K C Chakrabarty: ICT based financial inclusion – carving a new path through innovation

Address by Dr K C Chakrabarty, Deputy Governor of the Reserve Bank of India, at the Inaugural Plenary session of the 7th BANKing TECH Summit 2012, Mumbai, 28 June 2012.

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When the financial sector is going through perhaps the most chequered phase of its history and the usefulness of financial innovation is itself under extensive debate globally, it is heartening to be participating in a seminar which is endeavoring to carve a new path for Indian banking through innovations. Congratulations to the organizers for choosing this contemporary but forward looking topic.

Let me begin by referring to a recent report by the World Economic Forum titled "Rethinking Negative Innovation – Reducing Negative Outcomes while Retaining the Benefits". The report attempts to answer certain fundamental questions:

a. Is financial innovation needed?

b. There is a thin line of demarcation between innovation and violation.

c. What is needed to ensure that financial innovation better emphasizes the positive outcomes and reduces adverse consequences?

After the financial crisis, while it has become fashionable to condemn financial innovation *in toto*, we must recognize that without continued financial innovation, the financial markets in both developed and developing nations will perform below their potential. But for financial innovation to result in benefits, it needs to focus not on the treasury incomes but must, instead, have customer orientation. When innovations have focused on better alignment of interests between the bank and its customers, they have always resulted in win-win situations. I can say that most of the innovations in payment and settlement systems, particularly those which deal with one-time customer interface, had this customer focus. The results are visible across the globe. The only segment of the financial markets that came out unscathed during the crisis has been the payment and settlement system. However, the financial sector has not succeeded in innovating to bring in efficiency in products that engage customers on a life cycle basis. Finally, it has to be remembered that financial innovation cannot outpace the innovations in the real sector.

Customer-centric technology

You have assembled here to chart a new path for innovation. However, let us bear in mind that for innovation to be successful, it has to necessarily be customer focussed. In a country like India, where access to financial services remains an issue, Innovation should particularly focus on financial inclusion and on the small and marginalized, but viable sections of the society. What makes innovations feasible at a rapid pace today vis-a-vis say, the last century? Undoubtedly, it is the advent of technology. But, as I have said in the past also, in the financial sector, for technology and innovation to be of true value to the customers, it must lead to better customer service in three ways (a) faster and hassle free (b) safer and error free, and most importantly (c) easier access but cheaper. Have these happened? If asked to vote, I may cast a half vote to (a) abstain from vote to (b) and cast a negative vote to (c). Let me amplify.

What is the most important prerequisite of a computer or an electronic device from the customer's perspective and from an inclusion perspective? To me it is the standardization. Has it happened across banking services? Let me start with what is termed as the best financial innovation of the recent times – the ATMs. Do they result in faster dispensation of cash? A definite "yes". Is it hassle free? To me, "No". What are the problems faced by the *aam admi*? The problem starts with the standardization of ATMs. Some swallow your card, some require only swiping, some reckon paise when you key in the amount, some do not, some drop the cash on to a tray, some do not , some retract the cash if you are not prompt, some require keys to be pressed, others have a touch-screen. All these are confusing to the man on the street. Why do we not think of standardization even in this basic product? When this is the case with the most basic of the products, issues arising from lack of standardization are more serious in case of other products. There is no standardization of even the account numbering convention across the banking system. One Core Banking System of a bank is so different from another that a customer changing a bank will have to de-learn and re-learn banking operations all over again.

Coming to (b), the attention paid by the banks to database migration has been so casual that the full benefits of computerization and technology are yet to be reaped. Is it not an irony for the banks to claim that NPA levels in a particular period went up as they moved over to "system generated" NPA computation? As far as the customer is concerned, the systems fail at the most inappropriate time. Let us go back to ATMs. Even today, we continue to receive a large number of complaints on account of malfunctioning of ATMs. Is the incubation period for the ATMs installed by banks not yet over? Should the system continue to run based on fear of penalties for inefficient customer service? Or would White label ATMs, for which RBI has recently issued exhaustive guidelines, provide encouraging solutions to these issues?

Technology and consumer protection

One developing concern is the increasing number of frauds in our electronic banking payment scenario. As the banking and payment space becomes increasingly ubiquitous, the challenge is to maintain the quality of security at the highest level in the financial sector. In the recent survey conducted by the Bank for International Settlements, 55% of the financial market infrastructures surveyed indicated that cyber attacks are increasing on account of phishing, weaker credentials / passwords, trusted insiders, denial of service attacks, etc. Technology should result in reduction in risk, not otherwise. This situation warrants huge investments in IT security and I would urge the banks and the IT companies to work together in this regard.

Another angle to this issue is the protection that a customer has to be assured in the electronic banking scenario. The Reserve Bank expects banks to put in place checks and balances that provide confidence and protection to a genuine customer against frauds. Otherwise, the credibility of the entire system will come under scrutiny. The customer should be afforded the same kind of protection in an electronic transaction that he now gets in a paper-based transaction. The customer is not held liable if a signature is forged, whereas he is held responsible when a fraudulent transaction takes place electronically and the onus rests on the customer to prove that it was so. Is this fair? Will such a scenario encourage electronic transactions? We need to find a solution which provides a near zero liability to the customer.

