-related instruments.

2. **Physical Silver Specifications**: The notification outlines the specifications for physical silver. The standard form is a thirty-kilogram bar with a purity level of 99.9%. This means that a 30 kg bar should contain at least 99.9% silver, equating to 29.97 kg of pure silver[7].

3. **Standards Compliance**: Ensuring compliance with standards is crucial. The notification designates the London Bullion Market Association (LBMA) Good Delivery Standards as the authority for adherence. The LBMA is widely recognized as a leading global authority on metal standards.

4. **NAV Calculation**: To prevent confusion for investors, the notification includes a formula for calculating the Net Asset Value (NAV) of silver ETFs. The Net Asset Value (NAV) should be calculated to four decimal places. The exact formula for this calculation is provided in the notification:

Net Asset Value or NAV (in ₹) =	Fair Value of Scheme' investments + Current Assets - Current Liabilities and Provision —-- Number of units outstanding under the Scheme on the valuation date.[8]

PREPAID PAYMENT INSTRUMENTS

Prepaid Payment Instruments are generally instruments, or tradable assets, that help in enabling the purchase of goods and services, including transfers of cash, remittances, and financial services, for the value of the said instrument.[9] This said value would be representing the value

[7] Securities and Exchange Board of India, Norms for Silver Exchange Traded Funds (Silver ETFs) and Gold
[8] *Id.*
[9] ClearTax, https://cleartax.in/s/prepaid-payment-instruments (last visited Jan. 4, 2022).

the purchaser paid for through cash or through debit or credit card.[10] Examples of this are internet accounts, smart cards, mobile accounts, and so on.[11]

There are various types of Prepaid Payment Instruments. The first of these is the Closed System, where the issued PPI stands valid only against the issuing entity; if goods or services are attempted to be accessed by a person using a different provider, it will be invalid.[12] This includes gift cards issued by certain companies. The second type is the Semi-closed system, which includes only those PPI's that have the authorization of the RBI, unlike the Closed system. These are usually utilized at certain merchant locations who would have a contract with the issuer for the PPIs to be accepted by the merchants as payment instruments.[13] Finally, there is the Open System of PPIs, which are issued exclusively by RBI-approved banks in the form of credit and debit cards.

PPIs became quite popular soon after their founding, and thus to regulate this, the RBI introduced the Master Directions on Prepaid Payment Instruments in 2017. The 2017 Master Directions were issued for reasons including provision of a framework to authorise, regulate and supervise those using systems for issuing PPIs, and to increase competition and innovation while keeping in mind the importance of safety and security regarding the transactions.[14] These MD's also restricted Cross-Border Transactions of PPIs with the Indian Rupee denomination, with a few exceptions such as KYC (Know Your Customer) compliant semi-closed and open PPI's.

The usage of such PPIs has become very common especially during this pandemic, where minimal contact has become the norm.[15] Thus, the demand for such control grew. On August 27, 2021, the Reserve Bank of India released updated Master Directions for Prepaid Payment Instruments,[16] which brought about quite a few changes to the Master Directions on the same

[10] Reserve Bank of India, https://rbi.org.in/Scripts/bs_viewcontent.aspx?Id=1902 (last visited Jan. 4, 2022).
[11] *Ibid.*
[12] *Supra* note 1.
[13] Mint, https://www.livemint.com/money/personal-finance/three-must-know-prepaid-payment-instruments-11617611317926.html (last visited Jan. 4, 2022).
[14] Reserve Bank of India, Master Direction on Issuance and Operation of Prepaid Payment Instruments, RBI/DPSS/2017-18/58 (Notified on October 11, 2017).
[15] Ashima Obhan, *The RBI's New Master Directions on Prepaid Payment Instruments*, MONDAQ, (Sep. 21, 2021), https://www.mondaq.com/india/financial-services/1111936/the-rbi39s-new-master-direction-on-prepaid-payment-instruments.
[16] Reserve Bank of India, Master Directions on Prepaid Payment Instruments (PPIs), RBI/DPSS/2021-22/82 (Notified on August 27, 2021).

which was issued in 2017. First, there are two new types of PPIs: small PPIs and full-KYC PPIs. Small PPIs have a monthly value of up to Rs. 10,000 and an annual value of Rs. 1,20,000. They are provided after obtaining basic information such as a name, one-time password (OTP), and cellphone number. Full-KYC PPIs, on the other hand, are given once the Know Your Customer procedure is completed and may be used to purchase goods and services as well as transfer payments and withdraw cash. Its maximum point at any given time cannot exceed Rs. 2,000,000.

