

India's Financial Inclusion Agenda for 2019-24

In Brief

A financially inclusive India will be one where the poorest can easily receive, and at low cost, a range of good quality financial services. Such services are currently available mostly to the better off. The opportunities thrown by the digital economy make such an inclusive world possible within a short span of time.

India's financial inclusion mission has gone through a paradigm shift over the past five years, it has set up a strong technological and institutional backend, improved accessibility for a large majority of the households, and developed viable alternatives to the traditional cash economy.

These successes now require to enter the next phase, where usability and innovation lie at the forefront of a demand-driven ecosystem. However, a demand-driven ecosystem requires the supply side to benefit from the necessary flexibilities both technologically and in the rules that govern, and a mechanism where stakeholder incentives are aligned with the objectives of universal inclusion.

In other words, the new benchmark is not improvements relative to the past, but improvements that can help the Indian masses meet their full potential. We can broadly categorize this into four buckets – **prices, connectivity, monitoring, and collaboration.**

The Achievements in the Past

The financial inclusion domain has seen significant policy action, institutional strengthening and implementation of new schemes and projects, together they have expanded and improved the access of the underprivileged to financial services. Arguably this domain has seen greater progress than any other domain in India.

Expansion of low-value bank accounts through the Pradhan Mantri Jan Dhan Yojana (PMJDY) has ensured almost four-fifths of adult Indians have a bank account. Other synergistic developments include Aadhaar seeding, provision of RuPay cards and overdraft facility, setting a minimum Bank Mitra remuneration along with certification, monitoring the transaction readiness of Bank Mitras, instituting a GIS locator for banking services, etc. Each of these individually, and more so together, have helped get the inclusion infrastructure more accessible for the masses.

At the same time, new players have entered, with the Reserve Bank of India opening up the space. India now has Small Finance Banks (10

currently active), Payments Banks (7 currently active) and on-tap licensing for universal banks. P2P lending has also been regularised as Non-Banking Financial Company-P2P, with the RBI issuing licensing and prudential guidelines.

The inclusion of the small and micro business has also commenced with the Pradhan Mantri Mudra Yojana (PMMY) working towards providing credit for micro-enterprises; almost 70% of these low-cost collateral-free loans have been taken by women.

A relatively well functioning payments infrastructure has been created and is spreading rapidly throughout the country. Digital payments have been simplified with the introduction of the Unified Payments Interface (UPI) and non-banks have made a significant entry into the payments system. IMPS transactions have risen from 1.38 million in November 2013 to 149.94 million in November 2018. Usage of debit cards at PoS terminals has risen from 9% of total debit card transactions to 31% over the same period.

These are impressive achievements but pale in comparison to what is

Table 1: Financial Inclusion Indicators 2017 (Source: Global Findex)

	China	India
Account (% age 15+)	80%	80%
Account, female (% age 15+)	76%	77%
No deposit and no withdrawal from an account in the past year (% age 15+)	12%	39%
Saved at a financial institution (% age 15+)	35%	20%
Borrowed from a financial institution (% age 15+)	9%	7%
Used a mobile phone or the internet to access a financial institution account in the past year (% with a financial institution account, age 15+)	50%	6%
Made or received digital payments in the past year (% age 15+)	68%	29%

possible. Though China's largely unregulated digital payments domain is not the appropriate benchmark to set for India, it does set the lower benchmark despite the income differential. A well-governed mechanism that is quality and demand oriented such as India is putting in place should be able to achieve higher levels of good quality inclusive services.

The Vision for the Future

Imagine an illiterate tribal woman who can save a few rupees one day, withdraw a few rupees for her pooja the next day, and buy micro-health insurance for herself the day after, all on her mobile. She can receive a small collateral free loan to help her repay the costly loan she took from the local shopkeeper. The bank is able to give her credit because their automated algorithm is able to identify her as a well-connected and integrated member of her tribal community. Her micro-insurance is also an innovative one where she adds on to her insurance every time she has excess funds with no need to make future commitments.

Cash may remain as a primary store of value for this tribal woman and many of her transactions including those at the local market may remain in cash, and therefore cash-in cash-out within her vicinity and at all times will be an important component of this world.

The well-trained Business Correspondent (BC) is able to inform her of the various investment or insurance options from different providers, their pros and cons, and help her figure out what products work best for her. This requires the BC to be well trained and well incentivized.

