DVARA Research

A Strategy for Comprehensive Financial Inclusion

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Executive Summary

Ensuring comprehensive financial inclusion for low-income households (LIH) involves enabling access to basic financial services such as savings, credit, insurance and pensions in a manner that meets their financial needs and aspirations. Past efforts in India, both by the Government and private sector, have focused on providing access to bank accounts and credit access to non-credit financial products such as insurance, investment and retirement products continue to remain very low. This report documents the results of a study conducted by Dvara Research to understand the challenges across the customer life-cycle experience with these products. While we assume that demand for these products is universal, for the purpose of this study, we hypothesize that supply-side challenges in these products are less understood or addressed by financial service providers and policymakers as compared to that of the domains of payments and credit. The study undertook a deep dive into three categories of origination models, namely, traditional mono-product providers, the more recent multi-product providers, and the newest entrant digital-only fintech models, and interviewed a set of practitioners across these categories.

The study found a set of issues that were common across all origination models, a smaller set of issues that were specific to certain institution- or product-types, and a set of issues with distribution channel design and incentive design. There also exists certain issues in KYC and payment systems that are universal to all financial services providers, that have resulted in inadequate infrastructure needed to enable sustained financial transactions in these products. The absence of such infrastructure was found to result in higher costs, making the business of delivering these products to LIHs commercially unviable.

The study found that difficulties in prioritising insurance, investment and retirement products in the sale conversation and training the customer-facing representative to have such a multi-product sale conversation were two issues that all multi-product origination models faced. These, along with certain regulatory restrictions on Payments Banks and market practices for Business Correspondents were hindering the ability of multi-product providers from realising the full potential that their extensive networks could enable. The study also identified certain prescriptive product- or customer-segment specific regulations have led to design of products at the manufacturer-level, that were inadequate or unsuitable for LIHs. The lack of business strategies and business models focussed on the low-income customer, and the prevalence of mis-leading and unsuitable sales practices have resulted in loss of trust in formal providers.

This report lays out a set of recommendations that we believe would be catalytic to solving these challenges that the study revealed. These are bucketed into Distribution Channel Design, Operations and Suitability, Business Cost Reduction, and Product Design.

The recommendations on Distribution Channel Design call for all regulators to jointly agree upon a common set of eligibility rules that corporate financial services providers must meet to become eligible for a 'Financial Services Intermediary' license. Existing distribution / licensing types can be gradually collapsed into this license. . Additionally, the RBI can consider introducing a differentiated registration and certification mechanism for corporate BCs that have large ABC networks, large

clientele and multiple bank partnerships. Such a mechanism will make it possible for a 'marketplace' of banking products to evolve and can become a precursor to the evolution of a truly white-labelled BC model. A tiered approach to grading of BC agents can significantly release capacity constraints as a bottleneck for the BC model.

The recommendations on Operations and Suitability pertain to subjecting all distributors to the same standards of conduct towards their customers, irrespective of their licensing types. This can be in the form of a set of universal conduct obligations applied uniformly across all regulated entities. Also, the various financial sector regulators must jointly agree upon a set of suitability principles that govern the relevant financial functions such as 'investment', 'risk protection' and 'retirement income' that the products under question must abide by. Each regulator can then lay down prescriptive guidelines around how to meet these principles. Following this, regulators need to mandate the need for completing suitability assessments on providers, which they then supervise stringently. The regulator also needs to specify a set of globally unsuitable products that cannot be offered to households or businesses below a certain income threshold or net worth or individuals above a certain age. All incentive design must incentivise behaviour of distributors that is aligned with the right outcomes from these products for the low-income household. For this, the report lays out a set of guiding rules that can be applied.

The recommendations on Business Cost Reduction pertain to cost-reduction that can accrue from having a centralized KYC regime with two important functionalities: a) it allows an institution to reuse KYC completed at the time of customer-on-boarding for another product for the same customer (product overseen by a separate regulator), and b) it allows an institution to rely on KYC verified by another institution for the same customer whether or not the two institutions are regulated under the same regulator). Payments infrastructure that can support automating repeat transactions and the earmarking of small-ticket amounts for specific purposes, is needed across the length and breadth of the country in a uniform manner to significantly bring down operating costs for providers in executing these repeat transactions.

The recommendations on Product Design call for removing certain regulatory prescriptions at the product- or customer segment-level, that have resulted in the creation and sale of products that are inadequate to serve the needs of LIHs.

Overall, the recommendations in the report are aimed at enabling providers to deliver a comprehensive suite of products seamlessly at the point of contact with the customer, instead of the customer having to approach many different providers separately. We hope these recommendations can pave the way for attaining a robust financial system that is able to provide the functions of 'investment', 'risk protection' and 'retirement-income' in a reliable, convenient and continuous manner to its customers.

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1. Introduction and Background

Individuals, households and enterprises need a safe and an easily accessible place to store their savings, a way to access inexpensive credit for cash flow management and for increasing the capacity of their business concerns, insurance that can cover them adequately and protect them from the financial burden associated with shocks and unforeseeable events, and reliable investment options that are uncorrelated with risks of the local economy and that can be relied upon to meet a spectrum of long term goals based on their financial lives, ranging from education to pension. A robust financial system would be able to provide these functions in a reliable, convenient and continuous manner. Morduch and Rutherford (2003)[2] defines the important dimensions of access to financial services as being (a) reliability – whether finance is available when needed or desired, (b) convenience – how easy it is to access finance, (c) continuity – ability to access finance repeatedly, and (d) flexibility – whether the product is tailored to the needs of the household or enterprise.

Financial Inclusion is therefore used to describe a whole set of policy and practitioner efforts towards enabling individuals to have access to basic financial services such as savings, loans, insurance and pensions in a manner that meets the dimensions stated by Morduch and Rutherford (2003). However, the efforts in financial inclusion in India has been dominated by access to bank accounts and credit, as seen in the initiatives of the Government and the Reserve Bank of India (RBI). While challenges remain on last-mile financial connectivity and increasing the usage of bank accounts and credit facilities, significant progress has been made on the access front.

Global Findex Report 2017 indicates that 80% of Indians now have access to a bank account, an increase from 53% in 2014. Out of the 514 million bank accounts opened globally during 2014-17, around 55% were from India.[3] This was driven by the Government's National Mission for Financial Inclusion (NMFI), namely, Pradhan Mantri Jan Dhan Yojana (PMJDY) initiated in August 2014[4], through which, as of 30th September 2019, 370.5 million Jan Dhan accounts have been opened.[5] The Jan Dhan scheme is part of the JAM trinity (Aadhar cards for identity and mobile number for traceability and communication) which aims to achieve large scale, technology-enabled, real-time cash transfers of different government schemes, also referred to as Direct Benefit Transfers (DBT). These trends suggest that we are within striking distance of universal access to bank accounts.

The account usage data has been less encouraging. The Global Findex Report 2017 shows us that 39% of Indians (15 years and above) had made no deposit or withdrawal from a financial institution in the past one year, only 20% saved at a financial institution and 7% sent or received domestic remittances using an account. Other banking activities like receiving payments or wages and paying utility bills too are used by a very low percentage of the population, at less than 7%. The RBI in its efforts to further

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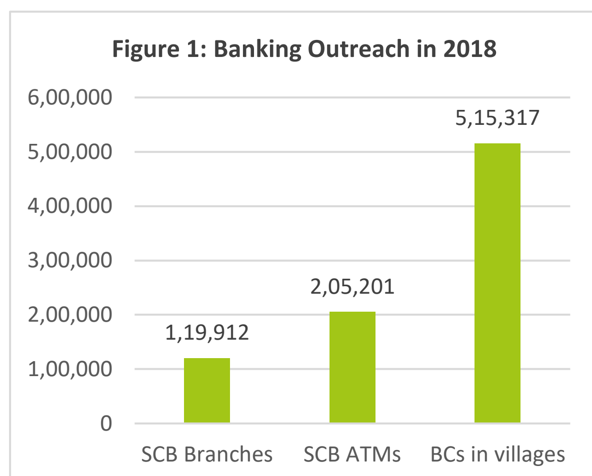
[2] Microfinance: Analytical Issues for India. Essay for the World Bank, South Asia Region. Morduch, J and S Rutherford. Finance and Private Sector Development, April 2003. World Bank

[3] Global Findex Report, The World Bank, 2017, accessible at: https://globalfindex.worldbank.org/

[4] Financial Inclusion, Department of Financial Services, Government of India, accessible at: https://financialservices.gov.in/financial-inclusion

[5] Performance Dashboard, Transforming India Portal, Government of India, accessible at: https://transformingindia.mygov.in/performance-dashboard/

account usage and access to basic services has licensed a set of payments banks[6] and small finance banks[7] to improve access to payments and transactions and bank credit and services in unbanked and under-banked regions (See Figures 2, 3). This is in addition to the earlier initiative of increasing the coverage of Banking Correspondents (See Figure 1[8]).



With the creation of enabling public infrastructure for digital payments and the advent of digital modes of transactions gaining prevalence, significant inroads have been made in transactions/payments inclusion and credit inclusion. With AePS permitted for receiving DBT benefits and more than 800,000 BC points in existence, about 200,000 ATMs[9], as well as the introduction of payments banks on the physical payments front, and with UPI-infrastructure adding to existing inter-bank payments systems gaining ground on digital payments front, there has been considerable increase in banking transactions. As of July 2019, there were 4.25 million Point of Sale (PoS) terminals deployed.[10] There has been considerable progress in the deployment of PoS terminals, with a CAGR of 33%% over the period 2014 to 2019.The total transaction value of digital payments as of May 2019 is Rs. 4.6 trillion and set to grow at a CAGR of 20.2%. [11]

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[6] RBI releases Guidelines for Licensing of Payments Banks, November 2014, accessible at: https://www.rbi.org.in/scripts/BS_PressReleaseDisplay.aspx?prid=32615

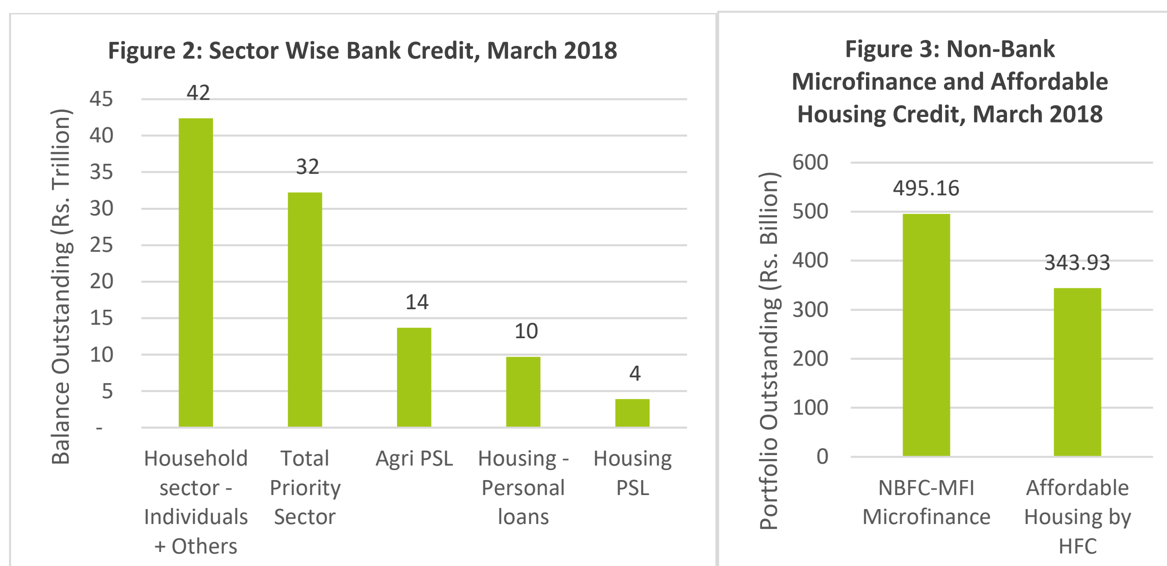
[7] RBI releases Guidelines for Licensing of Small Finance Banks in the Private Sector, November 2014, accessible at: https://www.rbi.org.in/Scripts/BS_PressReleaseDisplay.aspx?prid=32614

[8] Source: Appendix Table IV.7 Branches and ATMs of Scheduled Commercial Banks, Report on Trend and Progress of Banking in India 2017-18, RBI, accessible at: https://www.rbi.org.in/scripts/AnnualPublications.aspx?head=Trend%20and%20Progress%20of%20Banking%20in%20Indi a; Table IV.6: Financial Inclusion Plan: A Progress Report, RBI Annual Report 2018, accessible at: https://rbidocs.rbi.org.in/rdocs/AnnualReport/PDFs/0ANNUALREPORT2018193CB8CB2D3DEE4EFA8D6F0F6BD624CEDE.PD F

[9] ATM and card statistics for August 2019, accessible at: https://www.rbi.org.in/scripts/ATMView.aspx?atmid=102

[10] Bank-wise ATM/POS/ Card Statistics – July 2019, RBI Data Releases, accessible at: https://m.rbi.org.in/Scripts/ATMView.aspx#

[11] Emerging technologies disrupting the financial sector, Background Paper, PWC-Assocham, May 2019, accessible at: https://www.pwc.in/assets/pdfs/consulting/financial-services/fintech/publications/emerging-technologies-disrupting-the-financial-sector.pdf



Technology and internet-driven business models in financial services have seen rapid growth riding on initiatives of the Government and the RBI and aided by the enabling infrastructure created by the government including Unified Payments Interface (UPI), AePS platform for enabling biometric authentication for financial transactions, GSTN for small business invoice records, Bharat Broadband Network for creation of the National Optical Fiber Network (NOFN) for connectivity, Aadhaar pay for merchant payments, Common Service Centre (CSC) 2.0 scheme, and DigiLocker for paperless governance, among others. These initiatives are at varying stages of implementation but collectively represent a powerful digital infrastructure on which providers can further innovate.

FinTech innovations have been viewed as having the potential to provide solutions which can help tackle the issue of financial inclusion by lowering costs and enhancing efficiency. The various FinTech products/ services offered in the Indian financial markets include those by payments banks, mobile wallets, payment gateway providers, and payment infrastructures such as ATMs and m-POS on the payments side, digital credit solutions in lending and insurance, e-NPS, and mutual funds/ broking offered through digital platforms.[12]

Despite these developments on the supply side that can help providers reach out to individuals and households who were previously unbanked and underserved by formal financial services, the penetration and uptake of non-credit financial products such as insurance, investments, and pensions remain very low in India (See Section 2).

We examine the reasons for this and provide recommendations to improve the adoption of a broader range of financial services that will provide more resilience and growth opportunities to LIHs.

[12] Report of the Working Group on FinTech and Digital Banking, Reserve Bank of India, February 2018, accessible at: https://www.rbi.org.in/Scripts/PublicationReportDetails.aspx?UrlPage=&ID=892#ES

Box 1: Characterising the Indian Low-Income Household

Low-income households' (LIH) financial lives can be characterised by building their 'financial statements' to understand them through the lens of their cash flows, their profit and loss situation and their balance sheet consisting of assets and liabilities. A close look at a typical LIH's ***balance sheet*** indicates that their asset composition includes a) investments in illiquid and often indivisible assets like real estate, land, livestock[13] and b) low-value financial assets and their liabilities include multiple borrowing from institutional and non-institutional sources[14]. The liability composition of a balance sheet experiences a high churn of loans that are typically used to repay old loans and aid consumption smoothening[15] in the wake of their volatile cashflows. The illiquid and low-return investments are insufficient reserves to achieve their financial goals.

The ***cashflow statement*** of a household would comprise income earned and expenses, (including loan repayments) undertaken by household members. Literature shows that LIHs' cash inflows are usually irregular, volatile and seasonal. For instance, due to seasonality of occupation, agricultural households often cope with their income risks by diversifying their income sources and opting for multiple occupations at different seasons of the year[16]. The same can be observed for households involved in casual labour who are employed on temporary/contractual basis. Cashflow statements of LIHs are characterised by unpredictable inflows making it difficult for them to systematically build their reserves for future consumption or for subscribing to products that require equal monthly contributions.

The ***profit and loss statement*** of a household comprises of all the revenues (income sources, repayment of loans given to others, sale of homegrown/homemade items) and costs (expenses made towards household utilities, human capital investment, interest paid towards loans borrowed and material cost if selling homemade/homegrown items) preferably for a series of years. The profit and loss statement for a series of years would reflect their level of sustained profitability. However, given the vulnerability of their livelihoods, the contractual and seasonal nature of employment and volatile revenue streams, low-income households tend to have periods of time when expenses exceed income on an aggregate basis thus necessitating dipping into net worth by liquidating assets or incurring new liabilities.

These three financial statements, in combination, indicate the low-risk absorbing capacity of the households, particularly when faced with shock events like climate shocks, health shocks, unemployment shock, loss of livestock and so on. Empirical research conducted in rural India[17] indicates that when households face health shocks like illness, they typically cope by reducing consumption, working more, borrowing money and liquidating assets like jewellery. Often these events create short term and long-term negative impact for the household in terms of human capital disinvestment, erosion of safety net and increased stress levels. Another research on shocks[18] found coping mechanisms to differ based on household composition i.e. age profile, dependency ratio, occupational profile, geography and gender, thus underscoring the necessity to view the strategies as undertaken by a household unit instead of by individual members. These coping mechanisms are indicative of the low-risk absorption capacity of LIH as also corroborated and reflected by the financial statements.

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[13] Report of the Household Finance Committee, Reserve Bank of India, 2017, accessible at: https://rbidocs.rbi.org.in/rdocs/PublicationReport/Pdfs/HFCRA28D0415E2144A009112DD314ECF5C07.PDF

[14] Key Indicators of Debt and Investment in India, NSS 70th Round, Government of India, 2013, accessible at: http://www.mospi.gov.in/sites/default/files/publication_reports/KI_70_18.2_19dec14.pdf

[15] Portfolios of the Poor, data collected in 2000-2001

[16] NSSO Employment Statistics, 2011-12 for poorest 40% of rural households, accessible at: http://mospi.nic.in/sites/default/files/publication_reports/nss_report_554_31jan14.pdf

[17] Quintussi, M., Van de Poel, E., Panda, P., & Rutten, F. (2015). Economic consequences of ill-health for households in northern rural India. *BMC health services research*

[18] Dhanaraj, S. (2016). Economic vulnerability to health shocks and coping strategies: evidence from Andhra Pradesh, India. Health policy and planning, 31(6), 749-758

1.1 Scope of Study

Financial inclusion efforts have in the past been spearheaded by credit-dominant business models in India, with microfinance being the leading example. These business models have been able to scale operations in the delivery of small-ticket credit for low-income households. However, the operating cost of these models remain high, in the range of 6 – 12%.

Credit cannot be used as a substitute for savings or solve for problems such as retirement planning, and goal-based long-term savings. With experience and knowledge being created, the pathways between payments and credit are being better understood than those between payments and savings/investments or insurance, simply because the latter has not arrived at successful business models for serving low-income households.

We hypothesize that supply-side challenges of non-credit financial services available to low-income customers are less understood or addressed by financial service providers and policymakers. The combination of technology and financial services allows for several of these issues to be addressed, which was hitherto found difficult by traditional financial service providers, helping bridge the demand supply gaps.

Through our study, we attempt to understand the challenges in accessing and using non-credit products, namely insurance, investment and retirement products, by mapping the existing products and identifying gaps and barriers in the delivery channels for them. In doing so, we undertake a deep dive into three categories of origination models, namely, a) traditional mono-product providers, b) the more recent multi-product providers, and c) the newest entrant fintech models, to identify barriers that prevent uptake of these products by low-income households. Last, we identify the most catalytic interventions that can serve the poor and examine drivers for success in these interventions.

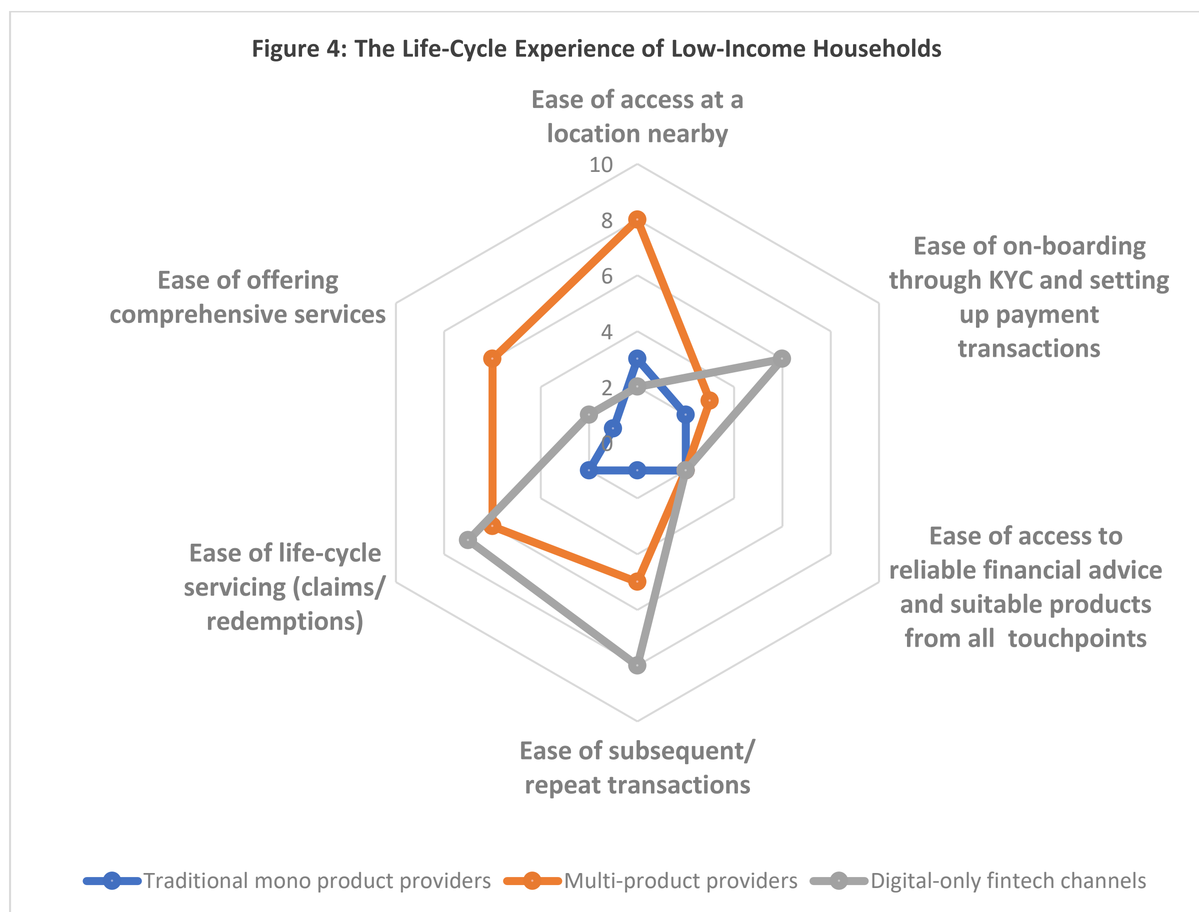
The study has been executed through a combination of secondary literature survey and a set of 21 interviews with practitioners across the three categories of models, investors and other stakeholders.

