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In future we need banking not banks...

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Introduction

In the Banking Regulation Act, 1949, one can refer to the Section 5 (b) to understand the statutory definition of banking and Section 5 (c) for banking company. A banking company is defined as the company which conducts the banking services i.e. a company that performs the function of **accepting, for the purpose of lending or investment, of deposits of money from the public, repayable on demand or otherwise**, **and withdrawal by cheque, draft, order or otherwise**. In 1949, when Banking Regulation Act was enacted, it was delivered known that availing banking services was impossible without a brick-and-mortar bank and its branches as defined in the Section 5 (cc). In 1960s, world's first ATM machines were introduced. These were the first signs for the technology to influence banking, wherein the service of 'dispensing' cash was possible while 'dispensing' the need to visit a bank. And half a century later, there were new possibilities mulled with the advent of technology and concomitant regulatory amendments. There were other harbingers of the digital banking era in India:

- As of 2020, rural India had 299 million internet users and urban India had 323 million internet users.
- As of April 2021, Unified Payments Interface (UPI) recorded 2.73 billion transactions worth Rs. 4.93 lakh crore (US$ 67.31 billion).
- By 2022, the country is expected to have 820 million smart phone users.
- By 2025, rural part of the country is projected to have more internet users than urban areas.
- Almost two-thirds of nearly 7.5 lakh panchayats have optical fibre connection.

Evolution of Banks

When very first banks came into existence, the purpose was to finance the wars. The banks in England and Italy had served the interests of the Monarchy. Merchant banking was the harbinger of modern banking wherein the commodities were traded. The goldsmiths were also considered as bankers for some time because the businessmen and traders trusted them for safekeeping of precious elements like gold and silver in exchange for a small fee. The first modern bank in India was established in 1806 under the British rule in one of its presidencies called Bank of Bengal. The name 'bank' which is used to refer to the institutions that offer the banking services today is etymologically derived from Italian word 'Banca' which literally translates to a bench used for holding, transferring and loaning currencies by the creditors.

Factors affecting banking

The factors affecting a financial system are related to demand and supply and digital literacy in the populace. The factors mentioned in Figure-1

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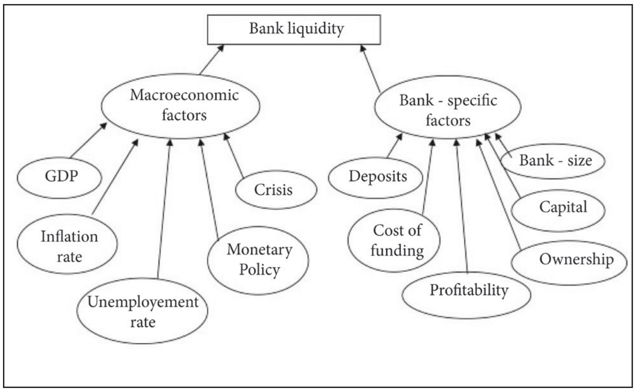
determine the 'health' of a banking company. Here, the term liquidity means the ability of the bank to convert the assets into cash, in order to pay-off short-term business and financial obligation.

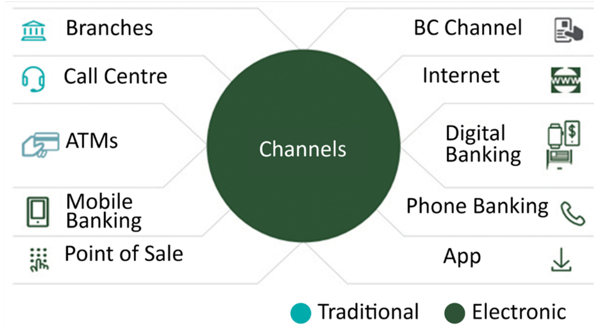
Figure - 1



However, in the 21st century, modernization of the bank through digital transformation would affect all the bank-specific factors because harnessing the data generated by a bank for automating business processes and cost reduction plays an important role in achieving competitive edge. The source of such high velocity and high volume data are various digital touch points enabled by various devices held by the customers and their digital literacy. The Omni-channel presence of the bank can be further supplemented with artificial intelligence, machine learning and cloud technology.