Since in this inclusive India, the bank is adequately compensated by the government for direct benefit transfer payments and other such government schemes, it is also better able to compensate the BCs. Realistic compensation for various government schemes helps set the frame for a more innovative, productive and competitive chain.

This illiterate underprivileged woman can put all her life-savings in such products because of the trust she has in the products and services and the confidence any problem can get resolved easily via the well-functioning easily accessible customer redressal mechanism. In this financially inclusive India, she can access all such services without having to visit the bank or insurance company office in the block headquarters a 100km away.

Given the massive increase in bank accounts largely through the PMJDY, a well-functioning payment clearance mechanism, a low-cost and well-spread telecom network the infrastructure backend for such an inclusive world has been created. Yet the infrastructure thus put up will not be able to translate the latent demand of the underprivileged if the remaining gaps are not addressed.

What remains is a greater focus towards good quality, accessibility and innovative services in the domain. This is critical, because good customer-oriented services occur best, when the supply mechanism is decentralized, sensitive and responsive to demand-side forces. In their absence as is the case currently, demand-side forces are not brought to life, and demand remains latent.

This policy note focuses on precisely this next step towards a financially inclusive India. We identify four main pillars of this world.

Getting the prices right – Enable competitive forces at each point in the chain. At places where this may not be possible, for example in the case of government-driven Direct Benefit Transfers, there should be an independent entity that can systematically derive the right

compensation package to the service provider.

Getting the monitoring right – Create a mechanism that focuses on the usage of financial services and monitors all aspects of the transactions that take place, whether this is to pre-empt, stop in real time, or pinpoint ex-post any fraud or flaw. This would necessarily require a cross-institutional mechanism that is able to oversee and rapidly correct the flaws within the system.

Getting the connectivity right – Identify the dark spots at a micro level, so that no village or habitation is left uncovered. The universality of financial inclusion requires that even the hinterlands are covered with 24x7 telecom access. This requires an improved monitoring mechanism and coordination between different regulators including the TRAI.

Getting collaborations right – Facilitate collaborations within and across institutions. A more innovative industry will be built on top of a host of partnerships and collaborations between institutions both in the public and private domains. Whether it is the evolution of walled gardens or emerging public platforms, the new ecosystem will be built on coordination led by the Department of Financial Services that cuts across regulators and private and public sector commercial entities. Within the government as well, a more collaborative approach will yield high payoffs.

A. Getting Prices Right

The Problem: The provision of financial services to low-income customers must be sustainable for every link in the supply chain. So far, banks have borne, and continue to bear, a high share of the costs of meeting government mandates. These mandates include providing access in rural areas through branches and business correspondent agents, ensuring cash disbursements of government subsidies to the beneficiary accounts, maintaining zero balance accounts for the poor, providing RuPay cards and to promote digital transactions etc. Unfortunately, the issue of the viability of the network continues to plague banks, Corporate Business Correspondents and individual agents. Two examples stand out:

A) A transaction processing charge of 3.14 percent on Direct Benefits Transfers (DBT) was recommended by the Task Force on an Aadhaar-Enabled Unified Payment Infrastructure in 2012; whereas those paid out in actuality by the central and state governments have been in the range of 1-2%.

B) Interchange fees for transactions on micro-ATMs, AEPS etc are fixed by the National Payments Corporation of India (NPCI), with no transparent underlying costing methodology. Not only does it make it unviable for banks to create and maintain acceptance infrastructure at the last mile, it also reduces the credibility of the NPCI as a fair player.

Proposed Solutions

First, since costs and technologies are ever-changing, an institutional mechanism that undertakes the costing exercise on an ongoing basis is required. This institutional mechanism would be like an independent commission under the Department of Financial Services (DFS) on lines of CACP under Ministry of Agriculture.

- i. In the case of Direct Benefits Transfers (DBT), for instance, transaction charges would need to be derived after taking inputs from many sources including NPCI, Banks and Business Correspondents.
- ii. While the PMJDY has specified a minimum monthly remuneration

for agents, there must be ongoing assessment of the viability of agents across the country and regular up-dation of the remuneration.

iii. NPCI being a monopoly in many product segments, until a viable competitor emerges, the same financial prices commission can recommend the charges on transactions through NPCI.