Table 1: Composition of Interview Respondents

Traditional mono-product providers	2 life insurers, 1 general insurer (with both offline and online presence), 1 actuary, 1 insurance broker,
Multi-product providers	2 payments banks, 1 small finance bank, 1 NBFC, 2 Corporate Business Correspondents
Digital-only Fintech models	5 investment plan providers, 1 credit provider (to understand digital payment issues), 1 provider of Online Dispute Resolution Systems
Investors	3 private equity investors

2. Current Status of Non-credit Financial Inclusion

We summarise our analysis of the current status of non-credit financial inclusion across the three origination models in the chart below. While each of the three categories of providers have their unique characteristics, the multi-product providers and digital-only fintech models fare relatively better compared to traditional mono-product providers when it comes to the quality of distribution to low-income households along the six dimensions in the chart (See Figure 4).



In the below sub-sections, we provide a detailed discussion of our findings around what the barriers might be that prevent these three categories of providers in providing welfare-enhancing comprehensive financial services to low-income households.

2.1 Insurance Products

Low-income households need risk management products which can at a minimum allow them to manage risks associated with death, disability and longevity of its members, death of livestock, and those associated with damage to crops and damage to property from rainfall and other extreme weather events.

The insurance market in India was dominated by Life Insurance Corporation of India (LIC) and the General Insurance Corporation of India (GIC) and its subsidiaries until the late 1990s. [19] In the year 2000, on the recommendations of a high-powered committee chaired by R.N Malhotra, the Insurance Regulatory and Development Authority of India (IRDAI) was incorporated to regulate, promote, and ensure orderly growth of insurance and re-insurance business in India and to protect the interests of the policyholder. Considered to be a milestone in the history of the insurance industry in India, the

[19] History of Insurance in India – Insurance Regulatory and Development Authority of India, accessible at: https://www.irdai.gov.in/ADMINCMS/cms/NormalData_Layout.aspx?page=PageNo4&mid=2

other key outcome of the committee's report was the opening of the industry to the private sector in the same year.[20]

The past two decades since the entry of private players in 2000 has seen the insurance industry grow significantly from having just 5 and 10 market participants in the life insurance and the general insurance business respectively to 24 and 44 insurance companies including the presence of foreign re-insurance companies. Over the past decade, the total premium income for the industry as a whole grew by 1.7 times from Rs 2.29 trillion in 2007-08 to Rs. 6.09 trillion for the financial year ending in 2017-18. It is to be noted that the market share of LIC and public sector General Insurance Companies based on the total premium incomes in 2017-18 stood at 69% and 51% respectively.[21]

Various delivery channels have been employed till date to deliver insurance products. These include individual agents, corporate agents, brokers, and through direct selling methods. In 2017-18, in the life insurance industry, while LIC was able to acquire individual new business mainly through its individual agents (95.6%), the dominant channel for private insurers was banks operating with corporate agent licenses (54.2%) followed by individual agents (27.9%). At an overall industry level, new individual business was acquired through individual agents (65.9%) followed by corporate agents (banks) (25.2%). For group insurance, new business was acquired mainly through direct selling.[22]

In the past decade, insurance distribution has seen a shift away from a LIC dominated network of individual agents to one that was dominated by banks selling insurance and insurance-cum-investment policies, further to the emergence of private insurance companies gradually occupying a sizeable pie of the insurance market (See Figures 5, 6, 7).

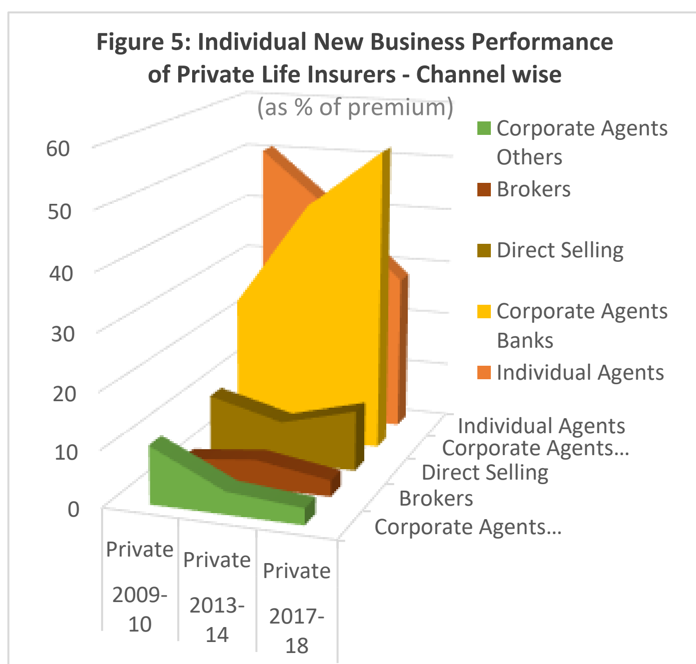


Figure 5: Individual New Business Performance of Private Life Insurers - Channel wise (as % of premium)

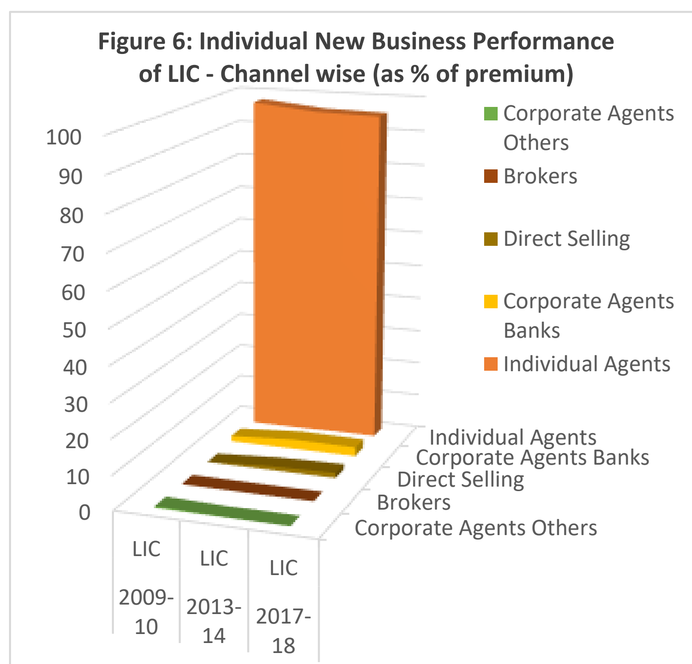


Figure 6: Individual New Business Performance of LIC - Channel wise (as % of premium)

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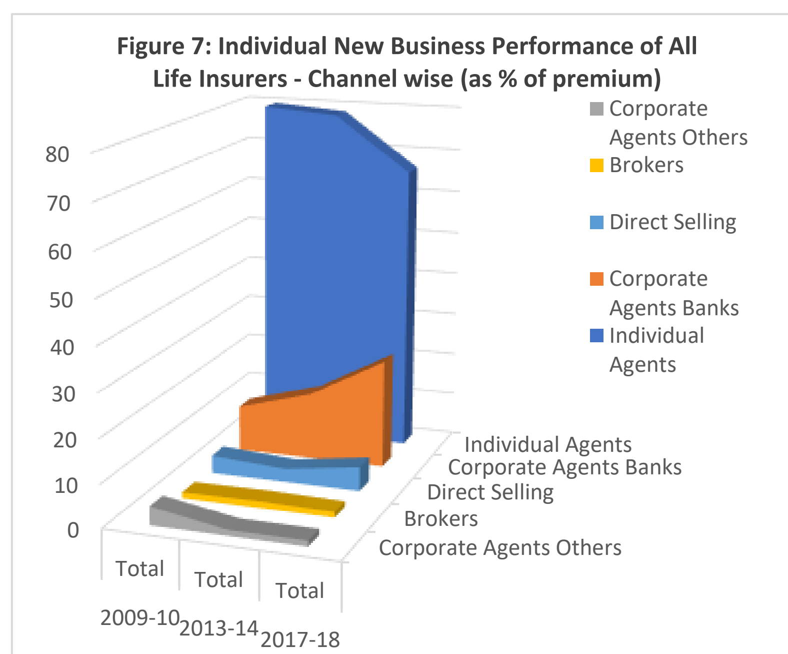
[20] Consultation Paper on Revision of the Insurance Act, 1938 & the Insurance Regulatory & Development Act, 1999, Law Commission of India, June 2003, accessible at: http://lawcommissionofindia.nic.in/consult_papers/insurance%201-27.pdf

[21] Handbook of Indian Insurance Statistics 2017-18, Insurance Regulatory & Development Authority of India, accessible at: https://www.irdai.gov.in/ADMINCMS/cms/frmGeneral_Layout.aspx?page=PageNo3729&flag=1

[22] Annual Report 2017-18, Insurance Regulatory & Development Authority of India, accessible at: https://www.irdai.gov.in/ADMINCMS/cms/Uploadedfiles/english_hindi_annual%20report%202018%20webcopy.pdf



The nature of life insurance products available to retail customers has been historically dominated by multi-year life plans sold by LIC. Such plans invariably have a return embedded in the product in the form of known bonus/money back at stipulated years during the term of the policy, and in many cases, an option to reinvest such bonus for further returns that will accrue to the customer at a later date during the term of the policy. These products were for many years, the only options available to Indian households to invest in financial instruments and have served as avenues for long-term investing. Since then, Unit Linked Insurance Plans (ULIP) were introduced to provide higher returns to customers. In both these product types, the available insurance cover/sum assured is much lower than that of a pure term life insurance product, but households in India have come to recognise insurance as an endowment-cum-investment product on which to expect returns, rather than considering insurance to be a pure expense for the household. Despite the growth witnessed in the insurance market, the persistency rates for the Indian insurance sector, tracked for the 13th, 25th, 37th, 49th and 61st months have been woefully low compared to global averages. Out of 24 life insurance companies in 2018, none crossed 90% persistency ratio for 13th month, 80% for the 37th month, or 65% for the 61st month[23].

Insurance penetration (measured as a ratio of premium to GDP, see Figure 8[24]) in India continues to be one of the lowest at 3.69% (as of 2017-18), and the number of individual life insurance policies in

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[23] Table 27: Persistency of life insurance policies (based on number of policies), Handbook of Indian Insurance Statistics, 2017-18, Insurance Regulatory & Development Authority of India, accessible at: https://www.irdai.gov.in/ADMINCMS/cms/--Select--?mid=11.2

[24] Collated from IRDAI Annual Reports

force at the end of 2017-18 was at 331 million. Insurance density (measured as a ratio of premium [in USD] to total population, see Figure 9[25]) was at USD 73 in 2017-18.[26]

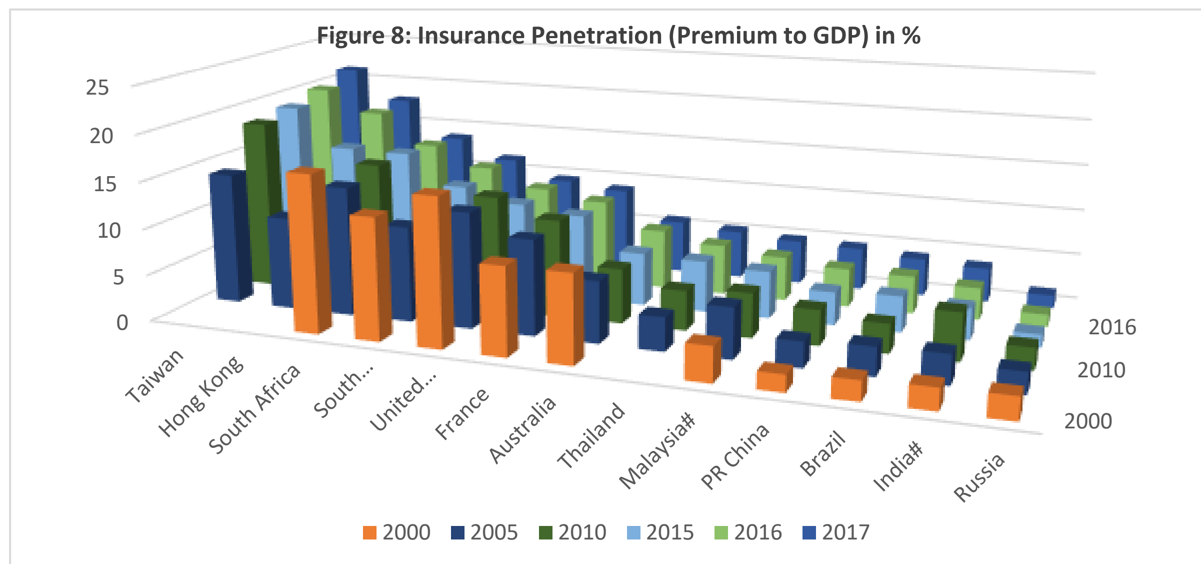

Figure 8: Insurance Penetration (Premium to GDP) in %

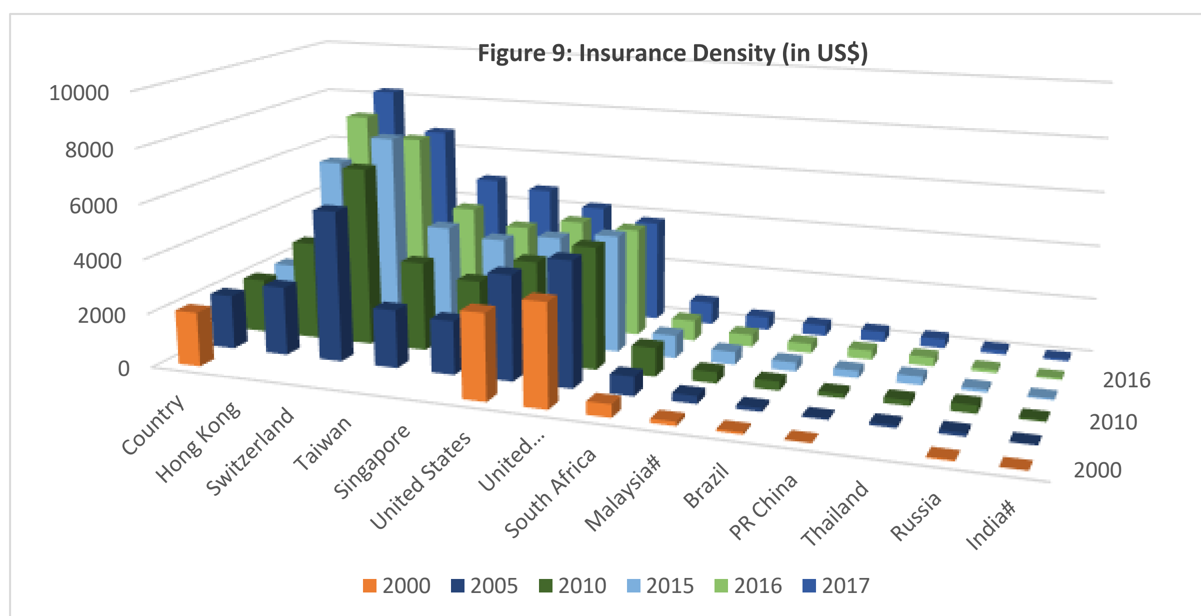

Figure 9: Insurance Density (in US$)

These figures indicate that a large section of the population is still uninsured or underinsured, reducing their ability to cope with and overcome financial shocks. According to our analysis of data by global reinsurer Swiss Re, an average working person is assured of only 8% of what may be required to protect a family after the death of an earning member[27]. This is much lower than the insurance coverage adequacy of 44% in Japan, 84% in Taiwan and 67% in Australia. This becomes an area of

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[25] Collated from IRDAI Annual Reports

[26] Annual Report 2017-18, Insurance Regulatory & Development Authority of India, accessible at: https://www.irdai.gov.in/ADMINCMS/cms/Uploadedfiles/english_hindi_annual%20report%202018%20webcopy.pdf

[27] "988 Mn Indians Do Not Have Life Insurance. Those Who Do, Are Insured For 7.8% Of What's Needed To Cover Financial Shock", Aparajita Singh, IndiaSpend, January 15, 2019, accessible at: https://www.indiaspend.com/988-mn-indians-do-not-have-life-insurance-those-who-do-are-insured-for-7-8-of-whats-needed-to-cover-financial-shock/

concern, especially in the case of poor households where insurance has been found to reduce the incidence of poverty.[28]

While such low-risk protection leaves low-income households especially vulnerable to financial shocks on account of various risks, the dominant insurance cover that these households have experienced, besides the LIC plans, is the credit-life insurance cover sold to them by lenders, such as NBFC-MFIs and other NBFCs. In such a cover which essentially protects the lender against default due to death of the borrower, the borrower pays premiums at the time of loan disbursement for obtaining a cover against the credit outstanding amount. Such a cover gets paid out to the lender from the life insurer in the event of the death of the borrower or co-borrower. However, such a cover is sub-optimal on account of three issues, a) it is not adequate life insurance in the sense that the coverage is way below that needed to sustain the nominee/household for a set number of years upon death of income-earner, b) it does not payout to the nominee but to the lender who uses it to cover one's credit exposure to the borrower and c) excessive premiums charged to the customer are used as a way to earn more by the lender who receives payments from the insurer in the form of commissions and marketing expenses[29].

Government-supported/Government-driven Insurance schemes

India has witnessed unprecedented government intervention in the delivery of pure term insurance relevant to low-income households with schemes including the PM's Jeevan Jyoti Bima Yojana (PMJJBY – one-year pure term life insurance), the Suraksha Bima Yojana (PMSBY – one-year insurance to cover accidental death and disability), the Jan Arogya Yojana/Ayushman Bharat Yojana (PMJAY – health insurance) and the Fasal Bima Yojana (PMFBY – crop insurance). While the former two schemes do not have a subsidy for the premium and are hence fully paid for by the insured, the premiums on PMFBY are partly subsidised through State and Central Government contributions and the premiums on PMJAY are fully subsidised between the Central and the State Governments.

The data available in the public domain suggests that these schemes have made significant inroads in coverage partly on account of its premia being auto-debited from PMJDY accounts. By December 2018[30], there have been 143 million and 56 million enrolments under the PMSBY and PMJJBY respectively. The number of claims disbursed under these schemes stood at 20,862 and 1,21,087, representing 0.014% and 0.21% for PMSBY and PMJJBY respectively. These indicators are, however, inadequate to comment on the efficacy of the scheme since the enrolment data used in this calculation is subject to revision[31]. Further, it seems that enrolment data is taken at a gross level and an annual performance snapshot is missing. For PMSBY and PMJJBY, the data on claims disbursed does not directly correspond to the more commonly used claim settlement ratio[32] and incidence of claims[33].

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[28] Morduch, J., Poverty and Vulnerability, 1994, The American Economic Review, Vol. 84, No. 2

[29] As stated by an interview respondent

[30] Department of Financial Services, Ministry of Finance, Government of India, accessible at: https://financialservices.gov.in/sites/default/files/Website%20Major%20Achievements%20November%202018.pdf

[31] Upon application for enrolment under PNJJBY and PBSBY, banks are required to verify the eligibility of the applicant. The data reported by the Ministry of Finance also includes applicants whose verification is pending.

[32] Claim settlement ratio refers to the number of claims received vs. the number of claims that were paid out

[33] Incidence of claim refers to the number of claims received in any given time (generally a year) vs. the number of policies in force

In case of PMJAY, 103 million e-cards have been issued with 4.65 million instances of availed benefits (hospital treatment),[34] as on September 2019. In case of PMFBY, the data (with settlements) is available only up to the Kharif 2017 season, whereunder 34.77 million farmers with a combined holding of 34.05 million hectares were insured, of which benefits were received by 13.79 million farmers. In terms of the sum insured and settlements paid, the former was Rs. 1.29 trillion and the latter stood at Rs. 172 billion[35]. However, akin to the cases of PMSBY and PMJJBY, the data released under the PMJAY and PMFBY are inadequate for an accurate comparison between these schemes and competing products being offered in the market.

Despite the limited data, researchers have over the years studied a few aspects of PMFBY, generally concentrating on specific regions. One study[36] concluded that in the Hyderabad-Karnataka region, there has been a decline in the farm-area covered between the Kharif 2016 and 2017 seasons and the number of farmers who were insured reduced in one of the regions. The settlement to premium ratio in the studied regions for Kharif season 2017 in the discussed period stood well below unity for the regions, varying between 0.64% and 0.99%, indicating their financial viability. However, given that only 29% of the total cropped area formed the net insured cropped area, the financial viability of insurance will come under pressure when a greater percentage of the cropped area gets insured. Similar observations were made by other studies[37] as well, as part of the performance evaluation of Pradhan Mantri Fasal Bima Yojana (PMFBY)'s Governance Analysis.

We, therefore, conclude that despite significant private participation in pure insurance markets and insurance underwriting, insurance, unfortunately, continues to be considered an investment rather than an expense by households due to historical reasons. Returns expectation, therefore, continues to be an important part of any sale conversation. Government initiatives have moved the envelope in this regard by bringing pure risk insurance for low-income households through affordable access. However, these efforts may not be a sustainable strategy to adopt for the long-term risk protection needs of low-income households and for the development of private insurance markets to fill the under-insurance gap in the country.