The Omni-channel usually refers to the digital mediums such as mobile phone, laptop and other handheld devices, however, brick-and-mortar branch of the bank also forms a part of omni-channel. Despite the advancement in digital economy, the trust on a particular bank is attributed to its physical presence and the long-standing reputation of the bank. The RBI's Master Circular titled "Mobile Banking Transactions in India - Operative Guidelines for Banks" issued in 2015 also asserts this criterion for digital banking service provider to have a physical presence.

Figure - 2



Sin qua non for Neo Banks

The contemporary Neo-banks have constraints for establishing themselves in India as the financial regulatory framework is not in their favour to operate as an individual organisation. They usually partner with an established bank for increasing the customer base in order to provide value-added services. A Neo bank typically acts as a facilitator for providing the banking services and verify KYC data received.

The partnership arrangement between a non-bank and bank is expected to abide by the RBI Guidelines, 2006 on 'Managing Risks and Code of Conduct in Outsourcing of Financial Services by banks' as well as the RBI Guidelines, 2010 on 'Financial Inclusion by Extension of Banking Services - Use of Business Correspondents (BCs)'. Neo Banks are currently targeting the MSME sector for providing credit to the underserved market, as the credit gap is expected to be 20 - 25 trillion. Neo banks made the corporate loan disbursal process seamless, which is usually considered as complicated and long process owing to the underwriting requirement.

The value added services provided by the Neo bank is appreciated by the tech-savvy and young customers because these services can be effortlessly availed through different channels. Some of the notable features and services offered are:

- Opening savings / current account
- Operating savings / current account with a licensed bank
- Access to loan offers or applying for loans
- Issuance of co-branded cards
- Payment gateway facilities
- Personal finance
- Expense management
- Invoice generation
- Accounting
- GST compliance
- Payroll management
- Enterprise resource planning

Progress of Far-east Neighbours

Countries such as Singapore and Taiwan have already made remarkable progress in creating a framework for digital only bank. For instance, Monetary Authority of Singapore (MAS) has devised a framework delineating the phases which a prospective digital bank has to go through to attain the status of autonomous fully functioning digital bank. Success of regulatory sandboxes in launching a digital bank has been witnessed by the Monetary Authority of Singapore.

Full Digital Bank

Entry Point	Progression

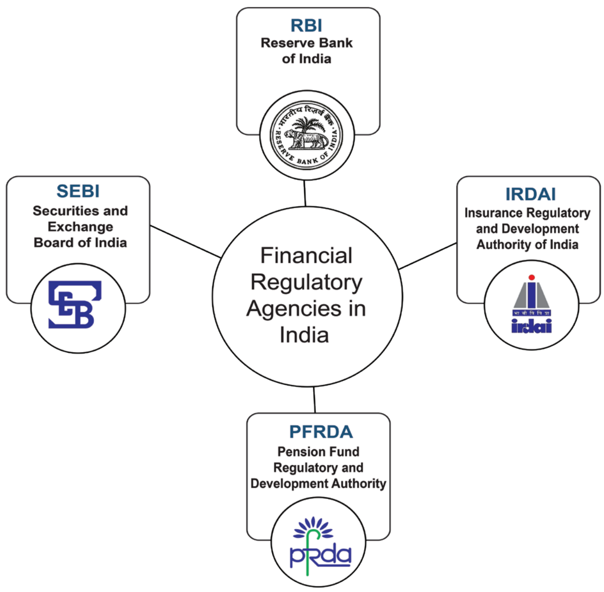
Minimum Paid-up capital	S$15m	progressively increase	To S$1.5bn
Deposit caps	**Aggregate deposit cap**: S$50m deposits Only can accept deposits from limited scope of depositors **Individual depositor cap**: S$75k	**Aggregate deposit cap**: To increase subject to meeting MAS' criteria **Individual depositor cap**: S$75k	**No deposit cap**
	Covered by Deposit Insurance Scheme		
Capital and liquidity rules	**Capital**: Same as local banks **Liquidity**: 16% minimum liquid assets		**Capital**: Same as local banks **Liquidity**: Same as local banks
Business restrictions	Offer simple credit and investment products 4 Banking operations in not more than 2 overseas markets	No business restrictions after meeting MAS' criteria	Full functioning bank
	• Physical place of business only • No minimum account balance and fall below fees • Compliance with unsecured credit rules •Allowed to offer cashback services through electronic funds transfer at point of sale (EFTPOS) terminals at retail merchants, but no access to automated teller machines ("ATMs") or cash deposit machines ("CDMs") network		

Regulatory bodies

The main objective of governmental institutions pertaining to BFSI (Banking, Financial Services and Insurance) sector is to ensure the following:

- Financial Stability
- Consumer Protection
- Market Confidence
- Controlling the rate of financial fraud/Crimes

Figure - 3



Among the major institutions in a country, a Central bank like Reserve Bank of India (RBI) is entrusted with the task of coordinating with other regulatory bodies and formulating broad policies related to banking and monetary stability.

