Transformation in Financial Sector Architecture: Just tremors or a Tectonic shift?

The Indian financial landscape has witnessed unprecedented changes in recent years as the issue of financial exclusion has moved to the mainstream and received attention from all corners. On the policy and regulatory front, landmark programmes such as the Pradhan Mantri Jan Dhan Yojana, combined with the push for universal Aadhaar enrolments and use of mobile technology are seen as game-changing initiatives. On the other hand, the rapid rise of fintech companies has given considerable fillip to the expansion of digital financial services. This factsheet presents a quick summary of some of the recent tremors and tectonic shifts in the sector.

Digital Identity

- 1.14 billion Aadhaar enrolments as of March 2017
- 44.7 million bank accounts opened using Aadhaar e-KYC
- Rs. 22,006 crore Direct Benefit Transfer Payments made using Aadhaar Payments Bridge in FY 2016-17
- 167 million PDS beneficiary households with at least one member seeded to Aadhaar

A unique digital identity can enable individuals to access resources which they are entitled to, such as government services and benefits, financial services, education, e-commerce, and communications. With Aadhaar, the Unique Identification Authority of India (UIDAI) has undertaken the largest digital identity project of its kind globally. The number of Aadhaar enrolments has seen a sharp rise over the years, backed by simplified enrolment processes. Moreover, Aadhaar based applications such as e-KYC and e-sign have the potential to simplify authentication processes and increase efficiency at scale.

However, several concerns have been raised regarding regulating the collection and use of this data, as well as implications for data privacy. The passing of the Aadhaar (targeted delivery of financial and other subsidies, services, and benefits bill of 2016) has provided a legal basis for the identity project and is seen as a significant step towards addressing some of these concerns. As the application of Aadhaar to financial services gains momentum, the policy and regulatory architecture must prioritize individual privacy, user consent and data control, and security as guiding principles.

*All statistics quoted from State of Aadhaar Report 2016-17

Policy and Institutional Developments

- All 10 Small Finance Bank licensees receive final approval from Reserve Bank of India and 8 commence operations
- RBI releases guidelines for 'on-tap' licensing of Universal Banks in the Private Sector
- The Central Bank also issues guidelines on regulation of peer-to-peer lending platforms

These policy and institutional developments signal a shift towards an 'ecosystem approach' to the development of the financial sector in India. This is reflected in the rise of differentiated banks such as small finance banks and payment banks, as well as a flexible approach to regulating innovative/alternative models such as peer-to-peer lending.

Overall, there has also been an increase in the physical outreach of formal sector touchpoints across the country (Sriram, 2016). While the PMJDY has resulted in opening of bank accounts at the household level, uptake and usage remains a challenge. With small finance banks and payment banks starting operations in the course of the year, increased focus is expected on the product design and development side, to cater to the specific requirements of low-income segments and other underserviced population groups.

Rapid rise of Digital, Fintech

The transaction value for the Indian fintech sector is estimated to be USD 33 billion in 2016 and is forecasted to reach USD 73 billion in 2020, growing at a five-year CAGR of 22 per cent (Statista, 2016). Backed by a significant spurt in mobile broadband and smartphone penetration, and a rapid growth of fintech companies along the entire value chain of financial services, digital finance is on the rise. Today, there are numerous start-ups cutting across multiple business segments and functions, predominantly in the payments and lending space.

Payments

46 per cent of Indian fintech firms are focused on payment solutions and trade processing (KPMG, 2016). Apart from private firms, the National Payments Corporation of India has played a significant role in promoting greater interoperability among service providers, with its Unified Payments Interface (UPI) and the Bharat Interface for Money (BHIM). While digital payments have picked up in the wake of demonetisation, the evidence on India's shift towards a 'less-cash' economy remains inconclusive.

P2P lending

Peer-to-peer lending has emerged as one of the most rapidly growing fintech segments in India and has demonstrated potential to address the credit needs of the 'missing middle' Micro, Small and Medium Enterprise segment. Recognizing its role in the credit market, the Reserve Bank of India has issued a notification that p2p platforms will be treated as non-banking financial companies (NBFCs). With this recognition, p2p companies can access credit records of potential borrowers from credit bureaus. This presents first-time borrowers an opportunity to access collateral-free credit and build their credit histories as well. India Stack, a set of Application Programming Interface for developers includes the Aadhaar for Authentication, e-KYC documents (safe deposit locker for issue, storage and use of documents), e-Sign (digital signature acceptable under the laws), unified payment interface (for financial transactions) and privacy-protected data sharing within the stack of API. Application of India Stack to credit services has the potential to transform customer acquisition, loan disbursal and recollection processes. Other promising innovations in the fintech space include personal financial and wealth management companies, blockchain, insurance, among others.

Looking Ahead

Apart from these fundamental shifts in approaches to banking in recent years, there have been several slow and steady developments. For instance, the landmark Self-Help Group movement continues to grow in terms of both savings collected from members and loans disbursed to them. NABARD has also continued its project of digitisation of SHG data. As of 2016, Microfinance Institutions have expanded their presence to 507 districts of the country. There is little doubt that India's banking and financial services sector is currently undergoing an unprecedented transformation and these shifts represent an exciting period in the country's banking history. Concurrently, they also underscore the need to strengthen the policy and regulatory architecture that underpins them.

It is important to ensure that appropriate laws and regulations are in place to protect the interests of consumers, especially from vulnerable populations, and provide them appropriate mechanisms to address their grievances. As first-generation users get accustomed to the use of formal financial services and digital banking, concerns regarding product suitability, informed consent, data privacy and financial capability are likely to surface as well.