2.2 Investment Products

Low-income households need access to and ability to invest in a variety of asset classes whose returns are uncorrelated with each other, in order to ensure good diversification of risks. Their current levels of exposures to physical assets such as agricultural land, livestock, and one's own human capital comprise almost the whole of their portfolios, and their performance is highly correlated with the

[34] PMJAY Annual Report, 2018-19, accessible at: https://pmjay.gov.in/sites/default/files/2019-09/Annual%20Report%20-%20PMJAY%20small%20version_1.pdf

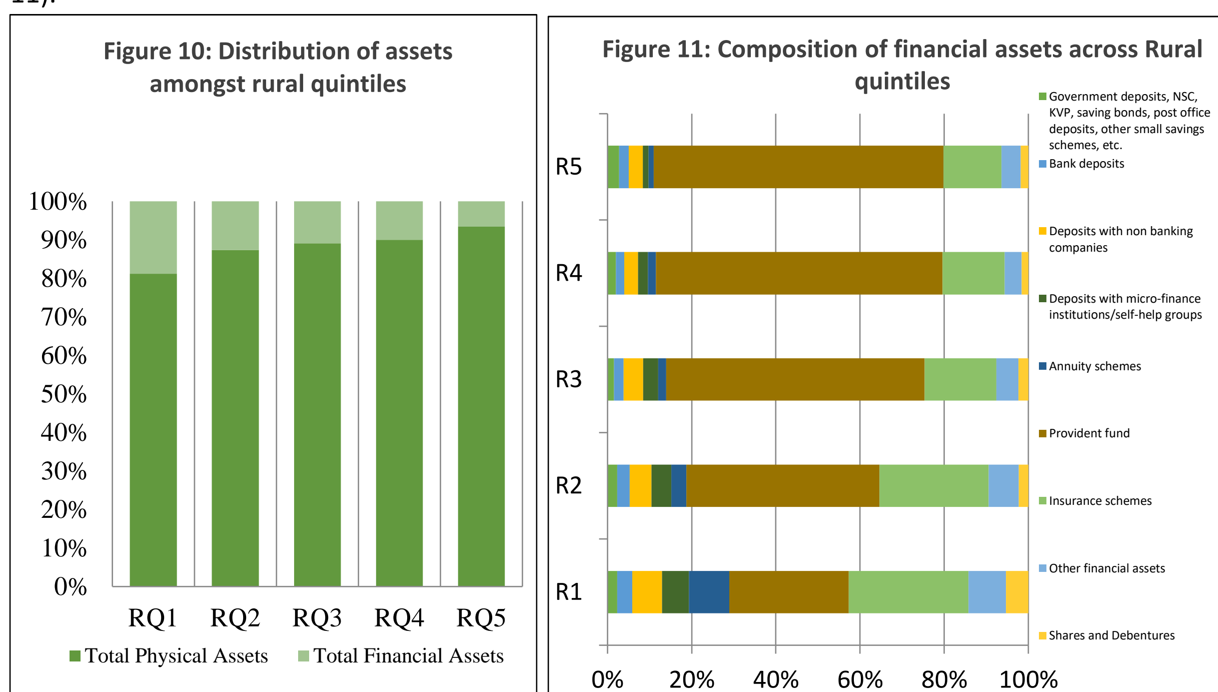
[35] Kharif 2017, Ministry of Agriculture & Farmers Welfare, Government of India, accessible at: https://pmfby.gov.in/pdf/Kharif_2017.pdf

[36] Performance of Pradhan Mantri Fasal Bima Yojana (PMFBY) in Hyderabad-Karnataka Region, A. Cariappa et al, J. Farm Sci., 31(4): (452-456) 2018, accessible at: https://www.researchgate.net/profile/A_G_Cariappa/publication/332222987_Performance_of_Pradhan_Mantri_Fasal_Bima_Yojana_PMFBY_in_Hyderabad-Karnataka_H-K_region/links/5ca7191e299bf118c4b343b0/Performance-of-Pradhan-Mantri-Fasal-Bima-Yojana-PMFBY-in-Hyderabad-Karnataka-H-K-region.pdf

[37] Report titled "Performance Evaluation of Pradhan Mantri Fasal Bima Yojana (PMFBY) Part I: Governance Analysis", Center for Management in in Agriculture under IIM Ahmedabad, August 2018, accessible at: https://www.iima.ac.in/c/document_library/get_file?uuid=ae2019ae-6e67-4ad8-964b-93c464f2223b&groupId=62390&filename=PMFBY%20(Part-I)%202018%20-%20Final%20Report%20-%20sent%20to%20MoA

local economy. Liquid Investment products must enable such households to manage unpredictable and erratic cash-flows. In its absence, several low-income households choose to invest in gold, which is held over the medium to long term. Households need investment avenues that can yield positive real returns for the purpose of meeting financial goals such as expenses relating to education, life events and retirement. Investment in equity through an index fund[38] obtains higher returns than the savings bank account and continues to do so over longer periods. These can generate long-term positive real returns with low volatility and lower costs as compared to investing in local physical assets such as land and gold.

In India, the composition of household assets is skewed towards physical assets such as land and building, which accounted for 94% of the total value of assets in rural areas and 92% in urban areas. At the national level, the average household held 77% of its total assets in real estate, 7% in other durable goods, 11% in gold, and only the residual 5% in financial assets (2% in rural areas and 5% in urban areas).[39] Taking a closer look at the household asset portfolios across rural wealth quintiles of the NSSO – AIDIS 2013 survey datasets, we see a predominance of physical assets among rural households (81 – 96% of asset holdings), and this increases along the quintiles RQ1 to RQ5. A closer look at the financial assets of the same rural quintiles indicate an almost complete reliance on provident funds and insurance schemes (which are usually endowment plans of LIC) (See Figures 10, 11).



Re-allocating assets towards financial markets and away from assets such as gold can greatly benefit the Indian households.[40] As per data published by the RBI, households in India hold their financial assets mainly in the form of currency, deposits, investments in debt securities, equities, mutual find units, insurance and pension funds and small savings. As at the end of Q2 of 2017-18, majority of the

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[38] Chapter 4: Asset Allocation, Portfolio Choice and Capital Asset Pricing Model, Financial engineering for Low-Income Households, edited by Bindu Ananth and Amit Shah, Sage Publications, April 2013

[39] Key Indicators of Debt and Investment in India, NSS 70th Round, Government of India, 2013, accessible at: http://www.mospi.gov.in/sites/default/files/publication_reports/KI_70_18.2_19dec14.pdf

[40] Report of the Household Finance Committee, Reserve Bank of India, 2017, accessible at: https://rbidocs.rbi.org.in/rdocs/PublicationReport/Pdfs/HFCRA28D0415E2144A009112DD314ECF5C07.PDF

financial assets at 48% were held in bank deposits, followed by life insurance funds at 20.9% and mutual funds at 13.1%.[41] Traditional products such as savings deposit and fixed deposits offered by banks have been found to provide negative real rate of returns.[42]

The mutual fund industry, which started in 1963 in India, has seen tremendous growth spread across several phases over the past few decades. At the end of the decade following the entry of private sector into the industry in 1993, there were 33 mutual funds with total assets of Rs. 1.22 trillion. With the establishment of the Securities and Exchange Board of India (SEBI) in 1992 as a statutory body, the mutual fund industry came under SEBI's scrutiny and is now regulated by the SEBI (Mutual Fund) Regulations 1996. [43]

Average Assets under Management (AUM) of Indian Mutual Fund industry has grown from Rs. 7.57 trillion as on 31st August 2009 to Rs. 25.48 trillion as on 31st August 2019, registering a 3 ½ fold increase in a span of 10 years. The total number of accounts (or folios as per mutual fund parlance) as on August 31, 2019, stood at 85.3 million, while the number of folios under Equity, Hybrid and Solution Oriented Schemes, wherein the maximum investment is from retail segment stood at 76.6 million.[44] Indian Mutual Funds have currently about 28.1 million Systematic Investment Plan (SIP) accounts through which investors regularly invest in Indian Mutual Fund schemes. AMFI data shows that the MF industry had added, on an average, 9.39 lacs SIP accounts each month during the FY 2019-20, with an average SIP size of about Rs. 2,900 per SIP account.[45]

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[41] Quarterly Estimates of Households' Financial Assets and Liabilities, RBI Bulletin, March 2018, accessible at: https://www.rbi.org.in/Scripts/BS_ViewBulletin.aspx?Id=17426#T3

[42] Report of the Committee on Comprehensive Financial Services for Small Businesses and Low Income Households, Reserve Bank of India, December 2013, accessible at: https://rbidocs.rbi.org.in/rdocs/PublicationReport/Pdfs/CFS070114RFL.pdf

[43] MF History, Association of Mutual Funds in India, accessible at: https://www.amfiindia.com/research-information/mf-history

[44] Indian Mutual Fund industry's Average Assets Under Management (AAUM) stood at Rs. 25.60 trillion, Association of Mutual Funds in India, accessible at: https://www.amfiindia.com/indian-mutual

[45] Mutual Fund SIPs accounts stood at 2.84 crore and the total amount collected through SIP during September 2019 was ₹8,263 crore, Association of Mutual Funds in India, accessible at: https://www.amfiindia.com/mutual-fund

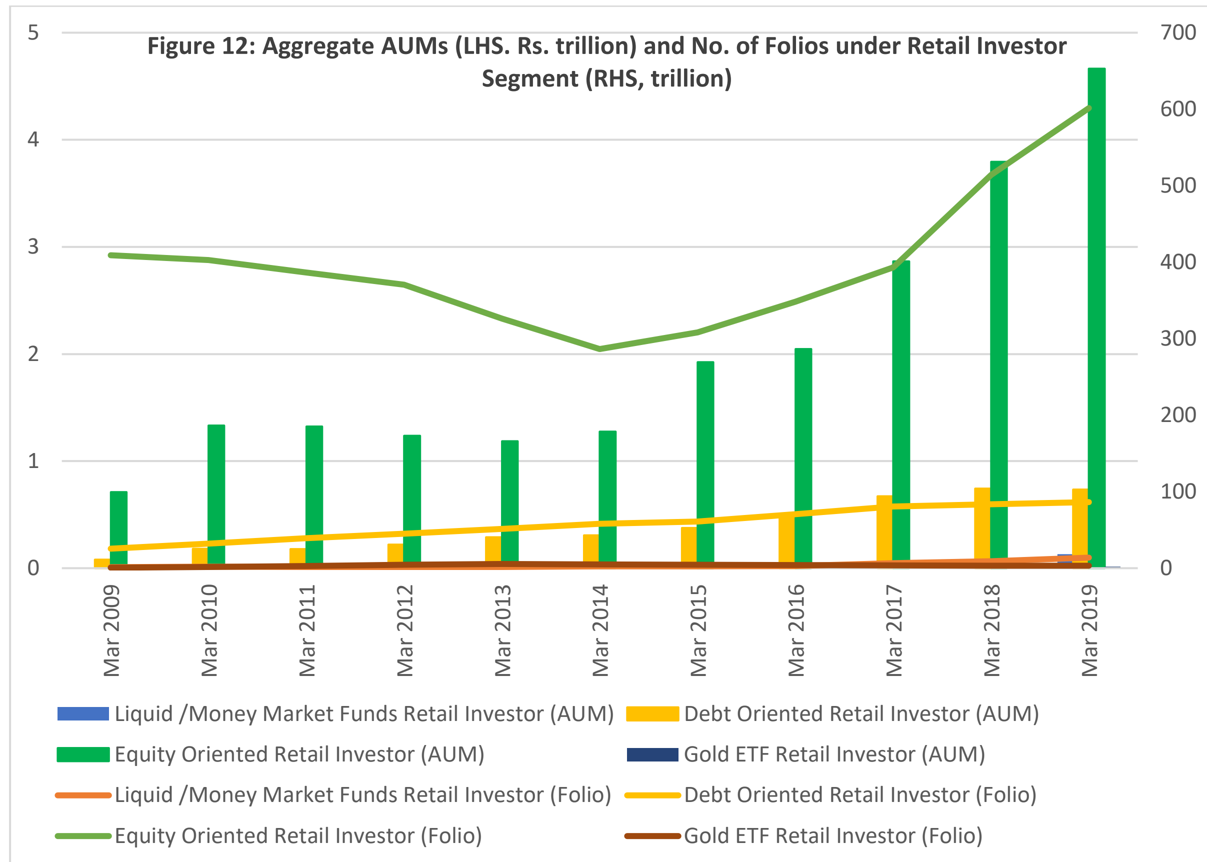

Figure 12 shows the growth in retail participation in the various categories of MFs across AUMs and number of folios held[46]). Retail consumers contribute over 52% to the AUM and make up over 95% of all the folios in equity oriented mutual funds. Over the last decade, the contribution of retail investors towards the AUM has increased from 23% to 35% and 4% to 10% in case of Gold exchange traded funds and debt-oriented funds respectively.

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[46] Corporates, banks/FIs, FIIs, High Networth Individuals, Association of Mutual Funds in India, accessible at: https://www.amfiindia.com/research-information/aum-data/age-wise-folio-data

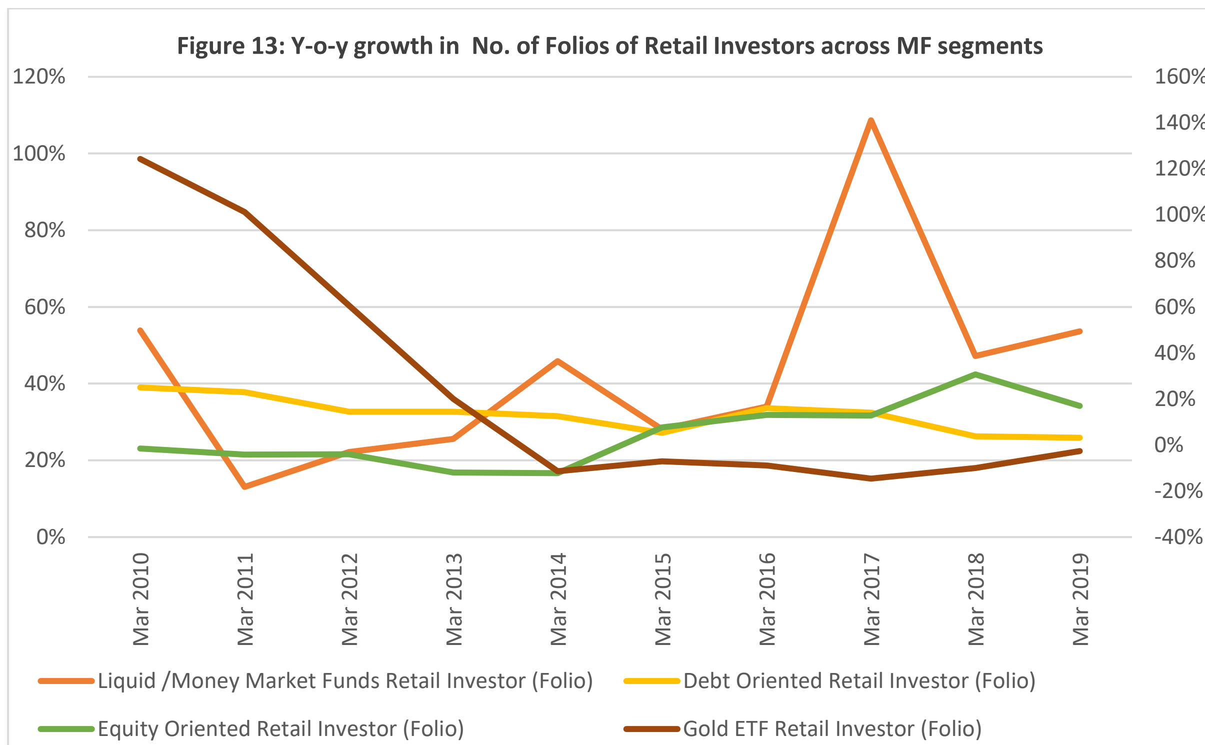
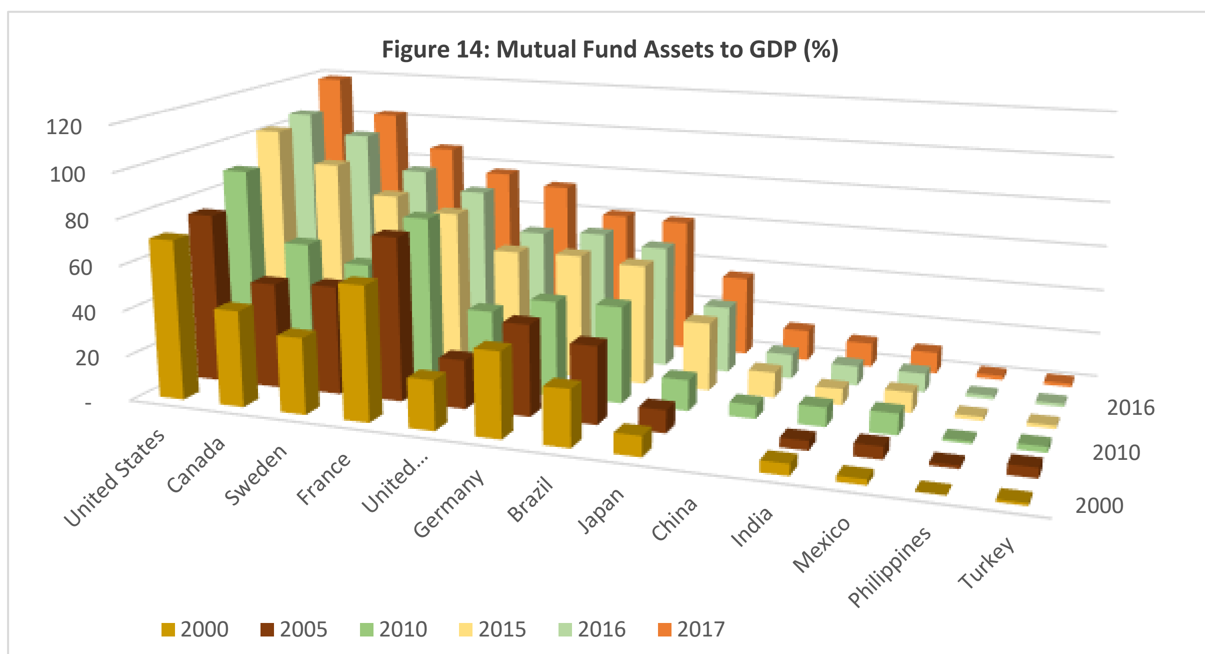


Figure 13 indicates the y-o-y growth in number of retail investor folios. While there has been a multi-year drop in growth of folios of gold ETFs, there is a marked systematic growth in equity-oriented, debt-oriented and liquid/money market mutual funds.



With AUM to GDP ratio at 12.7% in 2017-18, penetration of mutual funds in India is still low compared to the global average[47] (Also see Figure 14[48]). In August 2019, only 15% of the assets of the mutual fund industry came from B30 locations with a large proportion tending towards equity-oriented schemes[49] and 70% of the AUM was found to be concentrated in 5 states. Data also indicates that individual investors prefer hand-holding by distributors.[50]

In summary, households planning for long-term goals such as education of children and retirement, need access to formal investment products which can enable them to save systematically over a substantial period of time, protect them against inflation risk, and earn sufficient returns through exposures to debt and equity capital markets. Indian low-income households however, predominantly save in physical assets and in low- or negative- return financial assets. India, therefore, has a long journey to make in order to ensure low-income households have access to and take exposure in capital market instruments to meet their financial goals.

2.3 Retirement Products

Pension and annuity products provide income security in old age and in the absence of the same, financing of essential expenditure like food and health can leave households vulnerable to adverse shocks. It has been found that pension even at a minimal level, can be impactful in alleviation of poverty.[51] Therefore, securing post-retirement financial well-being of households becomes critical. The Report of the Household Finance Committee published in 2017 has found that a large part of the population which is going to be in the age bracket of 65 years and above in a decade and a half have not actively taken steps to insure adequate financial coverage during retirement. This issue is compounded by the fact that 85% of India's 460 million labour force are categorised as unorganised sector workers who are not covered by mandatory retirement savings which are generally made available by employers in the formal sector.

In India, the pension system was introduced in 1857, and the Indian Pension Act came into being in 1871. The developments over the past two decades, since the notification of National Pension Scheme (NPS) for central government employees in 2003, reflect the growing realisation of the need to extend affordable retirement security cover to every individual in the country. The Pension Fund Regulatory and Development Authority (PFRDA) was set up in 2003 as an interim regulator to administer the NPS and to develop the pensions market. In 2013, it was recognised as a statutory regulator and currently regulates the social security products offered by the government.[52]

In addition to the PFRDA which oversees NPS and Atal Pension Yojana (APY), the pension sector in India is regulated and governed by three other authorities, i.e., IRDA (pension products from insurance

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[47] Recent Developments in India's Mutual Fund Industry, Reserve Bank of India, October 2018, accessible at: https://www.rbi.org.in/scripts/BS_ViewBulletin.aspx?Id=17819

[48] Data obtained from World Bank database on Global Financial Development, updated till 30th October 2019

[49] T30 V/s B30 (Current v/s start of FY) - Association of Mutual Funds in India, accessible at: https://www.amfiindia.com/Themes/Theme1/downloads/home/B30vsT30-Aug-2019.pdf

[50] SIP-shape, Retail investors catalysing growth of mutual funds in India, Association of Mutual Funds in India, August 2019, accessible at: https://www.valueresearchonline.com/story/h2_storyview.asp?str=35493&utm_medium=vro.in

[51] Faye.O, 2007, Basic Pensions and Poverty Reduction in Sub-Saharan Africa, CREPP; Dethier. J, et al, 2011, The impact of minimum pension on old age poverty and its budgetary cost. Evidence from Latin America, Revista de Econom´ıa del Rosario. Vol. 14. No. 2

[52] Pension reforms: towards a secure future, British High Commission, accessible at: https://www.ey.com/Publication/vwLUAssets/EY-pension-reforms/$FILE/EY-pension-reforms.pdf

companies), SEBI (pension products from mutual fund houses), and Ministry of Labour and Employment (EPF and PMSYM).[53] Despite the existence of different pension products offered by these markets, the penetration of pension products remains low in India. According to RBI, the household sector's savings in financial assets that were deployed in provident and pension funds (including PPF) was at 2.3% of Q2 2017-18 GDP.[54] The Report of the Household Finance Committee published in 2017 also re-iterates this point by observing that the contribution of pensions wealth to household wealth is negligible.[55]

With the population in the post-retirement bracket expected to grow by 75% in the next decade and a half, there is an urgent and growing need to ensure that households are protected against vulnerabilities to adverse shocks in the later stages of their lives.[56]

2.4 Regulatory Design of Distribution Channel Architecture for Insurance, Investment and Retirement Products

Table 2 below lists out the licensing/registration models that each regulator has put in place for the distribution of these products. Financial services providers can choose what suits them most from these licensing/registration options.