RBI is also expected to supervise banks of varied functions. RBI monitors and regulates the Financial Technology (FinTech) in India. It initially played a superficial role but is gradually becoming holistic regulator. The central bank had also issued an Ombudsman scheme for handling complaints related to digital transactions on January 31, 2019. The concern of security is also considered by the RBI which is evident by the multiple clauses formulated for limiting the liability of the retail customer.

National Payments Corporation of India (NCPI) is another quasi-regulatory body in the digital payment space in the retail sector. It is a very successful initiative of IBA and RBI with the objective of developing a reliable retail payment and settlement infrastructure.

Unique Identification Authority of India (UIDAI) is a statutory body that governs the way Aadhaar is employed by the companies in the FinTech realm for on boarding new customers.

Smart phones are expected to be a medium for gauging and enhancing the e-governance initiatives of the institutions like **Ministry of Electronics and Information Technology (MEITY)**. It has the objective of promoting e-Governance by ensuring inclusive and sustainable growth of electronics, Information Technology and Information Technology enabled services in the country.

Incumbent frameworks that govern the FinTech:

- **Payment and Settlement Systems Act (PSS Act) -** This governs the entire payment lifecycle with RBI as the Authority.
- **Prepaid Payment Instruments (PPI) Master Direction** - This was issued on October 11, 2017. It contains the criteria for PPI issuers and operational protocols to be followed and inter alia definitions.
- **NPCI guidelines for UPI payments** - This framework allows only the licensed banks to integrate with the UPI platform for offering payment and digital money transfer services.
- **Master Directions, NBFC, P2P lending platform directions, 2017** - It prescribes the Peer to Peer lender exposure norms and aggregate borrowing limits along with operational protocols.
- **Guidelines for governing payment aggregators** - Payment Intermediary Guidelines were released

on March 17, 2020 for governing payment intermediaries on their baseline technology recommendations.

- **Data Privacy -** The Informational Technology Act, 2000 and IT Rules, 2011 govern the perception of personal data. Justice Srikrishna Committee recommended some points to strengthen Personal Data Protection Bill, 2019, which was critiqued by Joint Parliamentary Committee.
- **Data Protection** - Personal Data Protection Bill is derived from an international regulatory framework General Data Protection Regulation (GDPR) of European Union (EU) which is known for its 7 principles viz. Lawfulness, Fairness and Transparency, Purpose limitation, Data minimisation, Accuracy, Storage limitation, Integrity and Confidentiality (Security) Accountability.

Regulatory Sandbox

RBI had issued a 'Draft Enabling Framework for Regulatory Sandbox' in 2018 which in turn was refined into 'Enabling Framework for Regulatory Sandbox' in 2019 after receiving comments and feedback from the general public.

RBI employs regulatory sandbox technique for assessing the performance of new financial innovations and test its acceptance among the target customers or general public. This regulatory sandbox was used as preliminary test for issuing licenses to Small Finance Banks and Payment Banks. Similarly, RBI must take adequate steps for easing the mandatory criteria of having minimum physical branches for issuing full-fledged digital banking licenses.

The eligibility criteria for a startup or a new financial product to be a part of regulatory sandbox:

(I) Net worth of at least INR 1 million

(II) Satisfactory credit score/history of promoters and directors

(III) Promoters and directors of the applicant entity meeting the prescribed 'fit and proper' criteria

(IV) Demonstrated ability to comply with personal data protection laws

(V) Adequate IT infrastructure and safeguards to protect against unauthorised access, destruction and disclosure.

Future Institutions and Regulation

Regulatory equity

The regulatory framework should devise in a manner to ensure that they do not serve as a nemesis to the emerging FinTech players and innovative features in the market place. The financial statutes may strive to keep in check the integrity and consumer security.

De facto regulation

A methodical imposition of regulation i.e. considering the gradual increase in stringency or intensity of regulation and its scope. The regulatory requirement must be backed by technological principles rather than rules for barring a particular function or a service provider instead it must be flexible to the innovations that does not directly comply with the statutes imposed by the Institutions.

