POLICY BRIEF MARCH 2015

Digital Financial Inclusion: Agenda for India

2014 was a milestone year for financial inclusion, with several major developments towards an enabling regulatory and policy environment for universal financial inclusion in India. The major achievements were:

- Introduction of niche and differentiated banks-Payments Banks and Small Finance Banks.
- Roll-out of Prime Minister's Jan Dhan Yojana (PMJDY) on a mission mode.
- Resolution of the terms of service in USSD channels for mobile banking.
- Acceptance of Aadhaar as an e-KYC identifier for financial transfers.
- Clarification of the scope and remuneration terms of business correspondents agents.
- Enhancement of Direct Benefits Transfer (DBT) coverage by inclusion of major schemes and timeline set for digitization of all Central Schemes by June 2015.

In all of this, the role of the PMJDY has been central. The target of 100% coverage in opening bank accounts enabled with bundled benefits of debit card, overdraft and insurance cover has been the big game changer in the landscape. The JAM Trinity (Jan DhanYojana account + Aadhaar number + Mobile number) as mentioned in this year's Budget will be the crux of all the changes ahead and the emerging realities call for an increased emphasis on inter-sector and cross-sector analysis and policies.

With so much positive regulatory and policy change, we felt it necessary to conduct a fresh analysis of the remaining policy and regulatory barriers to digital financial inclusion in India. Rather than explore each barrier in detail, this note attempts to compile the remaining barriers in a single place.

The remaining barriers to digital financial inclusion have been assessed against three key objectives:

A. Maximize the impact of PMJDY.

B. Create an interoperable, ubiquitous retail acceptance infrastructure

C. Cultivate an enabling environment for enhanced digital savings, credit, and insurance services

The details in this checklist will be fleshed out in subsequent policy briefs and we look forward to feedback from all stakeholders as we monitor progress on this checklist and revise it every quarter.

While compiling the priorities, one critical barrier rose to the top - the inadequate commission government pays to banks for successful delivery of DBT payments in rural areas. The 1% commission notified by the Finance Ministry in Jan 2015 barely covers the bank's costs, making it difficult to pay Business Correspondents and their agents. Keeping the agent network viable should be the topmost priority, and there is merit in starting with higher commissions – the Report of the Task Force on an Aadhaar-Enabled Unified Payment Infrastructure had recommended 3.14% – and progressively reducing these over time as transactions, and thus agent viability, increase.

The Priorities

A: Maximize the impact of PMJDY:

- Establish a viable DBT commission system, including a multi-tier structure commensurate with delivery costs to ensure viability of agents at the last mile of service delivery.
- Accelerate financial literacy to increase transactions and activity in accounts.
- Clarify the eligibility of Payment Banks in processing DBT transfers at par with Scheduled Commercial Banks.

B: Create a ubiquitous, interoperable retail acceptance infrastructure

- Establish e-KYC access targets for all banks.
- Implement guidelines for agent interoperability through access to Immediate Payment Service (IMPS) for person to person transactions.
- Devise capital cost structures and remuneration terms including inter-change fees for effecting transactions to enable investment case for retail infrastructure.
- Implement universal telecom coverage obligations with signal quality standards and broadband access.

C: Cultivate an enabling environment for enhanced digital savings, credit, and insurance services

- Create appropriate regulatory framework for cross-sector partnerships: banks, insurance, telcos to offer bundled mutual products, and back end data analytics.
- Evolve regulatory guidelines for telcos, banks and insurance providers to share subscriber transaction history and analytics with due security safeguards.