Second, the NPCI should be classified as a Critical Payment Infrastructure Company (CPIC). When classified as a CPIC, NPCI would be bound by the principles of the CPSS-IOSCO Disclosure framework and assessment methodology which will bring greater transparency into performance metrics and governance. Meanwhile, the RBI DPSS should make public the risk assessment of NPCI and the steps taken by the NPCI as advised.

Third, the RBI has rightly initiated the move towards competition in the payments systems segment, including for the NPCI. In each segment of the financial inclusion value chain, regulation must incorporate not just customer protection and financial stability, but also a fairly competitive environment.

B. Getting Connectivity Right

The Problem: While PMJDY has been looking into the issue of covering dark spots in telecom coverage, a key missing element is information on the adequacy of telecom service coverage and quality mapped at the locations of these banking outlets. With the emphasis growing on digital payments through the mobile phone or cards, failure of a transaction to go through in real time creates difficulties for the customer and merchants, but more importantly, it leads to loss of trust in the digital payments option. Conventional telecom metrics – urban and rural teledensity – fall far short in monitoring the adequacy for financial transactions. Failed transactions and failed authentication process for withdrawal or transfer of funds using mobile phones/PoS transactions cause much harm to the credibility of digital payments ecosystem.

Proposed Solutions

First, the DFS must notify, in consultation with TRAI, NPCI, UIDAI, and others, the minimum telecom service requirements for devices for conducting digital financial transactions. This will enable mapping of device penetration across banking outlets and the requisite telecom connectivity to enable successful financial transactions, and lead to the need for metrics like 'transaction drops' equivalent to 'call drops' in the voice nomenclature.

Second, granular reporting that enables a direct mapping of availability and quality of telecom coverage at the habitation or village level must be instituted. This is critical for constantly monitoring the status of internet/broadband penetration, quality of telecom coverage – represented by uptime, transaction times and transaction failure data, at such a granular level. Such monitoring will achieve two ends (a) telecom service providers would be forced to provide answers behind harmful dark spots, and (b) a significant number of customer redressal issues may fall under such failures, and it will be crucial for the service provider to differentiate between telecom and service failure.

Third, note that it is not currently mandated for TRAI to be capturing from telecom companies and reporting coverage and quality at the district, block or sub-service area levels, even though technically feasible. Thus, an appropriate protocol needs to be put in place for

telcos to provide coverage maps to TRAI for voice and data services. This will also enable the DFS or RBI to generate GIS-based heat-maps for telecom coverage and BC outlets on a regular basis. Moreover, such service quality data should be requisitioned through TRAI, and a financial inclusion section must be included in the latter's quarterly review reports given that this initiative directly supports the cause of financial inclusion.

C. Getting the Monitoring Right

The Problem: The progress of financial inclusion should now be measured by the usage of financial services by rural and low-income consumer segments. This calls for understanding the flow of financial transactions, that go through many links in the chain, there are multiple entities both in the vertical value chain and horizontally. Given this, it is critical that the monitoring function is undertaken in such a manner that the principles of universality, identification, and timeliness are built in. Universality implies that everything needs to be accessible to the monitoring agency. Identification implies that an investigator should be able to drill down from an aggregated set of transactions or accounts to a specific transaction or account, and all of this should be possible in real time. That does not currently happen. And real-time naturally implies that algorithms can be created that can red flag suspicious transactions.

Currently, little transaction or use based monitoring and reporting is done. While that is understandable given the past focus on improving access to services and financial infrastructure, it is time to change to a more sophisticated mechanism.

Proposed Solutions

First, embrace a more comprehensive definition of financial inclusion. One such definition, set out by the GPFI is: 'Financial inclusion' refers to a state in which all working-age adults have effective access to credit, savings, payments, and insurance from formal service providers. 'Effective access' involves convenient and responsible service delivery, at a cost affordable to the customer and sustainable for the provider, with the result that financially excluded customers use formal financial services rather than existing informal options. (GPFI, 2011)

Second, with this definition, the government and the RBI would be able to take a more holistic view of service delivery and a usage-based approach. A more appropriate choice of measures to monitor financial indicators can then be categorized into three segments:

i. Access to infrastructure: This would include the spread of bank branches, ATMs, deployment of Business Correspondents, data connectivity at the granular level, device uptime of micro-ATMs etc.

ii. Availability of services: That is, the bouquet of financial services being offered at the access point and the offtake (opening of accounts, cash services, remittances, government benefits, savings, insurance, pensions etc., the activity of the Business Correspondents in the number and type of transactions, etc.

iii. Sustainability of last mile coverage: This includes commissions paid out, income earned by the agents and by each partner in the value chain of service provision etc.