Neo Banks and the banks of the future

The modus operandi of the banks will see a paradigm shift. Banking will be collaborative in the future. They are changing the face of FinTech and could one day eclipse traditional banks. Neo banks exist virtually and is purported to serve the customers who expect convenience and digital features which the physical branches lack. For now, the Neo banks collaborate with major banks with licenses to offer certain services because the Reserve Bank of India (RBI) does not authorise full-fledged digital banking.

Neo banks are agile as opposed to the traditional banks i.e they are capable of executing any new visions pertaining to the services and can supplement them with the partnerships with ease. These banks can reach those underserved customers in the retail and SME sectors.

Innovation and differentiation are the core factors in achieving competitive edge in any sector, especially in BFSI realm. The customers of the traditional BFSI companies have a perception of banking services in lines of a commodity. Thus, Neo banks or 'banks of the future' will exhibit high competitive spirit to meet the high standards of individual customers which in turn would lead to constant improvement in the quality of customer service available in the market.

Digital Literacy

45% of India's populace have found their way online. The incumbent digitalisation is also corroborated by the Financial Inclusion Index of RBI which is at 53.9 as of March 2021. Thus, online businesses are expected to proliferate to harness Indian Government's active involvement in nurturing the nation's financial inclusion goal. An ASSOCHAM - PwC, 2019 study revealed that by 2023 the country's online transaction value is expected to increase by 100% to $135 billion. However, further incentives are required for fuelling the use of digital finance features, many barriers across economy and social strata are expected to be overcome.

The digital inclusion has been made feasible through digital literacy; digital literacy and digital payment adoption in turn is dependent on various factors that enable the acceptance of technology few factors are listed below:

- User Interface and User experience (easy-to-use mobile application)
- Perceived usefulness
- Multiple regional language modes
- Speed
- Trust

New-generation NBFCs are leveraging partnership networks across the value chain of lead generation, client on boarding, underwriting, credit/loan disbursement, and collection more than ever before.

Financial Inclusion

Indian economy is ranked 2nd among the nation where digital finance and banking has not made significant strides. RBI's Financial Inclusion Index of 53.9 points highlights the fact that many people in the country are not exposed to digitalisation process. Indian Government has categorically recognised the importance of financial inclusion for reaching new highs in the productivity, initiatives such as 'Aatmanirbhar Bharat' aims to make India a 5 trillion economy. COVID-19 pandemic has proved that rural Indian economy can adapt to the plight by adopting digital payment mode when the situation was dire. Pradhan Mantri Jan Dhan Yojana (PMJDY) was launched in 2014 with the objective of nurturing financial inclusion by making the financial services more accessible and affordable to the underserved and remote communities.

JAM trinity (Jan Dhan, Aadhaar and Mobile) is another pivotal initiative of the Government for acquiring the trust of public. Here, Jan Dhan accounts, created for the beneficiaries of the Direct Benefit Transfer (DBT) programs, are linked with Aadhaar and mobile numbers. This initiative has increased the trust of the public on Government and the digital economy because it controls the frauds related to Government subsidies. There are close to 430 million bank accounts valued at 1.46 trillion, where 67% of account holders are from rural and semi-urban part of the country. It is to be noted that country's 65% of the population reside in the rural India and they are ones in need of digital literacy. JAM initiative yielded because the credit gap has gotten covered significantly and many Liability Groups (JLGs) and Self-Help Groups (SHGs) have raised funds.

Nascent and promising FinTechs of India

The new FinTech startups are specialising in a unique way on various functions of different classes of banks viz.