Let me now turn to the issue of technology and cost. Before I speak my mind on the issue, let me make it very clear that RBI does not support the argument that cash transactions in this country will disappear rapidly or that all paper based transactions would turn electronic if the financial sector was to offer electronic transactions free of cost. In fact, we firmly believe that anything that is offered free of charge can never be scaled up and that it cannot become robust and efficient unless it offers commercial viability to those who offer the product / service. Having said that, I also do not support the principle, ostensibly being followed by some of the institutions, to recover a large part of technology expenses from the customers. I was amused at the action of banks deciding to waive charges on "inter-core" transactions hitting headlines in the media. It should have never happened in the first place. In fact, such charges, rather than their removal, should have hogged the limelight. Further, in an electronic banking scenario, *ad valorem* charge to customers is an issue which needs to be relooked. In fact, in a country like ours, part of the cost efficiencies achieved through technology must be passed on to the smaller customers. This calls for a rejig in the way in which banks approach technology. In a technology led financial sector, collaboration among all stakeholders, including competitors, could prove to be the big cost saver. With rapid strides in security standards and capabilities, such a collaboration and sharing of IT infrastructure is feasible on a much larger scale than is happening today.

It is always perceived by the industry that the handholding / intervening by RBI is necessary for the systems to be operational in an efficient manner. I am unable to understand why collaborative approach cannot be the guiding force for success in adoption of shared IT infrastructure. Reserve Bank has contributed to the fostering of innovative methods to improve access to financial services through mobile and opened up and clarified the issue of Business Correspondent (BC) interoperability.

Leveraging technology for making financial inclusion possible and a success

Prior to the enablement of BC interoperability, the banks and technology providers had made a case that it was the lack of interoperability, that was a deterrent for financial inclusion and hence, much headway had not been achieved. According to the technology providers, investment in a non-interoperable technology would be a costly proposition and they did not see a business case to offer financial services at low cost. But now, with RBI permitting / clarifying interoperability, why is it that the transactions at BCs are not picking up, which ultimately, if increased, would change the cost and access equation, making it economically viable for financial service providers to reach poor and isolated individuals and communities? Banks have to make more investments in technology and work together with BCs for fast tracking initiatives under financial innovation. More importantly, focus of all innovations need to be customer, not process, system or employees. It must be recognized that only customer can bring business to the banks and contribute to their bottom lines. All other constituents such as technology, employees, BCs, etc only act as enablers to the process.

Recently, I came across the report submitted by Consultative Group to Assist the Poor (CGAP) and ACCESS based on the "Retreat on the Business Correspondent (BC) model" which was jointly organized by the College of Agricultural Banking (C.A.B.), Reserve Bank of India and ACCESS. The report spells out the challenges faced by both banks and BCs in extending facilities to the recently financially included and to the financially excluded. The findings indicate that the banks have to ensure that the BC model finds space in the business strategies of the banks and not in the footnotes of their annual reports and that the banks should make client acquisition under this model a business proposition; and not treat it as a CSR activity. An important observation indeed!

Further, it has become imperative for the banks to have full control and exercise due diligence, especially when the front end customer contact points are not regulated entities. While the customer has some relief at point of sales when a card is swiped in his presence, the uncertainty of a transaction going through in an E-Commence transaction is very high. Given the constraints of lack of control with respect to internet connectivity while doing such a transaction, banks have to step in to protect a customer when the transaction fails and ensure that the refund process is quick. Why is it that when a website like IRCTC can give the assurance to the customer through its terms and conditions that the refund will take place on such a day, other websites are not able to have similar efficient and transparent processes? Financial service providers should disclose key information clearly, at appropriate points before, during, and after a transaction is completed. Of course, some of the responsibility lies with consumers too – to make sound financial decisions to the best of their ability. However, inexperienced or low-income customers with lower levels of formal education or literacy can be particularly vulnerable to unscrupulous conduct.

Innovation through technology – creating a favourable ecosystem

Technology provides the opportunity to innovate at a much faster pace and to create products that are closely linked to the needs of the consumer. There is a need to create an enabling ecosystem which will encourage and foster innovation by leveraging the best available technological platforms. Here, I would like to highlight some of the essential prerequisites that would help in creating this enabling ecosystem:

i. Access to suitable and cost effective technology which can support multi-channel delivery system, particularly for low income groups.

ii. Standardized systems, structures, products and processes, at least for the small and marginalized customers.

iii. Efficient Business Models: viable but not exploitative.

iv. Efficient Delivery Models: having integrity, speed and low cost.

v. Comprehensive MIS capable of meeting all management information requirement and which is reliable and fast: Integrity of Information.

vi. Information literacy at all levels, more particularly, for senior management and for all sections of the society including customers, technology vendors, banks, regulators, policy makers, etc.

Way forward

Stepping into the shoes of a regulator, you would appreciate that the principal challenge for regulators is to strike an appropriate balance between financial openness that supports growth-enhancing innovation while at the same time implementing regulations and effective supervision that limits the potential risk of financial instability. Further, there can often be a thin line of difference between innovation and violation of regulation. This poses challenges on regulatory resources. In respect of payment systems, having reached a critical mass, attempt has to be made by the stakeholders to provide a canvas for safe, efficient, interoperable, inclusive electronic payment systems. The banks will have to firm up the business model with appropriate technology and definite plan of action, attract more and more customers through reduced charges, introduce a time line for post launch management, give top priority to downstream variants and conduct electronic banking financial literacy drives. All these require charting a totally new path through innovation.

We have an opportunity, like never before, to harness technology for the benefit of the masses. Responsible innovation is the key. We have to ensure that financial innovation is customer focussed and results in faster, safer and cheaper access to financial services, particularly for the large sections of our population that are still excluded from the formal financial system. Each one of us has a positive role to play in this process, including, banks, technology partners, customers, civil society, policy makers, regulators, etc. This alone can ensure financial and economic stability across the globe.

I wish the deliberations at the summit great success. Thank you.