Table 2: Regulator-prescribed licensing/registration models		
Insurance		
Term Insurance[57]	IRDAI	Besides direct sales by insurance companies, other models are: Corporate Agent, Insurance Agent (individual agents), Insurance Marketing Firm, Insurance Broker, Web Aggregator, Point-of-Sales Person, Insurance Self-Network Platform, Micro-insurance agent
Investment Products		
Mutual Funds	SEBI	Besides direct sales by asset management companies (AMC), other models are: Mutual Fund Distributor, Investment Advisor, Portfolio Management Service
Endowment Plans and ULIPs	IRDAI	Same as for insurance, but excludes Micro-insurance agents and POS persons (for certain products)
Fixed Deposits	RBI	Scheduled Commercial Banks[58], Cooperative Banks, Small Finance Banks, Business Correspondents of these banks

[53] ibid

[54] Annex II, Quarterly Estimates of Households' Financial Assets and Liabilities, RBI Bulletin, March, 2018, accessible at: https://www.rbi.org.in/Scripts/BS_ViewBulletin.aspx?Id=17426#T3

[55] Report of the Household Finance Committee, Indian Household Finance, Reserve Bank of India, July 2017, accessible at: https://rbidocs.rbi.org.in/rdocs/PublicationReport/Pdfs/HFCRA28D0415E2144A009112DD314ECF5C07.PDF

[56] ibid

[57] While insurance is also embedded in ULIPs and endowment plans, since these products are not sold as insurance products but as long-term investment products, we choose to characterise these products as investment products

[58] Except payments banks

		Retirement Products[59]
Atal Pension Yojana and NPS-Main	PFRDA	Scheduled Commercial Banks[60], Cooperative Banks, Small Finance Banks, Payments Banks, Business Correspondents of these banks; Retirement Advisor
Annuity Products	IRDAI	Same as for insurance, but excludes micro-insurance agents

2.5 Evolution of Business Models

Section 2.4 covers the universe of distributor licenses / certifications that financial services providers can choose to apply for in order to begin selling insurance, investment and retirement products. Historically, banks have been the dominant channel for the delivery of all three of these product categories, simply because the banking sector was established many decades prior to that of the insurance and MF sectors and has always had a relatively dominant distribution network of branches. The only exception to this dominance of banks is that of Life Insurance Corporation of India (LIC) that was underwriting insurance risk decades before the IRDAI was established. The LIC had its own large network on individual insurance agents for the sale of LIC products. This was based on the assumption that, and the need then, of using incentives-driven community-level models for achieving success in distribution. The LIC agent was almost as ubiquitous to the postman in terms of familiarity for the rural customer.

In addition to the bank-led corporate agent and bancassurance models, insurance companies built up their own network of corporate agents, as did AMCs of MFs. However, none of these distribution channels have successfully scaled up enough to solve the problem of insurance and investment inclusion. The cost of customer acquisition and repeat transaction costs are exorbitantly high for mono-product distributors to be able to establish a viable business model in locations other than the metro and urban regions. While this was the predominant reason why banks were expected to enjoy cost efficiencies given their sale was to existing deposit and credit customers, they still rely on a branch-based strategy for customer acquisition. There are also no examples of large banks successfully working out BC operations that can serve a full suite of products for their low-income customers. The increasing prevalence of NBFCs and the conversion of a few well-run NBFC-MFIs into Small Finance Banks gives additional channels for the distribution of insurance, investment and retirement products in a cost-effective manner to low-income households. Data on their commission income to total income ratios indicate that they behave similar to other scheduled commercial banks[61] and that it is unclear whether such commissions are predominantly coming from credit life insurance or not. The introduction of payments banks that ride on the payments capabilities of a national-level network of customer-touchpoints also hold promise for disrupting the course of non-credit financial inclusion. However, costs continue to be a barrier for serving certain customer segments and regions and the many reasons for this are covered in this report.

This study assumes that the demand for insurance, investment and retirement products is well-established and focusses on supply-side issues and bottlenecks that made it difficult to serve the demand.

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[59] ULIPs are also pitched as retirement-focussed products, they would not be suited for the low-income household given their reduced capacity for taking equity exposure at the annuity phase. Hence, we categorise ULIPs as pure investment products.

[60] Except payments banks

[61] Figure 12, Tracking Performance of Small Finance Banks against Financial Inclusion Goals, By Amulya Neelam, Dvara Research, November 2019, accessible at: https://www.dvara.com/research/wp-content/uploads/2019/11/Tracking-Performance-of-Small-Finance-Banks-against-Financial-Inclusion-Goals.pdf

3. Challenges Common across All Origination Models

Irrespective of whether a non-credit product supplier is a mono-product or a multi-product supplier, specific issues have been identified based on our conversations with practitioners which cut across this categorisation and have been flagged as hindrances to the efficient delivery of insurance, investment, and pension products.

3.1 Insurance Products – Distribution Models and Issues

3.1.1 Design of Distribution Models in Insurance

Annexure 1 captures the key features of the different licenses/ registrations allowed by IRDAI. Below we classify these 14 different licenses/ registrations into four broad groups highlight specific issues if any by classifying them into the following four categories.

A. Insurance Agent Model - This category of license is the dominant model of distribution in insurance and can be obtained by individuals and corporates, including banks and NBFCs. However, depending on the nature of the applicant (whether individual or corporate), the number of insurers (under life, general and health) whose product can be sold by the applicant is restricted. Such a restriction may have been introduced in the initial years to restrict attrition of individual agents which turn costly for the insurer who invests in his/her training, and to reduce conflicts of interest while choosing which product to sell to the customer. However, both of these outcomes do not seem to have been achieved. See Annexure 4 for changes to the number of individual agents and corporate agent partnerships by various life insurance companies.

B. Insurance Broking Model – While the significant differentiator for the insurance broker model was the restriction of an insurance broker to not undertake any other business, this has been removed as a design feature for the Insurance Marketing Firm model. Also, the restriction on the broker to not engage in any other business is lifted only for banks as a special case[62], through the bank as insurance broker model. The only features of the insurance broking licenses therefore that differentiate them from others is IRDAI's requirement on them to a) obtain a written mandate from the client to represent the client to the insurer and that b) there is no cap on the number of insurers whose products can be sold by an insurance broker (except in the case of an Insurance Marketing Firm).

C. Marketplace Distribution Model – This includes regulations and guidelines issued by IRDAI for Insurance Web Aggregators and Insurance E-commerce. The Insurance Web Aggregator model was first introduced in 2013 with the objective of facilitating comparison and distribution of insurance policies online. This license model allows the web aggregator to display insurance products on its website without any restriction on the number of insurers. In this regard, it is no different from the insurance broking model. On the incentive side, the

[62] IRDAI states in its Annual Report 2012-13 (pg. 7) that this model is "expected to facilitate the spread of insurance business to rural and semi urban areas". It was expected to allow banks that couldn't qualify under the corporate agent / bancassurance route to distribute insurance. Report accessible at: https://www.irdai.gov.in/ADMINCMS/cms/frmGeneral_Layout.aspx?page=PageNo2159&flag=1

web aggregator can charge a flat fee of Rs. 50,000 per year towards each product displayed and can be compensated for 'Insurance Services' outsourced by the insurer in respect of the policies procured by them. However, an insurance intermediary registered as an insurance broker, facilitating a similar service, by displaying the products of the insurers on its website does not get compensated in the same manner from the insurer.

D. Others – This category includes regulations for registration of referral companies by insurers with whom the insurance companies can enter into agreements for sharing of the database of the customers for generation of leads.

3.1.2 Design of Incentive Structures in Insurance

The maximum commissions, remuneration and rewards payable for distribution of insurance products, as laid by IRDAI, are largely uniform across all insurance intermediaries with the variation brought in at the product level depending on the type of product and whether the insurance is a single or a regular premium product.[63] Hence, viewed from the perspective of an insurer, there does not seem to be any significant issue in deciding which kinds of distribution models might be least expensive for them.

Incentives design for regular-premium life insurance products is characterised by the highest pay-out for the first year (the maximum incentive as a % of premium ranging between 15% to 35% for policy terms between 5 years to 12 years or more), which then falls to 7.5% per annum across all subsequent years. Such design is expected to have been introduced to ensure that costs incurred by intermediaries to convince a potential customer to enter into a multi-year contract are recovered adequately by the intermediary. Such costs are expected to be much higher than that for getting the customer to make subsequent premiums. It is unclear what percentage of customers make their subsequent premium payments voluntarily without any contact or persuasion by the intermediary. Subsequent-year incentives also seem to be not contingent on whether the intermediary had to remind/persuade the customer and/or help the customer process the premiums. While some of our interview respondents were of the view that such costs are justified for serving retail customers, others were of the view that this is the single biggest driver for the low persistency ratios and lapsation of policies seen in the industry and the losses to customers that has led to mis-trust in insurance, especially in products that also have returns embedded in them. Two of the respondents contrasted the high up-front commissions in insurance with the prohibition of volume-based entry loads in the mutual fund distribution incentives design that has led to an orderly increase in retail participation in the latter.

Misalignment of incentives for non-life insurance products was not as stark given there was no significant multi-year feature to these products.

Besides this, we also note other differences. Given the nature of their licensing model, the maximum incentive payable to Micro-insurance Agents, Insurance Web Aggregators, Point of Sale Persons (life, non-life, and health), and Referral Companies have been structured differently as captured in Annexure 2 which gives rise to specific issues. Three such issues are noted below.

[63] IRDAI (Payment of commission or remuneration or reward to insurance agents and insurance intermediaries) Regulations, 2016, accessible at: https://www.irdai.gov.in/ADMINCMS/cms/frmGeneral_Layout.aspx?page=PageNo3032&flag=1

Insurance Agent Model Vs. Insurance Broking Model

As seen in Annexure 2, the cap on incentives payable to insurance intermediaries acting as insurance agents (individual and corporate) and insurance brokers (both bank and non-bank) are similarly placed for all types of insurance (both life, health, and motor insurance) except general insurance (other than motor), where the cap for an individual insurance agent is less as compared to other intermediaries by 1.3-2.5% depending on the line of business. Although an insurance broker is expected to represent the customer to the insurers, the uniform volume-based incentive structure across agents and brokers significantly blurs the line between the functional differences of the two licensing models.

Micro-insurance Agent Vs. mainstream insurance intermediaries

The cap on maximum commission payable to a Micro-insurance agent selling micro-life insurance products is placed slightly different when compared to commissions/ remuneration payable in case of intermediaries selling non-micro insurance products (See Annexure 2). Considering that the ticket sizes in micro-insurance tend to be small[64], this creates disincentives for distribution of single-premium micro-insurance products, where an insurance intermediary (all other than the micro-insurance agent) would be able to earn greater incentives by selling non-micro insurance products and/ or to a customer base in an urban setting than a customer who is located in a remote rural area and is difficult to reach. Therefore, assuming that a micro-insurance product is suitable for a low-income household (see Section 6 for discussion on globally unsuitable products), the resources, or the effort required to acquire customers for a micro-insurance product far outweigh the income that can be earned by selling the same. This becomes specifically an issue as insurance agents in the industry are mostly doing the business of an intermediary on a part-time basis and the commissions allowed are not sufficient to incentivize them enough to make it a viable prospect.

Insurance Broker Model Vs. Insurance Web Aggregator Model

As discussed in the previous section, while the Insurance Web Aggregator model is structured in the same manner as an Insurance Broker, the additional incentive that a Web Aggregator licensee can earn for product placement on its website from an insurer is not available for an Insurance Broker who might be offering similar services to prospective customers.

The insurance distribution model in India is hence characterised by multiple license/registration categories laid out by IRDAI, with narrow functional differences between one or more of them. Some practitioners consider this approach to be justified, given the variety of approaches required to serve the diverse needs of Indian consumers. However, some others are of the opinion that this approach needs a significant revamp to align with the objectives of the end-customer and introduce clarity on the functional differences without compromising the satisfactory servicing of the customer’s needs. The incentive design for insurance distribution collapses almost all functional differences between distributor/intermediary models. For multi-year pure risk and non-pure risk products, incentives are such that there is a relatively high first-year commission, followed by lower trail commissions. The distributor/intermediary is eligible for the latter, whether or not there was effort needed on their part

[64] The maximum amount of cover that can be extended is Rs. 200,000 in case of Micro-Life insurance products. Refer Insurance Regulatory and Development Authority of India (Micro Insurance) Regulations, 2015, accessible at: https://www.irdai.gov.in/ADMINCMS/cms/frmGeneral_Layout.aspx?page=PageNo2480&flag=1

to get in contact with the customer for the purpose of making their premium contributions. The design of incentives needs to be revisited by taking into account the life-cycle experience of customers, including that of low-income households.

3.2 Investment Products – Distribution models and Issues

The prevalence of long-term savings and investment products for low-income households present a picture similar to that of the penetration (or lack thereof) of insurance in the Indian market (See Section 2.1). This lack of penetration may be attributed to three specific sectoral barriers, in addition to other barriers discussed in the rest of the report. The first sectoral barrier originates from a mismatch in the regulatory approaches to design of specific products and the consumer needs these products are meant to meet. The second barrier is caused due to market distortions caused by specific regulations. The third barrier is similar to that of the second but situates itself across all competing products like *Fixed Deposits*, *Unit Linked Insurance Plans (ULIPs)* and *Endowment Plans,* when the incentive to sell one product significantly outweighs the others, the distributors are more likely to *push* products that are lucrative to them, than products that may be *suitable* for the consumer. This section discusses the first two barriers in detail, while the third barrier is discussed in Section 6.

Traditionally investment products in India are envisaged as managed portfolios like mutual funds and other such similar products. However, in the context of low-income households which often have significant income volatility and low resilience towards exogenous shocks, e.g. illness or social events that may lead to significant unexpected or expected cash outflows, staying invested in long-term investment products requires a different set of behavioural characteristics on the part of the customer. Thus, this section focuses on products traditionally considered as investment products (like mutual funds) along with other products like endowment plans, ULIPs, and fixed deposits that households are much more familiar with. Table 3 provides a comparison of these products. Given this characterisation, a basic savings account may also qualify as an investment product but is excluded from this analysis. This is because their real returns are often negative, and their primary purpose is to be a liquidity store and to perform the functions of a transactions/checking account.

Table 3: Investment Products in India[65]

Characteristics	Mutual Funds	ULIPs	Endowment Plans	Fixed Deposits
Short Term Return (<1 Yr.)[66]	7.0-8.0%	6.0-6.5%	Returns are opaque due to their structure, but IRR varies between 2-5.5%	3.5-5.0%
Medium Term Return (1-5 Yrs)[67,68]	7.0-9.5%	7.5-10%		6.0-8.0%
Long Term Return (>5 Yrs.)[69]	9.0-9.5%	9.0-13%		7.0-8.5%
Liquidity[70]	High	Very Low	Very Low	Low
Associated Risk	Medium-High	Medium	Very Low	Very Low
Additional Benefits		Insurance Cover		

[65] Source: Moneycontrol.com

[66] Mutual Funds and ULIPs focusing on liquid debt are considered as short-term products and therefore were used for the calculations

[67] Returns greater than one year is annualised

[68] Mutual Funds and ULIPs with balanced mix of liquid debt and equity are considered as medium-term products and therefore were used for the calculations

[69] Mutual Funds and ULIPs focusing on equity are considered as long-term products and therefore were used for the calculations

[70] Restrictions on withdrawals were qualitatively assessed to obtain the liquidity profile of various products. In case of Endowment Plans and ULIPs, they come with dismal surrender values and lock-ins respectively, whereas in case of Fixed Deposits there is penalty for premature withdrawal.

While all the above products serve the purpose of investment avenues for the low-income household, their sale and distribution regulations come under four different sectoral regulators. In reality, what is suitable for the low-income household is a decision that depends on a set of factors including their existing exposures to physical and financial assets, their risk-absorbing capacity, human capital, and their abilities to commit to regular multi-year investments/intra-year systematic investment propositions that are aligned with their cash-flow picture.

Mutual Funds

The regulatory approach to liquid funds, especially with regard to maximum permissible expense ratio, hereinafter total expense ratio (TER), is different than that of equity funds (See Annexure 5). Across the various fund classes and AUM slabs[71], the expense ratio of debt funds is 25 basis points lower than that of equity funds[72]. These caps result in differential commission structures for distributors for different fund types and can potentially lead to a skewing of incentives for the distributor, whereunder instead of offering a suitable product to the consumer on the basis of their risk capacity, products with higher margins may be offered. Further, the presence of exit loads on withdrawal from debt funds within one-year disincentivises consumers from investing in them, since if withdrawn before a year their returns may diminish by up to one percentage point[73]. Therefore, it is imperative to reconsider such restrictions to ensure adequate incentive exists for the sale and purchase of suitable mutual fund products for low-income households.

In contrast to IRDAI, SEBI's approach to MF distribution incentives has been one of banning entry loads in 2009[74]and introducing an exit load for redemptions to incentivise staying invested. SEBI also permits an additional charge of Rs.150 to be paid to distributors who bring in first-time investors in MFs[75]. All incentives from AMCs to distributors have since then moved to a trail mode. Our interview respondents indicated that this aligned the distributor's interests with that of the investor as it incentivised a continued and long-term investment behaviour by the investor. Additionally, in September 2018, SEBI[76] has banned all up-fronting of trail commission, which means that in case a low-income household opted for a one-year SIP, the commission will be paid every month, instead of an upfront payment against the committed amount. However, for small-ticket investments, the trail commissions can be too small to ensure viability especially for mono-product distributors and digital-only fintech models. In the case of low-income investors being served by digital modes, customer acquisition cost would significantly outweigh the servicing cost (since most transactions are expected to be carried out electronically). This time delay between costs incurred and remuneration received is expected to further reduce the viability of mutual fund distribution business models targeting low-income households. The rule presently stands amended vide SEBI circular

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[71] Fund classes are computed on the basis of AUMs

[72] Proposal for review of Total Expense Ratio (TER) of Mutual Fund (MF) Schemes, SEBI Board Memorandum, accessible at: https://www.sebi.gov.in/sebi_data/meetingfiles/oct-2018/1539576106009_1.pdf

[73] Source: Moneycontrol.com, fund trackers

[74] Through SEBI Circular No. SEBI/IMD/CIR No.10/112153/07 dated December 31, 2007, SEBI mandated w.e.f January 4, 2009 no entry load shall be charged for applications received directly by the AMCs, accessible at: https://www.sebi.gov.in/sebi_data/docfiles/9845_t.html

[75] SEBI Circular no. CIR/IMD/DF/13/2011 dated August 22, 2011, accessible at: https://www.sebi.gov.in/legal/circulars/aug-2011/circular-for-mutual-funds_20481.html

[76]Proposal for review of Total Expense Ratio (TER) of Mutual Fund (MF) Schemes, SEBI Board Memorandum, accessible at: https://www.sebi.gov.in/sebi_data/meetingfiles/oct-2018/1539576106009_1.pdf

SEBI/HO/IMD/DF2/CIR/P/2019/42, whereunder it allows for up-fronting of trail commissions for first-time investors with SIP amounts not exceeding Rs. 3,000.[77]

Endowment plans and ULIPs

A similar alternative to that of mutual funds is presented by ULIPs. Regulated as an insurance product (thus by IRDAI), these products may be offered by most insurance intermediaries (see Section 3.1). In addition to lapsation and persistency issues discussed previously, these products have certain design level barriers. The lock-in period of five years for all ULIP plans[78] and dismal surrender value makes them a misfit for low-income households, since such households may face shocks which may require them to liquidate their investment in ULIPs. The case is similar for endowment plans (or par products, as defined by IRDAI)[79] as well, which have dismal surrender value and no scope of early maturity. Further, in case of endowment plans which are not required to disclose any rate of return, they often tend to provide negative real returns when adjusted for inflation,[80] and inadequate insurance cover[81]. Thus, the regulatory apparatus and the consumer needs seem at loggerheads, especially in these product categories and needs revisiting.

Fixed Deposits of Banks

Fixed (or term) deposits serve as another product within the umbrella of investment products. For the new to banking consumers, these products are generally offered through a network branch or a BC. The bank employee at the branch is incentivised to sell specific products irrespective of what is ideal for the customer or what meets the customers' needs, and this is driven by bank-specific incentive structures[82]. This, in itself, is a problem that is discussed in Section 6. While the branch distribution model does not suffer from any significant barriers, other than the issue that payments banks cannot offer FDs (See Section 4.1.2), the same cannot be said for the distribution through the business correspondent channel (BC). The BC channel behaviour is driven by bank-level incentives[83]. Furthermore, the model presently allows for an individual BC to be mapped to only one bank[84]. While the restriction help mitigate valid concerns, it also limits the scale of operations of BCs and therefore may further reduce their commercial viability (discussed further in Section 4.2).

Hence, as can be seen, investment products currently available to individuals from low-income households are spread across multiple regulatory regimes requiring them to approach multiple product distributors. In the absence of a uniform regulatory regime, varying incentive structures under

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[77] Review of Commission, Expenses, Disclosure norms etc. - Mutual Fund, SEBI, accessible at: https://www.sebi.gov.in/legal/circulars/mar-2019/review-of-commission-expenses-disclosure-norms-etc-mutual-fund_42468.html

[78] Insurance Regulatory and Development Authority of India (Unit Linked Insurance Products) Regulations, 2019, accessible at: https://www.irdai.gov.in/ADMINCMS/cms/frmGeneral_Layout.aspx?page=PageNo3849&flag=1

[79] Insurance Regulatory and Development Authority of India (Non-Linked Insurance Products) Regulations, 2019, accessible at: https://www.irdai.gov.in/ADMINCMS/cms/frmGeneral_Layout.aspx?page=PageNo3850&flag=1

[80] "Say no to endowment policies and ULIPs", Value Research, July 3, 2019, accessible at: https://www.valueresearchonline.com/story/h2_storyview.asp?str=32988&utm_medium=vro.in

[81] Financial engineering for Low-Income Households, edited by Bindu Ananth and Amit Shah, Sage Publications, April 2013

[82] "Misled and Missold: Financial mis-behaviour in retail banks?", Renuka Sane and Monika Halan, 2016, accessible at: https://ifrogs.org/PDF/Misled-and-Mis-sold-Financial-misbehaviour-in-retail-banks.pdf

[83] Presently banks have the prerogative to decide the commission structures for BCs, see Financial Inclusion by Extension of Banking Services – Use of Business Correspondents (BCs), RBI Notification, September 2010, accessible at: https://www.rbi.org.in/scripts/NotificationUser.aspx?Id=6017&Mode=0
This presents the scope of banks opting for skewed incentive structures which may lead to mis-sale of products.

[84] ibid

each of them can result in mis-selling of those investment products that have either laxer rules or those that result in higher incentives to the distributor, taking focus away from the objectives the products are meant to serve for the customer.

3.3 Retirement Products – Distribution Models and Issues

The governance and regulation of the market for retirement products in India, both pensions and annuities, is spread across four regulators, i.e., PFRDA for NPS-Main and the APY, IRDAI for annuities and pension products offered by insurance companies, SEBI for pension products offered by mutual fund AMCs, and Ministry of Labour and Employment for the Employee Provident Fund and the recently launched Pradhan Mantri Shram Yogi Maan-Dhan scheme.[85] We cover only those products that come under any of the financial sector regulators. Additionally, annuity services are regulated by IRDAI (See Section 5.2).

Life Insurance Companies and Mutual Funds

Annuities and pension products offered by life insurance companies are distributed either through individual insurance agents and insurance intermediaries who have obtained required licenses under the relevant IRDAI regulations or through direct selling by insurance companies themselves. The sale of single premium immediate or deferred annuity products can command a maximum remuneration to the insurance agent/insurance intermediary of 2% (of the premium/ lump sum) (See Annexure 2).