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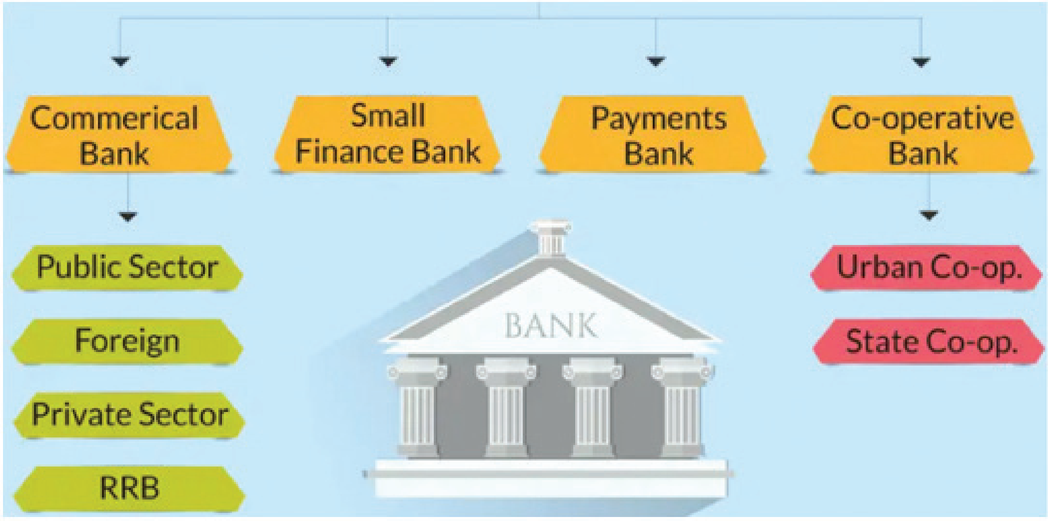

- Co-operative Banks
- Commercial Banks
- Regional Rural Banks (RRB)
- Local Area Banks (LAB)
- Specialized Banks
- Small Finance Banks
- Payments Banks

They are not issued licences by the RBI to operate solo, so they partner with licenced banks and financial institution for KYC and ratification of documents.

Startup	Established in	About
Lendingkart	2014	Working capital loans to MSE with minimal documentation. The USP is funding for entrepreneurs at their fingertips.
MoneyTap	2015	It is an NBFC which collaborates with the institutions regulated by RBI. Moderate cash loans, quick mobile credit and flexible EMIs. Signing-up and eligibility check in less than 15 minutes.
Instamojo	2012	A platform for startups, SMEs for expanding the business using a gamut of applications for handling finance, credit, logistics and e-commerce digitally (Mobile and Web)
Shiksha Finance	2014	A platform for educational institutions to raise funds. Amount ranging between Rs.10,000 and Rs. 30,050 for a tenure of 6 - 10 months.
ZestMoney	2015	A top platform for digital financing featuring artificial intelligence based recommendation system.

Many accelerators and incubators for growing the startups in FinTech realm are established and funded by several Governmental agencies and private trusts.

Centre for Innovation, Incubation & Entrepreneurship (CIIE.CO) is a one such renowned incubator of IIM Ahmedabad which houses the Financial Inclusion

Lab endorsed by Bill & Melinda Gates Foundation, J. P. Morgan, Michael & Susan Dell Foundation, MetLife Foundation, Omidyar Network, and runs in collaboration with MSC Consulting.

Conclusion

The Banking Regulation Act has defined a Banking company as any company which transacts the business of banking. Thus, a bank is a prerequisite for providing banking services, however its physical presence is optional. The perception of word 'banking' will undergo transformation, customer service, a differentiating factor among the FinTech players will be given more importance than the expected rate of return. The technology would enable a strong and persistent networking with its customers, although not in person. Tech savvy customers would prefer to avail banking services from any place through their handheld devices. The clarity and intuitiveness of the user interface would play a pivotal role in experiencing a reliable banking services because banking will be embedded into a lifestyle. The future will certainly pave way fully digital bank, but the time period which needs to be lapsed to reach that future is hard to determine and it is contingent to the rate of digital literacy and its percolation across the social strata along with the acceptance of financial company which has been established online.

The Regulatory frameworks that governs the launch and sustenance of new financial products also needs to be framed in such a manner that it does not mandate outright prohibition of financial innovations for small transgressions against few clauses. Regulatory sandboxes are very functional when it comes to assessing a new FinTech establishment and the newly launched products. The regulators such as IBA can increase the accessibility easily through digital means rather than establishing brick-and-mortar banks in remote locations. IBA should consider this and conduct an exercise and decide where banks should have a physical presence and where we are able to serve customers even without physical branch.

The era of digitalisation and financial inclusion has changed the battle ground for the players in the BFSI sector. FinTech companies are gaining prominence because of their esoteric knowledge which involves financial strategy in combination with the processing power of the computer. Bespoke applications and features can only be developed with the help of information technology and since personalisation becomes an important factor in providing satisfactory customer service, confluence of finance and technology will be appreciated for times to come.

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