Third, rather than the State-Level Bankers Committee (SLBC), the District Consultative Committee (DCC) would now need to be the appropriate authority to be the most important administrative node of the financial inclusion mission. With the expansion of government

subsidies and other schemes, the District Collector has become the nodal officer and is more closely identified with the target segments for financial inclusion. The SLBC, on the other hand, remains remote and more concerned with pure banking concerns. Further, the unit for monitoring must now change from the Sub Service Area, with one fixed point branch outlet for 1000-1500 households, to the Gram Panchayat. The financial inclusion parameters must be mapped to MGNREGA granularity, the Gram Panchayat, therefore, will then become the relevant unit for monitoring.

Fourth, the monitoring data so collected, should be put in the public domain through dashboards that also ensure privacy and confidentiality concerns are not violated. Since the monitoring unit starts from gram panchayat to district and above, the underlying granularity will also enable drilling down for the investigator-researcher. Red flagging algorithms can easily be developed to identify aspects in specific locations for the relevant authority to resolve. The administrative databases should enable a focus on under-served areas such that the specific issues in such areas are addressed.

Fifth, monitoring for fraud as well as systemic issues also needs to be undertaken at the centralized level and will be best done by a specialized cell within the RBI. The RBI has already set up a Central Fraud Registry that banks can access. While very useful other types of monitoring also need to be conducted that are more pre-emptive. This requires the RBI to have access to real-time data from the NPCI and other payment service providers. A dedicated team would need to be examining patterns in transactions on a real-time basis and red flag areas or domains which need further investigations.

Sixth, Ombudsmen already exist for banks, NBFC, and recently has been set up for digital transactions. While the ombudsmen may investigate complaints and attempt to resolve them based on representations of the involved parties, access to transactional and other information can help in faster and better resolution.

D. Getting collaborations right

The problem: There are two aspects to this problem. One, coordination amongst regulatory entities. The lack of coordination from multiple regulatory authorities has raised costs and uncertainty in doing business. Take the case of the lack of clarity over e-KYC and use of Aadhaar over the past year. The recent Supreme Court order restricting use of Aadhaar by private companies showed why the government and RBI must work swiftly and in tandem to ensure that there is clarity for all players in the digital payments space. Two, as technology evolves, every organisation will not be able to provide all services in the vertical. We are

moving into a world of cooperation, especially for the target segment for financial inclusion. Cooperation, partnerships, collaborations will be the order of the day and the regulator must gear for this new world.

A host of organizations, large and small, in the public and private sector, telecom and financial sector, banks and non-banks, for-profit and non-profit will need to be working in a cohesive manner. This would require the service providers, sometimes overseen by different regulatory entities, to be able to coordinate their actions. Moreover, many of these organizations may be components of complex organizations with multiple activities. For all of these to be working well in cohesion a partnership driven competitive ecosystem would help.

Proposed Solutions

First, since a multitude of entities are involved – RBI, TRAI, IRDA, UIDAI, NPCI etc. - the DFS would be the most likely primary coordinating entity, which will hold periodic meetings between different agencies to review the status of financial inclusion in the country, identify the problems and emerging issues where coordinated actions need to be taken. This coordinating body would also identify gaps in the rollout of different policy prescriptions as well as administrative actions.

Second, modularization is an important component of the emerging landscape that needs to be assigned adequate institutional space. Take, for instance, emerging fintech companies and banks, these may be competing organizations, but some part of a bank may also collaborate with a fintech firm for innovative products or processes. Recognition of such possibilities followed by light touch regulation where components of banks are given the space to innovate and not be bound by generic regulations that apply on banks would enable innovation at a far more rapid pace.

Concluding Note

Despite, or perhaps due to, the phenomenal success of government efforts at expanding the financially inclusive space, India's experience has thrown up institutional challenges that remain to be overcome. The main takeaways that emerge for the road ahead are that it is time for regulators and the government to have a coordinated policy, be nimble with a light touch rather than prescriptive regulation, and keep the interests of the consumer at the forefront. Having solved the challenge of access to financial services, it is time to create an ecosystem that is viable for all parts of the service delivery chain, one that is built on trust between the industry and consumers, an ecosystem which encourages competition and facilitates collaborations between banks and non-banks.