Similarly, with respect to retirement products offered by mutual fund companies, either mutual fund distributors or the AMCs themselves through their branches and websites act as the points of sale. The issues pertaining to distribution of insurance and investment products outlined in the previous two sections are therefore equally applicable to the distribution of retirement products through these channels.

Atal Pension Yojana

Atal Pension Yojana (APY)[86] which is administered by the PFRDA, is available only to bank account holders and relies exclusively on bank channels for distribution. Non-bank aggregators need to necessarily work through the banking channel as a Business Correspondent (BC) if they intend to enrol subscribers for the scheme.[87] This has been found to be particularly problematic as non-bank organisations with extensive grassroots outreach to unbanked individuals predominantly belonging to the unorganised sectors, namely, labour boards, NBFCs, cooperatives, microfinance institutions and NGOs cannot offer APY by restricting themselves to a single bank. RBI regulations do not prohibit BCs from providing services to customers of more than one bank. However, at a given customer-touch-point (the Agent BC), only one bank can be represented[88] (for the purpose of transactions, this becomes the acquirer bank for Off-US transactions using

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[85] Pension reforms: towards a secure future, British High Commission, accessible at: https://www.ey.com/Publication/vwLUAssets/EY-pension-reforms/$FILE/EY-pension-reforms.pdf

[86] Atal Pension Yojana (APY) is the government's flagship pension program launched in May 2015 for India's unorganized sector workforce

[87] Atal Pension Yojana (APY)1 – Details of the Scheme, NSDL e-Governance Infrastructure Limited, accessible at: https://npscra.nsdl.co.in/nsdl/scheme-details/APY_Scheme_Details.pdf

[88] Financial Inclusion by Extension of Banking Services – Use of Business Correspondents (BCs), RBI Notification, September 2010, accessible at: https://www.rbi.org.in/scripts/NotificationUser.aspx?Id=6017&Mode=0

AePS). Therefore, even if an agent BC can offer Off-US transactions if their parent bank (the acquirer bank) is willing, it still does not have permissions to transact on behalf of customers whose APY accounts are linked to their bank accounts held in non-acquirer banks. This adds to the barriers in making APY a recurring revenue stream in order to increase BC agent viability (also discussed in Section 4.2).

Under the current architecture, banks will be paid an incentive of Rs. 100 for every new subscription. Additionally, in order to incentivise the promotion and development of APY, banks will be paid an additional incentive every year based on the size of their subscriber base.[89] However, this incentive structure is skewed towards banks as they have been given the flexibility to devise their own incentive sharing pattern. This pattern determines the proportion of incentive banks are willing to share with their BCs.[90] The design of incentives, therefore, does not proportionately cover costs for the non-bank distributors who incur more cost and effort to ensure contributions are made by APY subscribers, as compared to banks who host the APY account and execute the electronic transactions at the backend.

While retirement/ annuity products are essential for low-income households, the movement towards ensuring the availability of these products has been slow and lacks a sense of urgency with which this issue needs to be addressed. The products which are already available in the market are less lucrative to sell compared to ULIPs and endowment plans, taking away much-needed focus on the former. In particular, APY, the guaranteed pension scheme offered through PFRDA does not adequately compensate those distributors who incur the most cost, thus hindering its wide-spread adoption and repeat-usage.

3.4 Possible Solutions for Distribution Channel and Incentive Design Issues

3.4.1 Distribution Channel Design

Distribution channel regulations have been split across various financial sector regulators as seen in Table 2, while products need to be synthesised at the level of the low-income household to meet its unique needs, financial situation and objectives. In order to do the latter, there is an element of personal financial planning that will need to go into the pre-sale assessment of almost all products. However, financial advice, according to the way today's advisor regulations are designed, are meant to be obtained separately from those who have taken advisor licenses. It is a known fact that

- Low-income households must go to multiple distributors in order to obtain a suite of financial products that will result in comprehensive financial wellbeing
- Low-income households are not able to access financial advice easily and reliably that will help them in deciding what products to purchase

Both these outcomes make it almost impossible for low-income households to engage with formal financial services providers for their investment and risk management needs. Therefore, a possible alternative may be considered for the design of distribution channel regulations. All financial sector

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[89] PFRDA Order No. PFRDAIAPY/4/62, PFRDA, May 19, 2015, accessible at: https://www.pfrda.org.in/writereaddata/links/incentive%20structure%20for%20apy5c598c21-5021-481a-8866-16213d2d1343.pdf

[90] PFRDA Order No. PFRDA/4/CRA/62, PFRDA, April 27, 2016, accessible at: https://www.pfrda.org.in/writereaddata/links/deregulation29d0044d-0716-4109-8954-3691fc199f26.pdf

regulators can jointly agree upon a common set of eligibility rules that any (corporate) financial services provider must meet in order to engage in selling customised product combinations for the household. We call such a distributor a 'Financial Services intermediary' (FSI). This can result in the evolution of integrated providers that can save on on-boarding costs including KYC (See Section 3.5), costs of making combined product pitches, and per-transaction costs across the suite of products that need customers to make contributions (such as for multi-year term insurance or for systematic investment or pension plans). These eligibility rules were first articulated by the RBI Committee for Comprehensive Financial Services for Small Businesses and Low-Income Households and have been further refined as provided below. While all banks must de facto meet all these eligibility rules, all other corporate intermediaries engaged in the sale of financial products can be required to meet these rules in a phased manner.

1. The FSI must be required to commit some capital against operating risks and customer protection risks for the business that they are engaged in. While the minimum amount may be structured as a Rs. 500,000 security deposit from the Financial Services Intermediary, the amount may vary depending on the number of customers and volume of transactions.
2. The FSI must not have been subjected to any disciplinary proceedings under the rules, regulations and by-laws of a stock exchange, SEBI, RBI, IRDA, FMC, or any other regulator with respect to the business involving either organisation, partners, directors, or employees.
3. Transactions should be accounted for and reflected in the Principal's books by the end of the day or next working day. Where the transfer of money from agent to Principal happens on the next working day, there should also be a stipulation that the FSI should transfer the day's collections to a non-operative pooled collections account on the same day itself. To ensure this, the Financial Services Intermediary has to maintain the account with a bank which has online fund transfer facility with standing instructions to transfer the funds to the designated pool account at the end of each day. This ensures that the customers' funds are secure even if the Financial Services Intermediary were to close operations or go bankrupt.
4. All transactions must be initiated by the customer, either using biometrics, OTP-based 2-factor authentication, UPI-based PIN. For recurring transactions, paper-based, as well as e-ECS mandates, are permitted, so is debit and credit card-based mandates (for amounts less than Rs.2000[91]).
5. The FSI should adopt the Suitability principles for the sale of financial products depending on the functions these products are expected to serve for the household. These suitability principles must be jointly agreed upon by the various financial sector regulators (Annexure 3 provides brief examples of such principles). Each regulator can lay down prescriptive guidelines around how to meet these principles.
6. The FSI must have trained staff that can communicate with the customer about the details of the products and take full responsibility for communicating with the clients.
7. The FSI must have a comprehensive human resource policy, including an incentive plan for staff that not only encourages them to achieve the business objectives but more importantly prevents mis-selling by removing any incentives that conflict with their abilities to undertake suitable sales and advice. The incentives are to be structured in a manner as articulated in Section 3.4.2.

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[91] Processing of e-mandate on cards for recurring transactions, RBI Circular, August 21, 2019, accessible at: https://www.rbi.org.in/Scripts/NotificationUser.aspx?Id=11668&Mode=0

8. The FSI should also have a mechanism to address queries and grievance of the customer about the services rendered by it and publicise it widely through electronic and print media. All customer grievances should be addressed within a defined time frame.

Any corporate with an FSI License must be permitted to reuse KYC already done, for the sale of multiple other products. Instead of having to consider the many licensing/registration types, such as under IRDAI, that have prescriptive restrictions on the kinds of products and the number of insurance companies it can partner with, the Financial Services Intermediary will have the freedoms to choose which product it wants to sell as long as it is able to ensure the product is indeed sold responsibility and keeping the best interests of the customer in mind. The various financial sector regulators can consider collapsing in a phased manner, the various distribution / licensing types under the Financial Services Intermediary license.

3.4.2 Incentives Design

Insurance products for low-income households become useful to households when there is adequate and continuous risk cover for life, livestock, property, crops, and so on. Investment products must get households to set aside small amounts in a systematic manner over long periods of time and remain invested in them in order to reap the benefits of long-term capital gains as well as compounding of returns, without having to worry about actively managing these investments. Retirement products work like investment products but must have an additional feature of annuities that are adequate for the future expected needs of the household, considering inflationary losses, and also that which can be accessed easily at regular intervals.

This, therefore, means that incentive design for these products must incentivise behaviour of distributors that is aligned with these outcomes from these products for the low-income household. The key features in this respect are:

1. The design of incentives must be such that the distributor who incurs more cost and effort to serve the customer gets incentivized proportionately[92].
2. The design of incentives must be such that economies of scale must result in a progressive reduction in commissions to large and/or more well-established distributors.
3. Repeat contact is to be incentivised with the customer in the form of trail commissions and commissions on subsequent year premiums that can cover for the cost of the distributor.
4. Heavy front-loading through the use of volume-based commissions to be avoided in order to prevent perverse behaviour resulting in lapsed policies. As a benchmark, any up-front commissions can be a) a percentage of premium but capped at a maximum amount say Rs.10,000 such that all expenses incurred by the distributor are adequately covered within this), and b) must not be greater than 1.2 to 1.3 times the trail/subsequent year commissions that are expected to be paid out to the distributor if the customer were to stay invested through the full period. A more radical approach to consider would be to gradually increase incentives as the years progress so that the inclination to give up on a customer reduces at any point in the tenure of the product for the distributor.

[92] A good example of this is the additional charge of Rs.150 that SEBI allows to be paid to distributors who bring in first time investors in MFs

5. Any distributor incentives that could induce customers into churning or exiting contracts prematurely must be carefully tracked through the behaviour of distributors and their customers, and distributors who exhibit high levels of such behaviour must be blacklisted.
6. Incentivising the distributor to be in contact with the customer for the purpose of ensuring benefits of these products are reaped by the customer, for instance, by initiating claims process, supporting the nominees/customers to complete a good quality claims process and documentation that reduces chances of it being rejected by the insurer. Another instance is by helping customers to understand when they are due to begin receiving annuity pay-outs (pensions) and helping them receive it in a seamless manner.

While all conflicted incentives work against good outcomes for the customer, volume-based incentives by themselves cannot be done away with given the current severe levels of exclusion in the country.

3.5 Universal Issues in KYC and Payments

Besides the barriers faced by all distribution channels hindering the penetration of insurance, investment and retirement products, discussed in the previous section, there are two key barriers that are common across all these products. The *Know Your Customer* (KYC) regime is the first barrier present at the gateway to all services, whereas the second barrier results from frictions in the payments systems that are needed for executing financial transactions by customers (such as investing small amounts in a regular basis or making contributions to the retirement account). This section discusses these barriers.

3.5.1 Universal Issues in KYC regimes across regulators

The KYC regime dates back to early 2000s, with RBI coming up with its guidelines first in 2002.[93] Other financial sector regulators followed suit soon after, especially given the requirements placed on financial institutions and under The Prevention of Money-Laundering (PML) Act, 2002.[94] There was little uniformity in the documentation required for executing PMLA-compliant KYC during customer acquisition since every institution was using its own format and processes for the verification of KYC. This phenomenon was observed amidst institutions with identical licenses, especially in the case of Asset Management Companies, all of who had different parameters for KYC verification. The issue was highlighted by SEBI in 2011, which led to the unification of data recording procedures within SEBI regulated entities[95], and the creation of a separate licencing regime for a set of entities called KYC Registration Agencies (KRAs). The introduction of KRAs removed the need for independent KYC authentication by every SEBI-regulated provider[96].

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[93] Guidelines on "Know Your Customer" Norms and "Cash Transactions", Reserve Bank of India, September 2002, accessible at: https://www.rbi.org.in/Scripts/NotificationUser.aspx?Id=7066&Mode=0

[94] Section 12(c) of The Prevention of Money-Laundering Act, 2002 accessible at: https://indiacode.nic.in/bitstream/123456789/2036/4/a2003-15.pdf requires banking companies, financial institutions and intermediaries to "verify the identity of its clients" and Section 12(d) requires them to "identify the beneficial owner, if any, of such of its clients"

[95] Uniform Know Your Client (KYC) Requirements for the Securities Markets, SEBI, October 5, 2011, accessible at: https://www.sebi.gov.in/sebi_data/attachdocs/1332309319628.pdf

[96] SEBI {KYC (Know Your Client) Registration Agency} Regulations, 2011, SEBI, accessible at: https://www.sebi.gov.in/legal/regulations/apr-2017/sebi-kyc-know-your-client-registration-agency-regulations-2011-last-amended-on-march-6-2017-_34700.html

Although there is a mandated requirement for all providers to have identical KYC rules,[97] there is a clear lack of any mechanism that can

a. Allow an institution to reuse KYC completed for a customer for the purpose of on-boarding the customer for another product (which is overseen by a separate regulator)
b. Allow an institution to rely on KYC verified by another institution for the same customer whether or not the two institutions are regulated under the same regulator)

The need for re-verification of KYC, especially in the traditional paper-based mode results in significant consumer acquisition costs and therefore is expected to render the sale of small-ticket products for low-income households, especially for those located in sparsely populated rural areas, an unviable business proposition. Although regulators do not mandate a physical document copy of the original OVD to be made and stored for the purposes of KYC, the absence of permissions to use Aadhaar-enabled e-KYC by non-bank distribution channels, and the capacity barriers of last-mile agents to undertake non-paper based processes imply that a physical documentation of KYC would continue to be needed in the near-term for incremental product sales, especially for providers operating in remote rural areas. This in-turn increases costs of selling insurance, investment and retirement products to an existing customer whose KYC has already been verified for opening a bank account or a credit account.

A mechanism that can allow for both functionalities described above holds promise to significantly reduce KYC verification costs for providers. In addition to this, digital means of completing KYC, (including through Aadhaar e-KYC and video KYC) need to be permitted by all the four regulators after adequate checks and balances are put into place.

The Case for a Central KYC System

Enabling a central and common KYC verification and registry system would decrease the consumer acquisition cost for businesses, while also reducing the time and resources spent by the customer to gain access to a suite of financial products (whether obtained through mono-product or multi-product origination channels).

The utility of such a registry has been acknowledged with the creation of the Central KYC Registry[98] (CKYCR) in 2015 by the RBI. The registry was created under the PML Act and housed under the Central Registry of Securitisation Asset Reconstruction and Security Interest of India (CERSAI) to remove the need for re-verification of KYC by different entities[99] since it would have a unique KYC identifier linked with independent ID proofs for the same individual. Though all financial sector regulators allow usage

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[97] Section 11(A) of The Prevention of Money-Laundering Act, 2002 accessible at https://indiacode.nic.in/bitstream/123456789/2036/4/a2003-15.pdf read with Rule 2(d) of Prevention of Money-Laundering (Maintenance of Records) Rules, 2005 accessible at http://www.bareactslive.com/ACA/ACT898.HTM) allows the passport, the driving licence, proof of possession of Aadhaar number, the Voter's Identity Card, job card issued by NREGA, the letter issued by the National Population Register, the Permanent Account Number (PAN) Card, the letter issued by the Unique Identification Authority of India as Officially Valid Documents for KYC

[98] Central KYC Registry, accessible at: https://testbed.ckycindia.in/

[99] Central KYC Registry Operating Guidelines 2016 (Version 1.1), accessible at: https://testbed.ckycindia.in/ckyc/assets/doc/Operating-Guidelines-version-1.1.pdf

of the CKYCR records for verification purposes,[100] its uptake has been dismal[101] since the registry still uses antiquated technology and the cost of uploading of data is significantly high[102] resulting in an inadequate coverage, and thus, utility. Presently, only the DigiLocker based e-KYC and Aadhaar based e-KYC come close to picking up the mantle left vacant by the CKYCR given they have been more broadly accepted across all regulators. However, the CVL-KYC completed by SEBI-licensed KRAs can also potentially be considered by RBI, IRDAI and PFRDA as being valid KYC. It is unclear why these regulators have not considered permitting the CVL-KYC of KRAs to be used by their regulated entities such as banks, NBFCs and insurers.

The case of DigiLocker

DigiLocker, a service under the *Digital India Initiative*, allows individuals to electronically store authenticated copies of various (almost all) Officially Valid Documents (OVDs). These documents, since pre-authenticated, allows the user to complete the KYC process electronically, thus reducing the time and resources required. The process is however repetitive since, for every provider, the documents have to be reshared, the storage of all these documents in digital, pre-authenticated format at a centralised location on the DigiLocker platform bring this mode of KYC-verification closest to that of a common/central KYC registry. However, the utility of the platform for the new-to-finance consumer segment is doubtful at best, since an individual would need to have access to appropriate technology and adequate information about the service to complete the process of first obtaining the pre-authenticated documents, and thereafter share it with the providers. A woman in a remote rural location who may own a smartphone cannot be expected to manage a Digi-locker all by herself. This issue is also a barrier with the video- conferencing / video-chat -based KYCs that are being undertaken by SEBI-regulated entities[103] and proposed by various providers[104] (for the other regulators to consider) and expert committees[105] as well as with the Aadhaar based offline e-KYC.

The Case of Aadhaar

Although the Unique Identification Authority of India (UIDAI) is not identical to the Central KYC Registry, it leverages the Aadhaar platform to provide identical functionalities to financial sector intermediaries. Since the Supreme Court judgement and the Aadhaar Amendment Act, restrictions have been placed on private sector entities (except banks[106]) from using the e-authentication, and these have greatly reduced the scope of Aadhaar based KYC. Presently, the statute allows any

[100] RBI Master Direction - Know Your Customer (KYC) Direction, 2016, accessible at RBI Master Direction - Know Your Customer (KYC) Direction, 2016; 2) SEBI Circular on Operationalisation of Central KYC Records Registry (CKYCR), accessible at SEBI Circular on Operationalisation of Central KYC Records Registry (CKYCR); 3) IRDAI Circular on Operationalisation of Central KYC Records Registry (CKYCR), accessible at IRDAI Circular on Operationalisation of Central KYC Records Registry (CKYCR) ; 4) PFRDA Circular on Providing KYC Information to Central KYC (CKYC) Registry by PoP, accessible at PFRDA Circular on Providing KYC Information to Central KYC (CKYC) Registry by PoP

[101] While there is no publicly available data to support this claim, practitioners we spoke to indicated so

[102] The Report of the RBI Committee on Deepening of Digital Payment, RBI, May 2019, accessible at: https://rbidocs.rbi.org.in/rdocs/PublicationReport/Pdfs/CDDP03062019634B0EEF3F7144C3B65360B280E420AC.PDF

[103] "Tata Mutual Fund Launches Video-KYC", Economic Times, April 26, 2019, https://economictimes.indiatimes.com/mf/mf-news/tata-mutual-fund-launches-video-kyc/articleshow/69021515.cms

[104] In our conversations with practitioners

[105] Report of the Expert Committee on Micro, Small and Medium Enterprises [(Box XIV) p. 90], Reserve Bank of India, June 2019, accessible at: https://rbidocs.rbi.org.in/rdocs/PublicationReport/Pdfs/MSMES24062019465CF8CB30594AC29A7A010E8A2A034C.PDF

[106] Banks are allowed to perform e-authentication by RBI, per direction 6(d)(i) of RBI Master Direction - Know Your Customer (KYC) Direction, 2016, accessible at RBI Master Direction - Know Your Customer (KYC) Direction, 2016

requesting entity, i.e. *Authentication User Agency*[107] to undertake e-authentication provided it is *compliant with such standards of privacy and security as may be specified by regulations.*[108] At the time of writing this report, such regulations were yet to be notified and therefore, it is unclear whether entities apart from banks may use the Aadhaar-based e-authentication services.

In the absence of clear guidelines, alternate KYC mechanisms, like the ones proposed[109] by the RBI Committee on Deepening of Digital Payments (CDDP) (May 2019) can be considered, where the need for KYC is eliminated or significantly reduced if transactions originate from a KYC verified bank account. For instance, for "opening a mutual fund account, by funding it from a KYC compliant bank account, while restricting that the folio continues to be funded from, and money refunded into that same account", or for "purchasing an insurance policy, by funding it from a KYC compliant bank account belonging to the proposer".

3.5.2 Universal Issues in Payment Systems

We note the following issues highlighted by practitioners in this regard.

<u>Inadequate banking infrastructure for setting up auto-debit instructions through physical mandates</u>

Setting up standing instructions to auto-debit one's bank account for making recurring contributions/premium payments to one's mutual fund account / insurance account reduces the cost to distributor to initiate this transaction each time a committed payment is due for the customer. This is of course as long as the customer is fully aware of her commitment and has fully funded her account. Digital investment practitioners we interviewed pointed out that the ability to set up an ECS debit through a physical mandate[110] (executed at one's bank branch) for a customer varies considerably between geographies, indicating severe regional variations in banking infrastructure. For instance, only about 28% of bank accounts in Bihar could potentially support an ECS mandate, while this number jumps to 60% for Tamil Nadu[111]. While any branch that is CBS-enabled and has Cheque Truncation System (CTS) facility should theoretically be able to set up ECS mandates through e-NACH and thus be able to provide coverage across the country, in reality, cost and capacity barriers may be preventing this from happening. The RBI can require banks to report the availability of this facility across their branches and metrics for the quality of this facility on a recurring basis[112]. Such reporting is to also cover debit card access for its banking customers and its usage.

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[107] Section 2(e) and 2(1)(g) of The Aadhaar (Targeted Delivery of Financial and Other Subsidies, Benefits and Services) Act, 2016, accessible a: https://indiacode.nic.in/bitstream/123456789/2160/3/a2016-18.pdf#search=aadhaar and Aadhaar (Authentication) Regulations, 2016, accessible at https://upload.indiacode.nic.in/showfile?actid=AC_CEN_37_85_00001_201618_1517807328460&type=regulation&filename=1_to_5_Regulations%20in%20Single%20Notification.pdf respectively

[108] Section 4(4)(a) of The Aadhaar (Targeted Delivery of Financial and Other Subsidies, Benefits and Services) Act, 2016, accessible at: https://indiacode.nic.in/bitstream/123456789/2160/3/a2016-18.pdf#search=aadhaar

[109] See Recommendation 55 of The Report of the RBI Committee on Deepening of Digital Payment, RBI, May 2019, accessible at: https://rbidocs.rbi.org.in/rdocs/PublicationReport/Pdfs/CDDP03062019634B0EEF3F7144C3B65360B280E420AC.PDF

[110] Data Mandates through destination banks – in this channel, the customer submits the physical mandate to their bank branch. The bank, after verifying the signature, will upload the data mandate through the NACH system on the sponsor bank.