It has implemented an interoperability framework for full-KYC PPIs. It refers to a technological compatibility that would assist ensure its synchronization with other payment systems.[17] It outlines three approaches for ensuring interoperability: common wallets and cards, card networks, and the Unique Payment Interface (UPI). For PPIs issued as wallets, interoperability will be facilitated via UPI, and for cards, it will be accomplished through authorized card networks. Non-bank PPI issuers can join approved card networks. It also encourages PPI issuers to offer the characteristics required for interoperability of UPI.[18] Furthermore, in a notice of the RBI dated May 19th 2021, it makes it essential for PPI issuers to provide interoperability to holders of full-KYC PPI holders, through authorized card networks and UPI.[19] However, it exempts the PPIs of Mass Transit Systems and makes it optional for Gift PPI issuers for interoperability to be offered. It states that this is to be enabled by 31st March, 2022.

There are also additions to the security point of view of PPIs, and this includes the introduction of a 2 Factor Authorisation system and alerts via messages with regards to any transaction to a holder of PPIs. It can help in increasing the transparency and awareness amid PPI users, as it includes customer protection related provisions and a framework for grievance addressals.[20]

DIGITAL BANKS

In India's banking system, a considerable transition can be seen. The banking sector was not

[17] Vikaspedia, https://vikaspedia.in/e-governance/digital-payment/operational-guidelines-for-interoperability-of-ppis (last visited Jan. 4., 2022).
[18] *Ibid.*
[19] Reserve Bank of India, 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, RBI/2021-22/40 (Notified on May 19, 2021).
[20] Lexology, https://www.lexology.com/library/detail.aspx?g=0b63f19a-b9e6-4e71-8974-9d324ce820f0 (last visited Jan. 5, 2022).

exempted from the digitization trend. Digital banks or DBs under the Banking Regulation Act, 1949, are defined as, "In other words, these entities will issue deposits, make loans and offer the full suite of services that the B R Act empowers them to. As the name suggests however, DBs will principally rely on the internet and other proximate channels to offer their services and not physical branches."[21] Digital banking has emerged as one of the most widely adopted and effective applications of information and communication technology in the banking sector. It enhances internal operations and improves external interactions, thereby offering better service to customers across public, private, and international banks.[22] Digital Banks are promoted through various platforms that provide banking services through UPI (United Payments Interface) or BHIM (Bharat Interface for Money).

In its 2016-2017 report, the Reserve Bank of India (RBI) noted that National Electronic Funds Transfer (NEFT), Real Time Gross Settlement (RTGS), Electronic Clearing Service (ECS), and similar online transaction methods have become widely accepted and utilized across the country.[23] Even the local shops and cafes are now accepting payments through UPIs and BHIM. This is because these platforms are consumer oriented, easy to use and provide benefits through rewards (coupons and cashbacks). As introduced above, Demonetisation, on the other hand, also played a significant role in digitisation of banks in India. Because of demonetisation that was announced in Nov, 2016, a lot of people have shifted to online banking.

The Reserve Bank of India has taken several tiny but crucial initiatives to strengthen and increase the efficiency of the banking system. This involves digitalizing banks and integrating digital payment systems into traditional institutions. SBI, India's most successful bank, has even established YONO SBI, a wholly digital-only bank in India.[24] YONO SBI offers both banking and financial services which are simple and intuitive.

Stiff and Strict compliance standards and practises, capital reserve minimums, and caps on transfers to different bank accounts are among the new regulatory requirements for e-wallets

[21] Basu Chandola*, Digital banks: A proposal for a licensing & regulatory regime for India,* Observer Research Foundation (Dec. 31, 2021) https://www.orfonline.org/research/digital-banks-a-proposal-for-a-licensing-regulatory-regime-for-india/.

[22]Pagaria V., *Use of Digital Banking for Improving Quality of Service Delivery: An Empirical Study of Selected Indian Banks,* 10, JSWM, 178, 178-179 (2018).

[23] Billus K. et. al, *Digitization of Banks in India,* 10, Purva Mimaansa, 153, 153-154, (2019).

[24] Shehnaz Ahmed & Krittika Chavaly, *Adapting India's Regulatory Framework to Digital-only Bank: A Case for Reform,* Oxford Business Law Blog (Oct. 23, 2020). https://www.law.ox.ac.uk/business-law-blog/blog/2020/10/adapting-indias-regulatory-framework-digital-only-banks-case-reform.

like Phone pay and Google pay[25]. In order to maintain trust of customers thereby increasing the number of users, banks are required to get a licence to operate digital banking. India's licences include provisions that limit the amount of money that can be deposited or omit lending from the list of permitted activities. Because the licences in the latter instance were not full digital-banking licences, the licensed firms in India are referred to as "payments banks."[26] To offer low-cost banking solutions, Payments Banks are also needed to have technology-driven and completely networked operations, while Small Finance Banks' operational costs are targeted to be minimised through high-technology operations.[27] With the internet and smartphones being available in almost all the rural areas, this will ensure that even the rural areas are benefitted from digitalized banking.