A: Maximize the impact of PMJDY

POTENTIAL BARRIER	ASKS	MAIN RESPONSIBILITY
The low service charges paid out for Direct Benefits Transfer(DBT)payments in rural schemes prevents banks and Business Correspondents (BCs) from building a steady business model. The current 1% payout for disbursements in rural schemes barely covers bank costs[1], increasing the stress on agents in the field. This has been a critical constraint in creating an effective and sustainable delivery chain to the last mile.	Establish a viable DBT commission system, including a multi-tier structure commensurate with delivery costs, whereby commission rates are higher in particularly hard-to-reach geographies. Consider large financial payments architecture as a public good; have a time bound phase-out of DBT service charges to enable investment recovery, and then move to competitive pricing models	Ministry of Finance
Banks and BCs are uncertain about the schedule of reimbursement for DBT commissions.	Issue guidelines on remuneration structures for Banks and BCs, which include the principles of sharing, and disbursement time limits	Ministry of Finance
Dormancy and 'nil' balance accounts detract from a digital financial culture.	Accelerate financial literacy to increase transactions and active accounts, incentivise corporate sector to use funds under their Corporate Social Responsibility budgets to support financial literacy.	Prime Minister's Office (PMO) Ministry of Finance Ministry of Law and Company Affairs
The success of the digital financial system depends on DBT flows attaining necessary scale and economic viability. The active participation of line ministries administering various schemes is essential.	Create focal points at relevant line ministries to Expand DBT coverage for schemes – seeding and de-duplication of beneficiary accounts with bank account and Aadhaar numbers	Ministry of Finance Relevant line ministries
Lack of clarity on whether Payments Banks will be allowed to process DBT payments directly, which are now allocated only to Scheduled Commercial Banks.	Clarify the eligibility of Payment Banks in processing DBT transfers at par with Scheduled Commercial Banks	Reserve Bank of India(RBI)/ Ministry of Finance

1. As detailed by MicroSave (December 2013), for banks to make a reasonable income, the pay-out to banks should be in the range of 3.0% to 3.3% (of this 1.9% should be passed on to the BCs and the CSPs; while 1.1% can be retained by banks to cover their costs and realise a small margin)

B: Create a ubiquitous, interoperable retail acceptance infrastructure

POTENTIAL BARRIER	ASKS	MAIN RESPONSIBILITY
Despite RBI declaring Aadhaar as adequate KYC for opening bank account; Aadhaar e-KYC access is lagging at many banks.	Establish e-KYC access targets for all banks as part of PMJDY • 40% of access points must offer e-KYC by Dec 2015 • 100% of access points must offer e-KYC by Dec 2016	RBI Indian Banks Association
A common KYC for banks and telcos will ensure full migration/ mapping of SIM accounts to bank accounts.	Issue notifications to accept Aadhaar KYC for SIM registration.	Telecom Regulatory Authority of India (TRAI)
There is no policy framework for establishing interoperability among BC agents of different banks for person to person transactions.	Implement guidelines for BC agents access to for Aadhaar-authenticated person to person IMPS remittances as independent parties (not as bank agents, with no liabilities of banks).	PMO, Ministry of Finance
There is no clarity on capital costs for retail acceptance infrastructure and who will bear these costs to what extent.	Elaborate capital cost benchmarks for interoperable (off-us basis) retail payment infrastructure- in retail micro ATMs, biometric authentication and cash systems at BC and retail merchant points.	PMO Technology Committee (to be created)
Weak telecom connectivity and bandwidth hinders e-KYC and biometric/ PIN authentication in remote areas, and limits digital transactions.	Implement universal coverage obligations Ensure telecom signal quality standards and broadband access to all BC/ retail points to catalyse mobile banking in poor communities.	TRAI

C: Cultivate an enabling environment for digital savings, credit, and insurance services

POTENTIAL BARRIER	ASKS	MAIN RESPONSIBILITY
Banks, insurance providers and telcos are unable to exploit synergies in serving same customers due to multiple domain regulators. Financial service providers lack credible data to establish credit scores of the poor; however, telcos have enormous customer data which can support improved customer profiling and risk management for additional product offerings.	Pilot test bundled offerings - e.g. SIM card bundled with insurance cover; bank credit linked to mobile bill payment and m-wallet history. Create appropriate regulatory framework for cross-sector partnerships: banks, insurance, telcos to offer bundled mutual products, and back end data analytics. Evolve regulatory guidelines for telcos, banks and insurance providers to share subscriber transaction history and analytics with due security safeguards.	PMO, Ministry of Finance RBI, Telecom Regulatory Authority of India (TRAI), Insurance Regulatory and Development Authority of India (IRDA)

Creating an Electronic Payments Culture and Inclusive Competitive Landscape

Account Access

- complete seeding of all DBT and bank accounts with Aadhaar #
- set up eKYC systems at banks and payment systems

Transactions

- increase financial literacy and conversancy with device and process
- universalise Aadhaar mapping of retail points
- allow interoperability among BC agents

Insurance/ pension

- inter-sector regulations for cross selling and bundling services with telcos-insurance providers

Credit

- use mobile payments history as additional criterion for credit linked to m-wallet