[111] Interview conversations

[112] Currently ECS volume data is not available separately for each bank. The 87 centres across the country where ECS facility is available through various branches indicate that these are cities or towns, that are meant to serve its suburbs, but such access is not reasonably available for rural regions. See Bank Branches Participating in ECS, Centerwise, RBI, updated as on December 19, 2011, accessible at: https://m.rbi.org.in/Scripts/ECSUserView.aspx?Id=27

Digital-only mandates are currently possible through API[113] where authentication is through net-banking, debit card and OTP (Aadhaar e-Sign based facility can no longer be provided), but this is not a possible option for low-income customers due to their lack of familiarity with net-banking and also because only five banks had this option as of November 2018[114]. While UPI 2.0 has a one-time e-mandate facility, RBI has not permitted this recurring-payments feature over concerns that this can end up being misused. RBI has however permitted debit cards, credit cards and PPIs including wallets to use the card + OTP authentication mode to be used for setting up e-mandates for amounts less than Rs.2000 (besides for credit cards where such a limit does not exist)[115] and more recently extended this to transactions through UPI as well[116].

Inadequate debit card enablement for Jan Dhan Accounts

In order to set up ECS mandate using the debit card + OTP mode that RBI has recently permitted for amounts less than Rs.2000, low-income households need to have an active debit card and a mobile number linked to it to receive OTP on. However, practitioners have pointed to the unavailability of debit cards for Jan Dhan account holders. A study by Microsave showed that only 47% of account holders had received their Rupay debit cards from their banks[117].

Severe penalties for defaulting on auto-debit mandates

If a consumer opts for auto-debit from her bank account for the servicing of a loan or for the payment of her insurance premiums or her investment needs, there exist severe penalties if the charge fails due to inadequate balance in her accounts. The amounts vary from Rs. 100 levied by few public sector banks like the State Bank of India[118] and Punjab National Bank[119] to Rs. 750 for ICICI Bank[120] (if there is more than one return per month). These charges especially penalise the low-income new-to-banking customers since they often have irregular cash flows, and therefore are more likely to have instances of ECS debit when the account balance is insufficient. Thus, it is the need of the hour to limit these charges in order to establish parity between distributors who opt for digital transactions vis-à-vis cash transactions. The elimination of such a huge difference between these 2 different kinds of digital transactions would be a big enabler for low-income households looking to familiarise themselves with using standing instructions. While the concern is that a failed auto-debit transaction is akin to a cheque-bounce, there are no significant operating costs that the bank incurs in the former

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[113] The customer, after entering the details of the mandate in the web page provided by the corporate or aggregator, will be directed to the internet banking page of his bank to authenticate the mandate. The customer can authenticate the mandate either through net banking or debit card mode (Debit Card No. and OTP). The aggregator here is usually a payment gateway but it could be any entity which integrates with the corporate e-commerce page and the destination bank's net banking gateway. See E-Mandate Procedural Guidelines, Annexure 2, accessible at: https://www.npci.org.in/sites/all/themes/npcl/images/PDF/E_Mandate_PG_Final.pdf

[114] "Another hit for digital lenders as NPCI suspends eSign-based eMandate", Mugdha Variyar, Economic Times, November 24, 2018, accessible at: https://tech.economictimes.indiatimes.com/news/internet/another-hit-for-digital-lenders-as-npci-suspends-esign-based-e-mandate/66774812

[115] Processing of e-mandate on cards for recurring transactions, RBI, August 21, 2019, accessible at: https://www.rbi.org.in/Scripts/NotificationUser.aspx?Id=11668&Mode=0

[116] Processing of e-mandate in Unified Payments Interface (UPI) for recurring transactions, RBI, January 10, 2020, accessible at: https://www.rbi.org.in/Scripts/NotificationUser.aspx?Id=11784&Mode=0

[117] PMJDY Wave III Assessment, Microsave, accessible at: https://www.microsave.net/wp-content/uploads/2018/10/PMJDY_Wave_III_Assessment_MicroSave.pdf

[118] Service Charges, State Bank of India, accessible at: https://www.sbi.co.in/portal/web/personal-banking/service-charges

[119] Non-Credit Related Service Charges, Punjab National Bank, accessible at: https://www.pnbindia.in/Non-Credit-Related-Service-Charges.html

[120] Common Service Charges, ICICI Bank, accessible at: https://www.icicibank.com/service-charges/common-service-charges.page

case, as compared to costs it incurs in returning a bounced cheque. The biller (in this case the AMC/insurer/distributor) can decide how to deal with a committed payment that did not come through on the expected date.

Though the call for rationalisation of charges was made by the RBI Committee on Deepening of Digital Payments, 2019[121], it may be worthwhile to explore waiver of the charges for a select number of returned transactions, say five, akin to the number of free off-US ATM transactions.

Inabilities for customers to electronically earmark and accumulate small-ticket amounts for funding insurance premiums or investment contributions

In our conversations with practitioners, one of the main reasons cited for lack of uptake of insurance products among low-income households is their inability to arrange and pay for premium amounts in lumpsum as and when they become due. We were pointed to the evidence gathered by them through primary research which suggests that low-income households find it difficult to pay an insurance premium of Rs. 500, for example in lumpsum. They were, however, willing to contribute a maximum of Rs. 100 in a week and not more than that towards the final premium payable, given the inherent volatilities in their cashflows that they need to manage for.

Herein lies the problem as there is no mechanism which is currently available either through the insurer/ AMC/ distributor/ payments system where the weekly / variable contributions can be accumulated to be paid out to the insurance company as and when they reach the required premium amount. For an insurance company, there is a regulatory requirement where they can extend risk cover only on receiving the premium from the insured and would not be willing to take responsibility for the instalments received in the interim. An arrangement where the distributor collects the weekly contributions and pays it to the insurer / AMC on reaching the required premium/contribution amount would expose the customer to chances of operational fraud. Even if customers were to accumulate these amounts in a bank account or a wallet, these are not permitted to be earmarked by the customer for a specific purpose. The One-time Mandate proposed under UPI 2.0 attempts to offer a solution where the customer can set a mandate for up to a fixed amount. The amount remains blocked in the customer's account and can be drawn down by the biller (insurer/AMC) up to that limit. However, RBI has not permitted this functionality yet.

4. Challenges Unique to Multi-product Origination Models

Insurance, investment and retirement products have manufacturers who underwrite or manage the respective risks on behalf individuals and households, and an army of customer-touchpoints that serve the distribution networks through which these products can be offered to end-customers. These distribution networks take on the shape of a wide variety of business models, each with its own unit-level economics and cost structures associated with the customer-offering and the channel.

The challenges covered in Section 3 pertain to more than one type of distribution channel defined by distribution regulations of one or more financial sector regulators. While the evolution in design of distribution regulations has been gradual, the nature of customer-interactions with the distribution channels have evolved considerably through the past few decades. Driven by business viability considerations arising from the costs associated with selling insurance and mutual fund schemes to

[121] The Report of the RBI Committee on Deepening of Digital Payments, May 2019, accessible at: https://rbidocs.rbi.org.in/rdocs/PublicationReport/Pdfs/CDDP03062019634B0EEF3F7144C3B65360B280E420AC.PDF

customer segments who require smaller ticket size products, the distribution of pure insurance products has seen a gradual yet consistent increase in the contribution of bank-led corporate agent channel for life insurance distribution. This increase is purely led by the private life insurance companies' distribution, with LIC having negligible distribution through all channels other than their individual agent channel (See Figure 4,5,6).

In this section of the report, we provide a detailed analysis of barriers faced by what is characterised as 'Multi-product originators'. While the universe of originators includes both manufacturer-led and distributor-led customer acquisition and servicing, the subset of customer acquisition and servicing channels that interact with the customer through a multi-product offering are characterised as 'multi-product originators'. Indeed, these multi-product originators have increasingly gained prominence in distribution given the cost and informational advantages they enjoy over mono-product originators. These include scheduled commercial banks, including small finance banks and payments banks, and NBFCs.

In this section, we focus particularly on the newer banking models, namely small finance banks and the payments banks, as well as the NBFC channel. This is because, while the traditional and well-established SCBs already form the dominant distribution channel for insurance, investment and retirement products through a relationship with the customer that is dominated through branch-based and deposit-account-based modes, they have not been successful in tailoring offerings that are designed for the low-income customer and household and at locations that are not branch-based, in a manner that the transaction costs can be brought down. The SFB and PB channel, as well as the NBFC channel, hold great promise in this regard and hence such a choice. In our conversations, the following two challenges raised were common to all multi-product origination channels:

1. The challenge of 'prioritisation' in the sale conversation

This pertains to the issues around two business practices inherent in multi-product origination models. One is where there is a bundling of products sold to the customer where one product is inherently needed by the customer, but where the customer has to purchase the other product even if it is not needed by him/her. Even if the second product is not harmful for the customer, the customer still incurs a cost that he/she will attribute to the first product. Two is where a product is pitched to a customer when he/she is trying to avail a loan from the provider. In such an instance, the customer who is eager to obtain the loan in a timely manner, opts to purchase additional products in order to increase his/her chances of receiving the loan.

2. The challenge of training the customer-facing representative to have a multi-product sale conversation

This pertains to capacity issues of employees / sub-agents of the multi-product originator to be thorough about all features of the suite of products. Additional training may not allay these issues, especially when catering to remote rural geographies. While this is not unique to multi-product origination models and can be faced by all distribution channels, the issue becomes stark for the former on account of multiple product types to be understood and sold to the customer.

In addition to these, we note other challenges in the below sections.

4.1 Challenges in Models where the primary relationship is a deposit account, namely the Small Finance Bank and the Payments Bank

4.1.1 Small Finance Banks

Many of the SFBs we approached were reluctant to participate in our interviews due to on-going efforts for their IPO processes. The one SFB we spoke to said they were too early in the process of setting up their banking operations to have any useful insights on challenges in offering the products under question.

4.1.2 Payments Banks

The payments bank model are characterised not by a branch-based strategy, but by an extensive network of partners and BCs that the PB engages with for the purpose of offering cash-in cash-out (CICO) facilities for the savings bank account (for individuals) and the current account (for businesses). These partner-locations and partner-representatives can potentially form touchpoints with the customer for the purposes of sale of insurance, investment and retirement products. Some of the PBs indeed sell simple term life insurance products as well as APY through their CICO/merchant points (which are typically app-enabled). The customer-interaction enjoyed by PBs is one of moderate to high-frequency small-ticket transactions (driven by DBT credits in especially remote rural locations) on the bank account including withdrawals and remittances, which make it possible to expect repeat visits by the customer and thereby offer insurance, investment and retirement products, both through cash-based as well as account-based purchases (for insurance) and redemptions (for investment and retirement products). Another key feature that PBs can enjoy is in tailoring offerings where purchases of insurance or investment contributions can be very small ticket size given the incremental costs of executing one additional digital transaction through these physical CICO/merchant locations is negligible as compared to the BC model (reasons discussed in Section 4.2).

However, the following key barriers were highlighted for PBs in our study:

1. At no point in time can a PB customer's account hold more than Rs.100,000 in the form of deposits. This makes the current account offering of PBs to small traders and merchants unattractive even when small merchants may be ready to move to a digital mode of transactions. Indeed, with the introduction of the GST regime, there is a use-case for using bank accounts for salary payments to avail GST credits. Such small and micro businesses are likely to hold good worth more than Rs. 100,000 and given the seasonal variations in revenue flows, experience higher levels of volatility in their bank accounts.
2. PBs are not permitted by the RBI to become a BC to NBFCs. While the reasons for this are not available in the public domain, this prevents a PB from monetising on its adjacencies with other financial inclusion players. If a PB's CICO points are closer for a customer to transact with, than the nearest branch of an NBFC, enabling the NBFC to use the PB as a BC can help bring down costs of servicing for the NBFC and open up an additional revenue stream for the PB with negligible additional costs for servicing the NBFC customer.
3. PBs are not permitted to offer term deposits in any form, namely as fixed or recurring deposits, although their CICO points experience a relatively much higher footfall of repeat customer transactions in a regular basis especially in rural areas (driven by DBT credits, among others).

4.2 Issues in Models where the primary relationship is a transactions service through a Business Correspondent

The Business Correspondent channel is a distribution channel for banking products and services envisaged by the RBI for banks and NBFCs. It can be characterised as another third-party outsourcing route to the sale of banking products and transactions services by banks. Similar to the individual and corporate agent licensing model for insurance distribution, BCs can be individual BCs or corporate BCs (CBC) who then sub-contract to a network of agent BC (ABC) touchpoints. Unlike for insurance distribution, the BC model does not have a licensing requirement but follows a registration and certification regime (the BC registry[122] is being set up by the Indian Bankers' Association). Besides un-regulated corporate BC companies, many NBFCs too offer bank-account transactions as well as bank-credit by becoming BCs to specific banks.

The BC channel comprises of a diverse set of transaction points clubbed together as a single channel. In reality, multiple factors determine the viability of each transaction point, such as the population density at the location, internet availability, education and comprehension levels of the ABC, the demand for transactions services driven by DBT credits, and the distance from the nearest alternative functioning transaction point (such as an ATM or bank branch), besides demand characteristics such as opportunity cost for the customer in trying to access her bank account, literacy levels, comfort with digital channels for transactions and so on. Also, similar to the individual agent model for insurance distribution, ABCs rely on their known local social networks to provide them business. Since the ABC is an integral member of the community, he/she is likely to err on caution and take the initiative to sell only products that he/she understands well (such as FDs or endowment plans instead of ULIPs or MFs).

For the purpose of this study, challenges faced by business models in the non-NBFC BC channel serving low-income individuals were studied. These challenges are articulated below:

Capacity Limitations of the Agent BC

Capacity limitations of the Agent BC to comprehend and sell insurance, investment and retirement products: BC representatives are of the view that of the ~ 800,000 BC touchpoints in the country, most are semi-literate and find it difficult to meet the certification requirements introduced through the IIBF on account of it being too difficult for them to comprehend[123], and too expensive to undertake[124]. One estimation shared is that about 15% of these touchpoints can be considered for the sale of more sophisticated products such as investment and retirement products.

Viability of the BC touchpoint

Unlike insurance distribution incentives which are set very high (leading to negative outcomes documented in Section 6), commissions to the ABC for enabling transactions are set very low. Numbers shared by practitioners indicate this to be not more than 1.5% of the transaction amount for a cash-out transaction, which is passed on to the CBC from the bank and which then gets split in the

[122] Business Correspondents(BCs) Registry, accessible at: https://www.iba.org.in/iba/home/HomeAction.do?doBCPortal=yes

[123] RBI has designated IIBF as the sole certifying agency for the banks of SCBs (including RRBs), SFBs excluding the payments banks. See Annexure 1 in the URL link for an overview of syllabus accessible at: http://www.iibf.org.in/documents/RulesSyllabus/2018/CeBCBF-Low-080119.pdf

[124] Books prepared for this (IIBF Publication List for the Examination of Business Facilitator/ Correspondence) cost in the range of Rs.500-600, accessible at: http://www.iibf.org.in/certificate_exam_schedule.asp?tab=ac-21

ratio of 60:40 between the CBC and the ABC respectively. The ABC effectively, therefore, gets not more than 0.5% of the amount cashed out. Rates for account opening are set by the parent bank and have been known to be revised downwards from around Rs.60 (during the PMJDY drive) to as low as Rs.5 more recently (of which 80% is used up in the form of consumables such as a photocopy of the account opening form). The very low commissions necessitate that the ABC does not run a pure BC business but engages in a multiple revenue streams which take away from his/her abilities to focus on selling FDs, insurance and investment products. To add to this, multiple parallel networks of BCs in a geography has resulted in fragmentation of income streams and profitability.

White-labelling of BCs

While RBI regulations permit the CBC to be BC to more than one bank, at the ABC level, there cannot be more than one bank for which the ABC can work for. There is no regulatory barrier to an ABC executing a transaction for a non-parent bank when a customer of a non-parent bank (issuer bank) were to approach the ABC. This is because the parent bank, being the acquiring bank, can execute an Off-US[125] transaction for the issuer bank at an AePS-enabled micro-ATM ABC point. However, market dynamics are such that banks that dominate the BC networks prefer On-US[126] transactions where they do not have to share revenue from enabling DBT transactions for other issuer banks.

In summary, the low commercial viability of the BC model is well-known, but incentives are stacked up against banks to enable viability through a white-labelling approach. This issue, along with the lack of capacity at the ABC level to sell investment and retirement products, make this channel very unattractive for the sale of these products. Two potential ways to change this 'low-level equilibrium' are discussed below:

- ✓ The RBI can consider providing legitimacy to a 'marketplace' approach to banking where customers can pick and choose their banking products by interacting with a 'marketplace', very similar to the web aggregators under IRDAI. The business correspondent model is the natural candidate for creating such a marketplace, and this can mitigate issues with the BC model discussed previously. In order to operationalise this, the RBI can consider introducing a differentiated registration and certification mechanism for corporate BCs that have large ABC networks and are therefore already important participants in the financial system due to the large clientele of customers across geographies and their partnerships with a variety of banks. Such an approach will provide legitimacy to those CBCs that are willing to meet certain net worth criteria and have in place the technological capabilities for real-time transactions. The latter is needed to make them less expensive and safer for banks to engage with (relative to establishing own BC networks). If such a marketplace model were to gain prominence, banks can be nudged to adorn a 'seller' hat and consider designing products that are truly suited for the low-income households and businesses, and the delivery can be taken care of by such large registered BC companies who can then create a marketplace of products from a variety of banks rather than be tied down to being the delivery channel for a single bank. This can be a precursor to the evolution of a truly white-labelled BC model.

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[125] One where there is movement of funds from one bank to another necessitating an interbank settlement. See AePS FAQs, accessible at: https://www.npci.org.in/aeps-faqs-banks

[126] Where an Aadhaar initiated transaction has effects only in accounts within one and same bank and does not necessitate an interbank settlement. See AePS FAQs, accessible at: https://www.npci.org.in/aeps-faqs-banks

- ✓ The RBI in consultation with other stakeholders can consider introducing a tiered approach to grading of BC agents on the lines of the complexity of products they are capable of offering and the sophistication in business processes they can execute for offering and servicing these products. The complexity of products is to be driven by the level of complexity the product can introduce in the financial lives of low-income households and businesses. Therefore, certification examinations will also have to be across different progressive grades rather than take the form of a single examination.

4.3 Issues in Models where the primary relationship is a Credit Account

This channel comprises of all NBFCs serving low-income customers through the lending business, which becomes the primary lever for the institutional relationship with the customer. These also include NGO-MFIs, SHGs, other lenders conducting lending business through a company set up under Section 8 of Companies Act 2013 or as a society. We focus our study on barriers faced by NBFCs (including NBFC-MFIs) since the remaining do not come under the purview of the RBI for its lending business.

Other than issues highlighted for all multi-product origination models (see Section 4), there were no NBFC specific issues that were highlighted by the NBFC respondents who we spoke to.

5. Product Design Issues at the level of the Product Manufacturer

An important theme that the interview respondents raised is the dire lack of strategic business focus on serving low-income households. This translates to the lack of products designed especially for them after gaining an understanding of their needs, sales pitches that are contextualised to their contexts, and a lack of consideration of their financial situation and risk capacity. In the absence of such strategic focus, products designed for the mass affluent consumer get sold to low-income households in the case of insurance, and they lose out on gains from investing long term in the capital markets. On the providers' side, incentives become inadequate for ensuring viability.

A board-driven strategy must drive product design and sales processes targeted at low-income households. Business processes and technology must be employed to assist staff where additional training can no longer solve their capacity limitations.

In addition to this, the following issues were identified at the regulator's level for insurance and insurance-linked investment products and annuity products that have led to the creation of products that are inadequate for the needs of low-income households and the targeting of these products to them as a particular customer segment.

5.1 Insurance Companies

Many restrictions that existed previously (such as restrictions on annuities design by insurance companies in the form of prohibition to switch to another insurer at the time of annuity purchase by customer[127]; restrictions on insurers to reinsure certain risks[128]) have been removed in the recent

[127] See 5. Surrender Value and Options on Surrender or Vesting, IRDAI (Non-Linked Insurance Products) Regulations, 2019, accessible at: https://www.irdai.gov.in/ADMINCMS/cms/frmGeneral_Layout.aspx?page=PageNo3850&flag=1

[128] While the earlier regulations (IRDA (Life Insurance-Reinsurance) Regulations, 2013, accessible at https://www.irdai.gov.in/ADMINCMS/cms/frmGeneral_Layout.aspx?page=PageNo1971&flag=1 had various monetary limits on retention based on (a) either the age of the Insurer or the product, and (b) the type of the product year in which, this is not the case in the latest regulations as the insurers are required to formulate a suitable retention policy per insurance segment (IRDAI (Re-insurance) Regulations, 2018, accessible at: https://www.irdai.gov.in/ADMINCMS/cms/frmGeneral_NoYearLayout.aspx?page=PageNo3685&flag=1

years. One significant design restriction has been in the regulatory design of micro-insurance products, as detailed below:

Micro-insurance regulations are described[129] as insurance policies of up to Rs.100,000 sum assured for personal accident insurance, asset insurance and individual health insurance contracts, and up to Rs.250,000 for family/group health insurance contracts. Microinsurance products can be endowment plans but cannot be in the ULIP format, which means that purchasers of multi-year and long tenure microinsurance products cannot have access to long term capital gains from having exposure to equity (similar to APY, see Section 5.2). These prescriptive product-specific regulations inadvertently restricted freedoms of insurers and distributors to innovate in deciding how they want to serve the under-served or low-income customers, even if these regulations were meant to limit exposure of customers to a specific product type in order to 'protect' them. While such regulations are aimed at facilitating financial inclusion, these end up creating a product-specific restriction, making the product inadequate for the end-customer. Such regulations take away obligations on providers to ensure they are acting in the customers' interests and stifle innovation in areas where exclusion is prevalent due to cost and risk considerations that cannot be overcome by traditional business models. This inadvertently keeps certain classes of customers away from accessing and fully benefiting from innovative products and they are left to transact only in 'basic' cookie-cutter products. To add to this, microinsurance policies count under the rural and social sector obligations[130] placed by IRDAI on insurance companies. This inadvertently results in the sale of inadequate covers, especially to low-income households.

5.2 Annuity Providers

Table 4 below provides a comparison of key regulatory design features of annuities[131] that are permitted across various retirement product offerings potentially available to the low-income customer.