As mentioned in the introduction, some of the banks are additionally linked with the government's billing system, such as the Bharat Bills Payment System, so that any consumer agency of the government can receive payments from its consumers through the use of these apps.[28] This in turn makes the use of such apps more efficient and consumer friendly. The concept of Cheque Truncation System(CTS) -based cheques was also implemented by RBI, with the assistance of which not only can the authenticity and legitimacy of cheques be confirmed and assured in a much better way than previously, but also the time for processing inter and intra city cheques has been greatly decreased.[29] Additionally, many digital banks are backed by established financial institutions, which can provide an added layer of security.

When selecting a digital bank, thorough research is crucial. Ensure that the bank is FDIC-insured, which guarantees government protection for your deposits up to a specified limit. Additionally, consider the bank's reputation and customer feedback. Digital banks offer the advantage of 24/7 accessibility, allowing you to manage your account, transfer funds, and pay bills at any time, which is particularly beneficial for those with demanding schedules or unconventional work hours.

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[25]James Guild , *Fintech and the Future of Finance,* Social Science Research Network (Aug. 22, 2017) https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3021684.

[26] Tarik Alatovic, Luís Cunha, Hernan Gerson, Elias Hajj, Joe Saade, and Giuseppe Siciliani, *Lessons from rapidly evolving regulation of digital banking,* McKinsey & Company (Oct. 01, 2021). https://www.mckinsey.com/industries/financial-services/our-insights/lessons-from-the-rapidly-evolving-regulation-of-digital-banking.

[27] *Supra* note 24.

[28] Shreya Shambhavi, *Digital transformation of banks : legal issues and challenges,* IPleaders (Feb. 06, 2021). https://blog.ipleaders.in/digital-transformation-banks-legal-issues-challenges/

[29] *Id.*

Moreover, digital banks often present a cost-effective alternative to traditional banks. With lower operational expenses, they can provide more attractive interest rates and reduced fees, helping you save on banking costs and increase your earnings from interest.

In summary, digital banks provide several advantages compared to conventional banks. They offer convenience, cost savings, and security. Although they might lack the personal touch of traditional banks, their round-the-clock access and comprehensive range of financial services can make them a suitable choice for those seeking a modern banking solution.

Even after all these steps that were adopted for more efficient working of Digital Banks, a lot of people still have not registered or linked their bank accounts for digital and online banking. This is probably because of lack of awareness among the consumers, tough and strict rules to adhere to, too many passwords and pins etc. Although some banks have robust systems and smooth functioning softwares, people are used to traditional methods and are not ready to adopt new methods of online and digital banks. Also, banks still have to assure citizens and gain their trust.[30]

CONCLUSION

For a country's efficient functioning, the performance of the banking and financial sectors is essential. Over the last decade, there have been significant advancements in the management of Silver Exchange Traded Funds (ETFs), Prepaid Payment Instruments (PPIs), and Digital Banks. The regulatory framework, as described, comprises the guidelines, recommendations, and directives established by government bodies. These regulations are vital for the seamless operation of various systems within the financial and banking sectors.

This research paper highlights several guidelines and recommendations from the Reserve Bank of India (RBI) and the Securities and Exchange Board of India (SEBI). It offers a comprehensive explanation of Silver ETFs by providing relevant examples, which enhances the clarity and coherence of the study. The paper details the regulations governing Silver ETFs and explores the different types of Prepaid Payment Instruments (PPIs)—closed, semi-closed, and open systems—along with the associated regulatory framework. Additionally, it examines Digital Banks (DBs), noting that while these banks are increasingly regulated to encourage

[30] Revathi P., *DIGITAL BANKING CHALLENGES AND OPPORTUNITIES IN INDIA,* 7, IJEBR, 20, 20-22 (2019).

their use, they still face challenges due to user skepticism and limited awareness. However, since events like demonetization and the pandemic, the adoption of DBs has been growing steadily.

The paper concludes with an analysis of the regulatory frameworks for Silver ETFs, PPIs, and Digital Banks, including examples and references to the government entities that issue these guidelines.

Key findings include:

- Silver ETFs are regulated by SEBI under the SEBI (Mutual Funds) Regulations, 1996. This regulation mandates that at least 95% of a silver ETF's assets be invested in silver and related instruments, emphasizes adherence to specific standards, and provides a formula for calculating Net Asset Values (NAVs).

- PPIs are governed by the Master Directions on Prepaid Payment Instruments, which include restrictions on cross-border transactions involving Indian Rupees.

- The use of Digital Banks has increased since the demonetization period, as more people have shifted to online payment methods. These banks are under strict regulation by the RBI.

Recommendations include:

- The RBI should maintain rigorous oversight of Digital Banks due to their susceptibility to cyber threats, which could have severe consequences.

- Regulatory updates should be regular and aligned with the evolving landscape of online finance to ensure effective oversight of the sector.