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[129] IRDAI (Micro Insurance Regulations) 2015, accessible at: https://www.irdai.gov.in/ADMINCMS/cms/frmGeneral_Layout.aspx?page=PageNo2480&flag=1

[130] IRDAI (Obligations of Insurers to Rural and Social Sectors) Regulations, 2015

[131] Gathered from 1) Insurance Regulatory and Development Authority of India (Minimum Limits for Annuities and other Benefits) Regulations, 2015, accessible at https://www.irdai.gov.in/ADMINCMS/cms/frmGeneral_Layout.aspx?page=PageNo2636&flag=1; 2) Insurance Regulatory and Development Authority of India (Non-Linked Insurance Products) Regulations, 2019 accessible at: https://www.irdai.gov.in/ADMINCMS/cms/frmGeneral_Layout.aspx?page=PageNo3850&flag=1 ; 3) Pension Fund Regulatory and Development Authority (Exits and Withdrawals under the National Pension System) regulations, 2015, accessible at https://www.npscra.nsdl.co.in/download/Gazette-PFRDA%20(Exits%20and%20Withdrawals%20under%20NPS)%20Regulations,%202015.pdf; 4) FAQ's on APY, accessible at: https://npscra.nsdl.co.in/nsdl/faq/APY-FAQs.pdf (accessed on 01-10-19); 5) Insurance Regulatory and Development Authority of India (Investment) Regulations, 2016, accessible at: https://www.irdai.gov.in/ADMINCMS/cms/frmGeneral_Layout.aspx?page=PageNo2934&flag=1; 6) Amendment to the Investment Guidelines, NPS and APY, 2019

Table 4: Key Regulatory design features of Annuity Options available to the low-income customer			
	Life Insurers	**NPS**	**APY**
Minimum Monthly Pension Benefit	Rs. 1000 per month or a gross amount of Rs. 5000 (lumpsum)	No minimum specified. However, since these are life insurers regulated by IRDAI the minimum benefit applicable to other life insurers would also be applicable to them	Rs. 1000 per month
Annuity options	Can purchase the annuity from the same or different insurer	Can purchase the annuity from 1 among 5 life insurers	No option given
Annuitisation	No mandatory commutation if purchased from same insurer (up to 100% and at least 40% must be annuitized). 50% annuitisation if purchased from different insurer	No mandatory commutation, with the stipulation that at least 40% of the accumulated pension wealth be converted into an annuity	100% annuitisation
Exposure to Debt and Equity Capital Markets	Central Govt. Securities – not less than 20%; Central and State Govt. Securities – not less than 40%; Approved Investments – not exceeding 60%[132]	Depends on the NPS scheme, customer can choose to invest up to 75% in Equity (under Active Choice), with tapering off of the Equity allocation after the age of 50[133]	Govt. Securities and related investments – up to 55%; Debt instruments and related investments – up to 45%; Equity and related investments – up to 15%; Asset Backed Securities – up to 5%; Short term debt – up to 10%

<u>Adequacy of pension receipts under Atal Pension Yojana</u>

An internal analysis[134] of pension benefits of APY found that an 18-year old who contributes Rs. 42 per month will result in a real monthly pension of Rs. 129 for the household. Assuming that the 18-year old's income falls within the first income quintile, the defined benefit will cover 10.3% of her monthly expenditure. The primary driver for the insufficiency of corpus is the current investment mix which allows for exposure to equity instruments to not more than 15% irrespective of the life-cycle stage of the customer. The investment mix for APY can be redesigned to mirror the Moderate Life Cycle Fund Mix for NPS-Main[135].

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[132] Pg 61, IRDAI (Investment) Regulations 2016, IRDAI, accessible at: https://www.irdai.gov.in/ADMINCMS/cms/frmGeneral_Layout.aspx?page=PageNo2934&flag=1;

[133] PFRDA Circular on Amendment to Investment Guidelines for NPS Schemes {other than Govt Sector (CG&SG), Corporate CG, NPS-Lite and APY}, 22nd May 2018, accessible at: https://www.pfrda.org.in/myauth/admin/showimg.cshtml?ID=1365

[134] "An Initial Analysis of the Atal Pension Yojana", Vishnu Prasad and Anand Sahasranaman. Dvara Blog, March 9, 2015, accessible at: https://www.dvara.com/blog/2015/03/09/an-initial-analysis-of-the-atal-pension-yojana/

[135] Investment options under NPS, accessible at: https://npscra.nsdl.co.in/download/Investment-options-under-NPS.pdf

These examples of microinsurance and APY illustrate the need for checks and balances to ensure that product regulations must not lead to the creation and sale of products that are inadequate for the customer segments they are meant to serve.

6. Challenges around Product Suitability and Disclosures

A common demand-side barrier to adoption of insurance, investment and retirement products is the concern around mis-selling of products unsuitable for the low-income household. Mis-selling can take various forms, we describe in Table 5, a few examples shared by our interview respondents.

Table 5: Examples of mis-selling	
Insurance	Withholding information on important exclusions in health insurance by distribution agent at the time of sale, resulting in claim rejection for the customer Insurers have attempted to overcome this using telephonic verification calls to the customer to check for his/her understanding of the product before issuance of the certificate. However, agents now 'teach' unsuspecting customers to lie on these calls.
Endowment Products	When IRDAI clamped down on ULIP mis-selling by cutting commissions, the market, overnight, shifted to selling endowment plans. Certain endowment plans have a negative IRR, making them unsuitable for anyone availing them. However, customers do not know this because regulations do not require returns to be disclosed in percentage terms. Lapsing of policies[136] due to agent attrition has led to customers losing trust in their agents. These policies are most commonly endowment plans, and customers who have had a bad experience are doubly wary of purchasing pure term products.

Non-credit products involve payments of customer monies or a commitment by the customer to pay their monies into the future. Mis-selling in this context, has involved people being unaware that they are expected to pay lumpsum amounts into the future. Another form of mis-selling, seen with the ULIPs before it came under the regulatory radar, was the exposure that people were made to take in equity instruments despite this being unsuitable for their requirements. In the context of pure term insurance, the scope for mis-selling takes on a different form. For instance, for a term life insurance, one can expect there to be not much variation in the extent to which pricing would vary for premiums for an individual of a particular age and income bracket. However, a distributor can be swayed by rewards she/it can be eligible for from various insurers while selling or showcasing various options available to the customer. The impact of incentive and commission design in insurance and insurance-cum-investment products, in MFs and in pension products such as the APY on outcomes for the low-income customer are discussed in Sections 3.1, 3.2 and 3.3 respectively. Opaque benefit illustrations[137]

[136] A lapsed life insurance policy' is defined by IRDAI as a policy on which premium remains unpaid even after six months from the due date

[137] "33. Benefit Disclosure: Except for products where all the benefits are assured in absolute amounts at the outset of the contract, all other insurance products shall provide the prospective policyholder a customized benefit illustration at the point of sale, illustrating the guaranteed and non-guaranteed benefits at gross investment returns as stipulated by the Authority". IRDAI (Non-Linked Insurance Products) Regulations 2019, accessible at: https://www.irdai.gov.in/ADMINCMS/cms/frmGeneral_Layout.aspx?page=PageNo3850&flag=1

for non-linked products make it easier to mislead customers who do not know how to compare returns[138]. The inability of customers to make repeat contributions due to the non-availability of their agent (lapsed policies) has been such a severe industry-wide phenomenon that IRDAI intervened to place liability on insurers to reallocate lapsed policies to other agents or through their own operations in order to revive them. This has led to a further increase in costs for the insurer to offer smaller-ticket multi-year products and difficult-to-reach customer segments.

Regulatory interventions around preventing mis-selling have focussed on separating sale and advice into distinct offerings for the customer through separate licensing/registration requirements. SEBI has investment advisor registration requirements and such advisors are to act in a fiduciary capacity on behalf of clients and cannot be paid volume-based commissions. PFRDA has retirement adviser registration[139] for intermediaries interested in providing retirement advice[140] for customers. However, similar to the insurance broker license of IRDAI, and unlike SEBI's investment advisor license, the retirement advisor can charge a volume-based advisory fee of 0.02% of the AUM of the customer subject to minimum of Rs.100 and maximum of Rs.1000[141] as well as a flat fee per transaction in addition to an onboarding fee. Therefore, it can be concluded that regulators have taken the approach of separating advice and sale as offerings but the separation is not complete, with advisors being allowed to receive volume-based incentives, thereby reducing the effectiveness of such a separation for preventing mis-selling to customers. Also, such an approach assumes that customers would be willing to pay separately for advice, which many of our interview respondents stated was found to be not the current reality in serving low-income customers. More importantly, such separation has led to a prevalence of non-advisor type registration route gaining favour among providers because of the absence of a 'fiduciary' element to their responsibilities to their customers. They can, therefore, provide free incidental advice that they have no accountability for but for which they receive volume-based incentives for sales. This is problematic if these touchpoints engage in misleading, wrong, or harmful advice to maximise sales. Indeed, SEBI has acknowledged that this is a problem and its three consultation papers[142] between 2016 and 2018 proposed some steps to resolve this, though these are yet to fructify.

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[138] "For non-participating plans that carry a guaranteed return, the return should be disclosed as a percentage of the investment made. The IRR should be a disclosure in the benefit illustration.", as recommended by Committee to recommend measures for curbing mis-selling and rationalising distribution incentives in financial products (Chair: Sumit Bose), Ministry of Finance, August 2015, accessible at: https://www.finmin.nic.in/sites/default/files/Final_Report_Committee_on_Incentive_Structure_0.pdf

[139] PFRDA (Retirement Adviser) Regulations 2016, accessible at: https://www.nism.ac.in/certification/images/pdf/PFRDA-Retirement-Advisers-Regulations-2016.pdf

[140] As part of this, the retirement adviser is required to "collect and suggest to the customer the most suitable scheme, taking into consideration the following aspects of the prospects and based on utmost good faith and fair market practices: a. Due diligence on the requirements of the prospects to suggest them the most suitable products by collecting basic information of the prospects such as information pertaining to age, marital status, dependents, current assets, liabilities, income, planned purchases, planned retirement age; plans post retirement, family history of health and longevity and the current health position". ibid

[141] Introduction of Advisory Fee under Regulation 15 of PFRDA (Retirement Adviser) Regulations 2016, Circular dated September 22, 2016, accessible at: https://www.pfrda.org.in/writereaddata/links/circular%20-%20advisory%20fee44f66101-6c47-4d1e-98fd-008a4cbe11dc.pdf

[142] Consultation Paper on Amendments/Clarifications to the SEBI (Investment Advisers) Regulations, 2013 – First, Second, Third, published on the SEBI website on October 7, 2016, June 22, 2017 and January 2, 2018. Accessible respectively at: https://www.sebi.gov.in/reports/reports/oct-2016/consultation-paper-on-amendments-clarifications-to-the-sebi-investment-advisers-regulations-2013_33435.html; https://www.sebi.gov.in/reports/reports/jun-2017/consultation-paper-on-amendments-clarifications-to-the-sebi-

In order to remove this arbitrage, all distributors must be subject to the same standards of conduct towards their customers, irrespective of their licensing types. Universal conduct obligations[143] applied uniformly across all regulated entities is the need of the hour. As part of their obligations, all providers must ensure that customers have access to good quality, non-obfuscatory disclosures of product features. Expected returns as a percentage of the premium/invested amount, and past and expected IRR are to be clearly known upfront[144].

The various financial sector regulators must jointly agree upon a set of suitability principles that govern the relevant financial functions such as 'investment', 'risk protection' and 'retirement income' that the products under question must abide by (Annexure 3 provides brief examples of such principles) and each regulator can then lay down prescriptive guidelines around how to meet these principles. Following this, regulators need to mandate the need for completing suitability assessments within all product sale processes by regulated entities serving retail customers. Such an assessment must consider whether the product being sold is meeting the suitability principles when serving the specific customer. Supervisory processes must then monitor and track distributor channel performance on the quality of such assessments, publish the results of such supervisory audits, and take stringent actions against those distribution channels found to be selling products that are unsuitable for their customers. IRDAI has set a good beginning in this regard in September 2019[145] by introducing a requirement on insurance companies to undertake a suitability assessment for all life products except pure risk products, and this is applicable on all intermediaries and agents.

Additionally, with an intention to prevent low-income households from entering into contracts of globally unsuitable products[146], the regulator can specify a set of globally unsuitable products that cannot be offered to households or businesses below a certain income threshold or net worth or individuals above a certain age. Such products should be prescribed by each regulator and could be amended from time to time based on feedback from customers and financial services providers, including from learnings from the various regulatory sandboxes.

7. Market Infrastructure and Supporting Services

Exciting progress has been made in the creation of various elements of market infrastructure in both the insurance and investment sectors to improve outcomes for retail customers.

The Insurance Information Bureau (IIB) under IRDAI has been tasked to create a database of all insurance agents, broker qualified persons, specified persons of corporate agents, authorized verifiers for web aggregator, point of salesperson, and so on. This database is expected to help in de-duping, with the help of Aadhaar number of PAN number, of persons who may be engaged with multiple

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investment-advisers-regulations-2013_35152.html; and https://www.sebi.gov.in/reports/reports/jan-2018/consultation-paper-on-amendments-to-the-sebi-investment-advisers-regulations-2013_37247.html

[143] See Universal Conduct Obligations for Financial Services Providers Serving Retail Customers, Deepti George, Dvara Research, 2019, for a full discussion, accessible at: https://www.dvara.com/research/wp-content/uploads/2019/05/Universal-Conduct-Obligations-for-Financial-Services-Providers-Serving-Retail-Customers.pdf

[144] For a full discussion on this, see report of the Committee to recommend measures for curbing mis-selling and rationalising distribution incentives in financial products (Chair: Sumit Bose), Ministry of Finance, August 2015, accessible at: https://www.finmin.nic.in/sites/default/files/Final_Report_Committee_on_Incentive_Structure_0.pdf

[145] IRDAI Circular (a) Benefit Illustration, and (b) other market conduct aspects, dated September 26, 2019

[146] The Report of the RBI Committee for Comprehensive Financial Services for Small Businesses and Low-Income Households (Chair: Nachiket Mor), RBI, 2014, discusses globally unsuitable products, accessible at: https://rbidocs.rbi.org.in/rdocs/PublicationReport/Pdfs/CFS070114RFL.pdf

insurers although they may not be permitted to do so under their respective distributor regimes[147]. The benefits of such an effort will help to check agent performance and persistency rates, and agent churn and lead to improved market-monitoring of agent-level conduct. Insurers have begun using the database to weed out bad actors.

The IRDAI has also licensed four insurance repositories to aid in dematerialising insurance policies and to aid in the issuance of e-insurance policies (since 2011). However, market usage has been dismal with only a total of 1.6 million electronic insurance accounts being created and 1.25 million policies converted into an electronic mode[148].

In the mutual fund industry, the MF Utility (MFU)[149] launched in 2015 by AMFI, is a digital aggregator platform for the industry. Through this, distributors and individual investors can set up bank mandates and execute purchase and sale transactions through completely digital mode across all AMCs, through a Common Account Number mapped to the investor. Investors can transact in multiple schemes and make single consolidated payments.

No major infrastructural barriers were noted by our interview respondents. The developments described above are useful for customers who are comfortable transacting digitally, the barriers to digital adoption, including lack of awareness and illiteracy on the part of low-income households can continue to serve as impediments to adoption at least in the short run.

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[147] IRDAI Annual Report 2017-18, accessible at: https://www.irdai.gov.in/ADMINCMS/cms/frmGeneral_Layout.aspx?page=PageNo3704&flag=1

[148] ibid

[149] MF Utility System, MF Utilities, accessible at: https://www.mfuindia.com/MFUtility

8. A Summary of Challenges

<table>
<tr><th colspan="4">Table 6: A Summary of Challenges</th></tr>
<tr><th></th><th>Traditional Mono-product Distribution Channels</th><th>Multi-product Distribution Channels</th><th>Digital-only Fintech Channels</th></tr>
<tr><td>Ease of access at a location nearby</td><td>Customers in remote locations need to go to multiple mono-product distributors in order to avail a comprehensive set of financial services. The most ubiquitous today is LIC's individual agents (LIC's predominant distribution strategy) who offer insurance products with returns embedded returns. These are losing ground to multi-product channels, especially banks who can potentially be the most efficient multi-product distributors. Besides this, insurers and AMCs sell through own branches and website - these are unlikely to be viable ways to access products for low-income households in the near future.</td><td>Multi-product distributors such as SCBs and PBs are accessible through their branches and BCs; however, the board-driven strategy has not adequately focussed on risk protection, investment retirement planning offerings for low-income households</td><td>The universe of potential customers is restricted to the 150 million customers expected to use online banking out of the 350 million internet users in the country; this excludes a vast majority of low-income individuals who need non-digital means to access products</td></tr>
<tr><td rowspan="2">Ease of on-boarding through KYC and setting up payment transactions</td><td colspan="3">Fresh KYC needed for all new purchase transactions; Significant scope for reducing cost of KYC for provider and customer; reuse of existing valid KYC not permitted (both for products under same regulator, and products under different regulators); the Central-KYC Registry has not taken off; SEBI's CVL-KYC providers not permitted to be accessed by providers regulated by RBI, PFRDA, IRDAI.</td></tr>
<tr><td colspan="3">Regional disparities in the quality of ECS infrastructure and the penalties levied on insufficient funds turn new-to-banking customers away from opting for auto-debits. One-time mandates through UPI 2.0 is not yet permitted by RBI.</td></tr>
<tr><td rowspan="2">Ease of access to reliable financial advice and suitable products from all touchpoints</td><td colspan="3">Rampant mis-selling of insurance products with embedded returns at the cost of providing adequate pure risk cover. The regulator does not recognise 'advice' in sale process; incidental advice is misleading. However, recent rules on suitability (for non-pure-risk products) seeks to improve this. Supervisory processes need to be significantly expanded to monitor this.</td></tr>
<tr><td colspan="3">Banks selling FDs, ULIPs, endowment plans, MFs are driven by conflicting incentives that cannot prevent perverse behaviour on the part of employees and BC touchpoints to avoid engaging in unfair and misleading sales practices.
While retirement/annuity products are essential for a low-income household, these are less lucrative to sell compared to ULIPs/endowment plans. Since there is no requirement on distributors to provide reliable advice, retirement planning products are</td></tr>
</table>

<table>
<tr><td rowspan="2"></td><td colspan="3">rarely pitched to customers.
In MF investments, differential commissions based on whether equity or debt/liquid MFs are being distributed, introduces perverse behaviour by distributors to sell equity MFs to those households for whom it would be unsuitable.</td></tr>
<tr><td colspan="3">Certain product design regulations have inadvertently resulted in the creation of products that are inadequate for the needs of low-income households and in the targeting of these products to them.</td></tr>
<tr><td rowspan="2">Ease of subsequent/repeat transactions</td><td colspan="3">Lapsing of policies is rampant; very poor persistency ratios even if the metric is being tracked by regulator</td></tr>
<tr><td colspan="3">Incentives work against ensuring small-ticket subsequent / repeat transactions as the upfronting is very steep in insurance, causing distributors to seek business away from low-income households and towards mass affluent customers. Incentives are not proportionately increasing for distributors who take more effort and incur more costs for serving difficult-to-reach customers.</td></tr>
<tr><td rowspan="2">Ease of life-cycle servicing (claims/ redemptions)</td><td colspan="3">A lack of awareness about the claims process, an inability to execute the process by oneself, and the lack of any responsibilities placed on the distributor (who is the touchpoint) to provide support to claimants, takes away the value that insurance is expected to provide for the household. Bad experiences from rejected claims, omission of important information by distributors during product sale, makes customers doubly wary of subsequent insurance purchase transactions.
MF redemptions are seamless and did not pose any challenges for customers invested in MFs.</td></tr>
<tr><td colspan="3">No incentives to process claims by the distributor; not in the interests of an insurer to improve claims efficiency. Cost to assess each claim especially for smaller ticket claims is prohibitive without adequate support for both the insurer and the customer</td></tr>
<tr><td rowspan="2">Ease of offering comprehensive services</td><td>Individual agents and certain other traditional mono-product channels such as IMFs, microinsurance agents, MF distributors are free to sell products across various regulatory jurisdictions after meeting necessary regulatory requirements. However, the absence of a uniform regulatory regime for investment products results in perverse incentives to mis-sell investment products that have laxer rules.</td><td>All multi-product providers are best placed to offer comprehensive financial services. However, the absence of a uniform regulatory regime for investment products results in perverse incentives to mis-sell investment products that have laxer rules.</td><td>Banks are reluctant to allow FDs to be originated by digital-only and app-based investment platforms even if API-based solutions exist.</td></tr>
<tr><td colspan="3">BCs of banks form credible last-mile touchpoints for offering these products. However, banks are reluctant to allow their BCs to sell products of other banks. This therefore prevents any healthy competition at the BC's CSP level to offer products that work best for the customer.</td></tr>
</table>

Very High	High	Medium	Low

9. Recommendations

In this section, we organize proposed solutions and recommendations along three broad themes, namely Distribution Channel design, Operations and Suitability, and Business Cost Reduction.

9.1 Distribution Channel Design

- ✓ All low-income households must be able to obtain a suite of financial products that will result in comprehensive financial wellbeing with minimal effort. This means that providers must be able to offer such an offering seamlessly instead of customers having to approach many different providers separately. Also, it must be ensured that any and all financial advice, whether paid for/free/incidental to the sale, must be easy to obtain, reliable and helpful in deciding what products to purchase. [Refer Section 3.4.1]

- ✓ All financial sector regulators can jointly agree upon a common set of eligibility rules that any (corporate) financial services provider must meet in order to engage in selling customised product combinations for the household. We call such a distributor a 'Financial Services intermediary'. While all banks must de facto meet all the eligibility rules, all other corporate intermediaries engaged in the sale of financial products can be required to meet these rules in a phased manner. This can be achieved by collapsing in a phased manner, the various distribution / licensing types under the Financial Services Intermediary license. [Refer Section 3.4.1]
    - A FSI must be required to commit some capital against operating risks and customer protection risks for the business that they are engaged in. While the minimum amount may be structured as a Rs. 500,000 security deposit from the Financial Services Intermediary, the amount may vary depending on the number of customers and volume of transactions.
    - The FSI must not have been subjected to any disciplinary proceedings under the rules, regulations and by-laws of a stock exchange, SEBI, RBI, IRDA, FMC, or any other regulator with respect to the business involving either organisation, partners, directors, or employees.
    - Transactions should be accounted for and reflected in the Principal's books by the end of the day or next working day. Where the transfer of money from agent to Principal happens on the next working day, there should also be a stipulation that the FSI should transfer the day's collections to a non-operative pooled collections account on the same day itself. To ensure this, the Financial Services Intermediary has to maintain the account with a bank which has online fund transfer facility with standing instructions to transfer the funds to the designated pool account at the end of each day. This ensures that the customers' funds are secure even if the Financial Services Intermediary were to close operations or go bankrupt.
    - All transactions must be initiated by the customer, either using biometrics, OTP-based 2-factor authentication, UPI-based PIN. For recurring transactions, paper-based, as well as e-ECS mandates, are permitted, so is debit and credit card-based mandates (for amounts less than Rs.2000[150]).

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[150] Processing of e-mandate on cards for recurring transactions, RBI Circular, August 21, 2019, accessible at: https://www.rbi.org.in/Scripts/NotificationUser.aspx?Id=11668&Mode=0

  - The Agent should adopt the Suitability principles for the sale of financial products depending on the functions these products are expected to serve for the household. These suitability principles must be jointly agreed upon by the various financial sector regulators (Annexure 3 provides a brief examples of such principles). Each regulator can lay down prescriptive guidelines around how to meet these principles.
  - The FSI must have trained staff that can communicate with the customer about the details of the products and take full responsibility for communicating with the clients.
  - The FSI must have a comprehensive human resource policy, including an incentive plan for staff that not only encourages them to achieve the business objectives but more importantly prevents mis-selling by removing any incentives that conflict with their abilities to undertake suitable sales and advice. The incentives are to be structured in a manner as articulated in Section 3.4.2.
  - The FSI should also have a mechanism to address queries and grievance of the customer about the services rendered by it and publicise it widely through electronic and print media. All customer grievances should be addressed within a defined time frame.

- ✓ The RBI can consider providing legitimacy to a 'marketplace' approach to banking where customers can pick and choose their banking products by interacting with a 'marketplace', very similar to the web aggregators under IRDAI. The business correspondent model is the natural candidate for creating such a marketplace, and this can mitigate issues with the BC model discussed previously. In order to operationalise this, the RBI can consider introducing a differentiated registration and certification mechanism for corporate BCs that have large ABC networks and are therefore already important participants in the financial system due to the large clientele of customers across geographies and their partnerships with a variety of banks. Such an approach will provide legitimacy to those CBCs that are willing to meet certain net worth criteria and have in place the technological capabilities for real-time transactions. The latter is needed to make them less expensive and safer for banks to engage with (relative to establishing own BC networks). If such a marketplace model were to gain prominence, banks can be nudged to adorn a 'seller' hat and consider designing products that are truly suited for the low-income households and businesses, and the delivery can be taken care of by such large registered BC companies who can then create a marketplace of products from a variety of banks rather than be tied down to being the delivery channel for a single bank. This can be a precursor to the evolution of a truly white-labelled BC model.
- ✓ The RBI in consultation with other stakeholders can consider introducing a tiered approach to grading of BC agents on the lines of the complexity of products they are capable of offering and the sophistication in business processes they can execute for offering and servicing these products. The complexity of products is to be driven by the level of complexity the product can introduce in the financial lives of low-income households and businesses. Therefore, certification examinations will also have to be across different progressive grades rather than take the form of a single examination. [Refer Section 4.2]

- ✓ Given that a PB's CICO points are closer to a customer to transact with in comparison to a nearest NBFC and can potentially form touchpoints with the customer for the purposes of sale of insurance, investment and retirement products, enabling the NBFC to use the PB as a BC can help bring down costs of servicing for the NBFC and open up an

additional revenue stream for the PB with negligible additional costs for servicing the NBFC customer. [Refer Section 4.1.2]

9.2 Operations and Suitability

- ✓ All distributors must be subject to the same standards of conduct towards their customers, irrespective of their licensing types. Universal conduct obligations applied uniformly across all regulated entities is the need of the hour. As part of their obligations, all providers must ensure that customers have access to good quality, non-obfuscatory disclosures of product features. Expected returns as a percentage of the premium/invested amount, and past and expected IRR are to be clearly known upfront

- ✓ The various financial sector regulators must jointly agree upon a set of suitability principles that govern the relevant financial functions such as 'investment', 'risk protection' and 'retirement income' that the products under question must abide by and each regulator can then lay down prescriptive guidelines around how to meet these principles.

- ✓ Following this, regulators need to mandate the need for completing suitability assessments within all product sale processes by regulated entities serving retail customers. Such an assessment must consider whether the product being sold is meeting the suitability principles when serving the specific customer. Supervisory processes must then monitor and track distributor channel performance on the quality of such assessments, publish the results of such supervisory audits, and take stringent actions against those distribution channels found to be selling products that are unsuitable for their customers.

- ✓ Additionally, with an intention to prevent low-income households from entering into contracts of globally unsuitable products, the regulator can specify a set of globally unsuitable products that cannot be offered to households or businesses below a certain income threshold or net worth or individuals above a certain age. Such products should be prescribed by each regulator and could be amended from time to time based on feedback from customers and financial services providers, including from learnings from the various regulatory sandboxes. [Refer Section 6]

- ✓ A board-driven strategy must drive product design and sales processes targeted at low-income households. Business processes and technology must be employed to assist staff where additional training can no longer solve for their capacity limitations. [Refer Section 5]
- ✓ While all conflicted incentives work against good outcomes for the customer, volume-based incentives by themselves cannot be done away with given the current severe levels of exclusion in the country. Therefore, incentive design for these products must incentivise behaviour of distributors that is aligned with the right outcomes from these products for the low-income household. The key features in this respect are: [Refer Section 3.4.2]

    - The design of incentives must be such that the distributor who incurs more cost and effort to serve the customer gets incentivized proportionately.
    - Incentivising repeat contact with the customer in the form of trail commissions and commissions on subsequent year premiums that can cover for the cost of the distributor.
    - Heavy front-loading through the use of volume-based commissions to be avoided in order to prevent perverse behaviour resulting in lapsed policies. As a benchmark, any up-front

commissions can be a) a percentage of premium but capped at a maximum amount say Rs.10,000 such that all expenses incurred by the distributor are adequately covered within this), and b) must not be greater than 1.2 to 1.3 times the trail/subsequent year commissions that are expected to be paid out to the distributor if the customer were to stay invested through the full period. A more radical approach to consider would be to gradually increase incentives as the years progress so that the inclination to give up on a customer reduces at any point in the tenure of the product for the distributor.

- Any distributor incentives that could induce customers into churning or exiting contracts prematurely must be carefully tracked through the behaviour of distributors and their customers, and distributors who exhibit high levels of such behaviour must be blacklisted.
- Incentivising the distributor to be in contact with the customer for the purpose of ensuring benefits of these products are reaped by the customer, for instance, by initiating claims process, supporting the nominees/customers to complete a good quality claims process and documentation that reduces chances of it being rejected by the insurer. Another instance is by helping customers to understand when they are due to begin receiving annuity pay-outs (pensions) and helping them receive it in a seamless manner.

9.3 Business Cost Reduction

- ✓ A centralized KYC regime is needed, that can allow for the following two functionalities: a) allow an institution to reuse KYC completed for a customer for the purpose of on-boarding the customer for another product (which is overseen by a separate regulator), and b) allow an institution to rely on KYC verified by another institution for the same customer whether or not the two institutions are regulated under the same regulator).

- ✓ The Central KYC Registry of the CERSAI needs to be revamped on an urgent basis.

- ✓ All regulators can consider permitting the use of CVL-KYC completed by SEBI-regulated KRAs to be used by their regulated entities such as banks, NBFCs and insurers.

- ✓ Alternate KYC mechanisms to the ones which presently exist can be considered, whereunder, the need for KYC is eliminated or significantly reduced if transactions originate from a KYC verified bank account. For instance, for "opening a mutual fund account, by funding it from a KYC compliant bank account, while restricting that the folio continues to be funded from, and money refunded into that same account", or for "purchasing an insurance policy, by funding it from a KYC compliant bank account belonging to the proposer".

- ✓ Digital means of completing KYC, Aadhaar e-KYC and video KYC need to be permitted by all the four regulators after adequate checks and balances are put into place. [Refer Section 3.5.1]

- ✓ Setting up standing instructions to auto-debit one's bank account for making recurring contributions/premium payments to one's mutual fund account / insurance account reduces the cost to distributor to initiate this transaction each time a committed payment is due for the customer. However, given the severe regional variations in banking infrastructure to enable ECS debits, RBI can require banks to report the availability of these facilities across their branches and metrics for the quality of this facility on a recurring basis. Such reporting is to also cover debit card access for its banking customers.

- ✓ In order to establish parity between distributors who opt for digital transactions vis-à-vis cash transactions, there is a need to rationalise charges arising from penalties for failed ECS debit transactions (due to insufficient balance). In this regard, it may be worthwhile to explore waiver of the charges for a select number of returned transactions, say five, akin to the number of free off-US ATM transactions.

- ✓ Payments infrastructure available at present do not allow customers to electronically earmark and accumulate small-ticket amounts for funding insurance premiums or investment contribution. The One-time Mandate proposed under UPI 2.0 attempts to offer a solution where the customer can set a mandate for up to a fixed amount. [Refer Section 3.5.2]

9.4 Product Design

- ✓ Product regulations must not lead to the creation and sale of products that are inadequate for the customer segments they are meant to serve. [Refer Section 5]

A summary of these recommendations along with a high-level indicator of the modes of intervention needed and the order of prioritisation is provided below.

Table 7: Summary of Recommendations

	Recommendation	Outcome of Interest	Mode of Intervention: Regulatory	Mode of Intervention: Supervisory	Mode of Intervention: Market	Prioritisation
DISTRIBUTION CHANNEL DESIGN	Universal Distributor licenses can be issued by all 4 regulators – 'Financial Services Intermediary' (FSI) that can offer comprehensive offerings including to LIHs	Greater coverage of LIHs	✓			Low
	Collapse in a phased manner, and bring under the fold of FSI, existing types of distributor regimes		✓			Low
	Applying a tiered approach to grading individual distributors such as BC agents so that the more capable ones can begin to sell these more sophisticated products		✓	✓	✓	High
	Registration regime for white-labelling of Corporate BCs so that banks can begin to adorn the 'seller' hat and be nudged into better product design for LIHs		✓		✓	High
	Permissions for Payments Banks to become BCs to NBFCs		✓			Low
OPERATIONS & SUITABILITY	Incorporating suitability assessment within product sale process such for various financial functions these products serve such as 'investment', 'risk management' and 'retirement income'.	Delivery of suitable products to LIHs in a comprehensive manner	✓		✓	High
	Supervisory processes to track distribution channel performance against suitability requirements, publish results, and take stringent actions for non-compliance			✓		High
	A board-driven strategy must drive product design and sales processes targeted at LIHs. Business processes assist staff there training cannot solve for capacity issues			✓		Medium
	Expected returns as % of the invested amount, and past and expected IRR to be clearly known upfront		✓	✓	✓	High
	Upfronting of incentives to be carefully reviewed and to not exceed a fixed cap, incentives for claims processing and annuitisation support to be considered for aligning these incentives with that of customer's		✓		✓	High
	Globally unsuitable products must not be sold to LIHs		✓			High
BUSINESS COST REDUCTION	Uniform KYC regimes and centralised KYC systems enable reuse of KYC by the provider for enrolling under products that cut across 4 regulators	Cost Efficiency in business	✓			High
	Digital means of completing KYC, Aadhaar eKYC and Video KYC to be put in place with adequate checks by all 4 regulators		✓	✓		Medium
	Rationalisation / waiver of penalties on ECS defaults by LIHs				✓	High
	Supervisory focus on improving banking infrastructure debit card outreach, ECS facility availability and efficiency		✓	✓	✓	Low
PRODUCT DESIGN	Product regulations must not lead to the creation of products that are inadequate for the needs of LIHs and the targeting of the customer segments they are meant to serve.	Suitable Product Design	✓	✓		Medium

High | Medium | Low

Annexure 1: Insurance Distribution Models

	Insurance Intermediary	Represents Customer	Represents Insurer	Insurance Intermediary as Exclusive Business[151]	Business Restrictions[152]	Remarks
			A. Insurance Agent Model			
1.	Corporate Agents		✓		3 in each category	Banks intending to act as corporate agents are required to apply for this license.
2.	Insurance Agents		✓	No specific mention	1 in each category	Applicable for individual insurance agents.
3.	Micro-insurance Agents		✓		1 in each category	Regulation of appointment of micro-insurance agents by insurers for the sale of micro-insurance products.
4.	Point of Sales Person - Life Insurance[153]	✓	✓		Engage with only 1 insurer/ intermediary	IRDAI introduced this category to expand the universe of existing individual distributors. POS persons can sell only 'simple' products such as pure Term Insurance products, non-linked/non-participatory Endowment Products and immediate Annuity Products.
5.	Point of Sales Person - Non-Life & Health Insurers[154]	✓	✓		Engage with only 1 insurer/ intermediary	Introduced with a similar objective as POS – Life insurance, POS persons in this category can sell pre-underwritten Motor

[151] Refers to the requirement to carry out the insurance intermediary business as the only business by the entity

[152] Business restrictions refers to the restrictions on the number of insurers (includes life, general, and health) whose products can be sold by the insurance intermediary

[153] Point of Sales Person – Life Insurance has been included under both Insurance Agent and Insurance Broking Model as POS persons can be appointed by any insurance intermediary for the sale of insurance products

[154] Point of Sales Person - Non-Life & Health Insurers - has been included under both Insurance Agent and Insurance Broking Model as POS persons can be appointed by any insurance intermediary for the sale of insurance products

						Comprehensive Insurance Package Policy & Third-party liability (Act only) Policy for Two-wheeler, private car and commercial vehicles, Personal Accident Policy, Travel Insurance Policy and Home Insurance Policy.
6.	Referral Company	-	-		1 in each category	Banks are not eligible to become referral companies. Exception has been provided in the case of Regional Rural Banks and Co-operative Banks satisfying certain criteria stipulated by the RBI.
			B. Insurance Broking Model			
7.	Insurance Brokers	✓		✓	None	
8.	Banks as Insurance Brokers	✓			None	
9.	Point of Sales Person - Life Insurance	✓	✓		Engage with only 1 insurer/ intermediary	IRDAI introduced this category to expand the universe of existing individual distributors. POS persons can sell only 'simple' products such as pure Term Insurance products, non-linked/non-participatory Endowment Products and immediate Annuity Products.
10.	Point of Sales Person - Non-Life & Health Insurers	✓	✓		Engage with only 1 insurer/ intermediary	Introduced with a similar objective as POS – Life insurance, POS persons in this category can sell pre-underwritten Motor Comprehensive Insurance Package Policy & Third-party liability (Act only) Policy for Two-wheeler, private car and commercial vehicles, Personal Accident

						Policy, Travel Insurance Policy and Home Insurance Policy.
11.	Insurance Marketing Firm		✓		2 in each category	This new category was introduced by IRDAI in 2015 with the stated objective of increasing insurance penetration in the country, especially in trying to get distribution presence in the Aspirational Districts[155]. In its design, it resembles the insurance broker model but with freedoms to undertake non-insurance financial services business[156] for enhancing revenue streams. It has also reduced the minimum net worth requirements (Rs.0.5 -1 million) as compared to that of a direct broker license (Rs.7.5 million capital).
C. Marketplace Distribution Models						
12.	Insurance Web Aggregators		✓	✓	None	IRDAI first introduced this model in 2011 in the form of guidelines for registration of web aggregators with the objective of facilitating online distribution of evaluation of insurance products.
13.	Insurance E-Commerce	✓	✓		As per the restrictions applicable to the licensed intermediary.	This license was introduced to promote e-commerce in insurance space in order to lower costs and bring inefficiencies. This allows an insurance company or an insurance intermediary to set up

[155] Aspirational District means a district designated as such by the NITI Aayog, Government of India or any other economically backward district, as may be recognized by IRDAI

[156] Can also distribute other financial products as permitted by RBI, SEBI, PFRDA, and Department of Posts

						an electronic platform to undertake e-commerce activities including issuance of e-insurance policies.
D. Others						
14.	Insurance Repositories	-	-		-	This license was first issued in 2011, and five entities were granted the license. The objective as stated was to provide the policyholder with the facility to maintain insurance policies in electronic form. Additionally, insurers intending to issue e-insurance policies are required to enter into service level agreements with insurance repositories.

Annexure 2: Incentive Structure Design for Insurance distribution licenses/ registration models

The maximum commissions or remuneration allowed[157] by IRDAI under each insurance product category is provided below.

Key Definitions	Applicability
Commission - paid to or received by an insurance agent from an insurer.	*Applicable* to payment of commission or remuneration or reward, to insurance agents and insurance intermediaries.
Remuneration - paid to or received by an insurance intermediary	*Not applicable* to insurance products specified under IRDAI (Micro Insurance) Regulations, 2015 and IRDAI (Insurance Services by Common Service Centre) Regulations 2015 and such other insurance products as may be specified by the Authority from time to time.
Reward - an incentive paid to an insurance agent (towards benefits) or an insurance intermediary (towards services rendered)	No Insurer shall pay both commissions to an insurance agent and remuneration to an insurance intermediary on the same insurance policy.
Insurance Intermediary for the purpose of this regulation includes - (a) Corporate Agents (b) Insurance Brokers (c) Web Aggregators (d) Insurance Marketing Firm (e) Any other entity as may be notified by the Authority from time to time.	

Life Insurance: The maximum commission or remuneration as a percentage of premium that is allowed for life insurance products offered by life insurers is as under:

	Category of Life Insurance Product or Policy	Maximum Commission/ Remuneration on Single Premium payable to insurance agent/ insurance intermediary
1	**Single-Premium**	
A	All individual life products except pure risk products	2%
B	Individual Pure Risk products	7.50%
C	Individual Immediate/ Deferred Annuity	2%

[157] IRDAI (Payment of commission or remuneration or reward to insurance agents and insurance intermediaries) Regulations, 2016, accessible at: https://www.irdai.gov.in/ADMINCMS/cms/frmGeneral_Layout.aspx?page=PageNo3032&flag=1

D	One year renewable group pure risk insurance	5% of premium paid during the year or Rs 1 million, whichever is less	
E	Group Pure Risk (incl Group credit)	5%	
F	Group Savings Variable Life Insurance	2%	
G	Group Fund based	0.5% of the premium paid during the year or Rs1 million, whichever is less	
2	**Regular Premium**	**First-year premium**	**Renewal premiums**
A	Individual Pure Risk	40%	10%
B	Individual Other than Pure Risk		
i)	In respect of policies with premium payment terms of		
	5 years	15%	7.5%
	6 years	18%	7.5%
	7 years	21%	7.5%
	8 years	24%	7.5%
	9 years	27%	7.5%
	10 years	30%	7.5%
	11 years	33%	7.5%
	12 years or more	35%	7.5%
C	Individual Deferred Annuity / Pension	7.5%	2%
D	Group Pure Risk (incl Group credit) and Group Savings Variable Life	7.5% (only on pure risk premium)	7.5%
E	Government Scheme-Life-Health	As per Government Notification	As per Government Notification

Health Insurance (General & Stand-alone Health Insurers): The maximum commission or remuneration as a percentage of premium that is allowed for health insurance products offered by general insurers or stand-alone health insurers is as under:

	Line of Business	Maximum Commission/remuneration payable to insurance agents/ insurance intermediaries
1	Health-Individual[158]	15%
2	Health-Group (Employer-Employee only) - Annual	7.5%
3	Health-Group (Non Employer-Employee groups – not formed solely for availing insurance as defined in IRDA Group Guidelines of 14th July 2005) – Annual	15%
4	Health – Group (credit linked upto 5 years)	15%
5	Health-Govt Scheme	As specified in the Government Scheme/Notification

[158] Individual includes annual premium, 3 years single premium, 3 years regular premium

General Insurance (other than the motor[159]): The maximum commission or remuneration as a percentage of premium that is allowed for general insurance (other than the motor) is as under:

	Line of Business (Other than Motor)	Maximum Commission payable to an insurance agent	Maximum remuneration payable to an insurance intermediary
1	Fire-Retail	15%	16.5%
2	Fire-Corporate (Risks with S.I. < Rs 2,500 crs)	10%	11.5%
3	Fire-Corporate (Risks with S.I. > Rs 2,500 crs)	5%	6.3%
4	Marine-Cargo	15%	16.5%
5	Marine-Hull	10%	11.5%
6	Miscellaneous – Retail	15%	16.5%
7	Miscellaneous – Commercial/ Group[160]	10%	12.5%
8	Miscellaneous – Commercial (Engineering Risks with S.I. > Rs 2,500 crs)	5%	6.3%

Rewards:

Three channels of distribution[161]	**Rewards**
Insurance agents	Maybe paid
Insurance intermediaries - insurance intermediary business forms the core. (revenues from other than insurance intermediation is 50% or less of their total revenue from all the activities)	Maybe paid
Insurance intermediaries - insurance intermediary business does not form the core (revenues from other than insurance intermediation is 50% or more of their total revenue from all the activities)	Not allowed
Rewards Payable (Overall basis and not linked to each and every policy solicited):	
Life Insurance	Not more than 20% of the 1st year commission or remuneration paid.
General Insurance including health insurance	Not more than 30% of the 1st year commission or remuneration paid.

[159] We have not covered discussion on motor insurance in this report

[160] Commission/ remuneration shall be payable as per Government notification

Important Observations

Insurance Intermediary	**Maximum Commission/ Remuneration Payable**	**Remarks**
Corporate Agents	Caps on incentives for life, general, and health insurance are similarly placed.	
Insurance Agents		
Insurance Brokers		
Banks as Insurance Brokers		
Insurance Marketing Firm		Entitled to receive fees for undertaking insurance service activities as may be mutually agreed between the IMF and the Insurance Company.
Insurance Web Aggregators		No charges shall be paid for transmission of leads, and only leads which are converted into the sale of insurance policies will entitle the Web Aggregator to earn remuneration. Fee or remuneration on any type of renewal premium/policy not allowed. A flat fee of not exceeding Rs. 50,000 per year towards each product displayed. The insurer may pay reasonable service charges at mutually agreed if it outsources 'Insurance Services' in respect of policies procured through them.
Micro-insurance Agents	(a) Life Insurance Business: Single premium - 10% of the premium. Non-single premium - 20% of the	

	premium for all the years of the premium paying term. (b) General Insurance - 15% of the premium. (c) Group Insurance - The limits specified in (a) and (b) would be applicable. (d) In case of registered insurance intermediaries (other than Micro-insurance agents): According to the respective applicable regulations.	
Point of Sales Person - Life Insurance		
Point of Sales Person - Non-Life & Health Insurers		
Referral Company	Only for such database that is converted into sales, which shall not exceed 25% of the commission payable or actually paid, whichever is lower, on the first-year premium of the first policy sold based on the lead obtained from the referral company.	Fee or remuneration on any type of renewal premium/policy not allowed.
Insurance Repositories	As per the agreement entered by the two parties.	

Annexure 3: Suitability Obligations

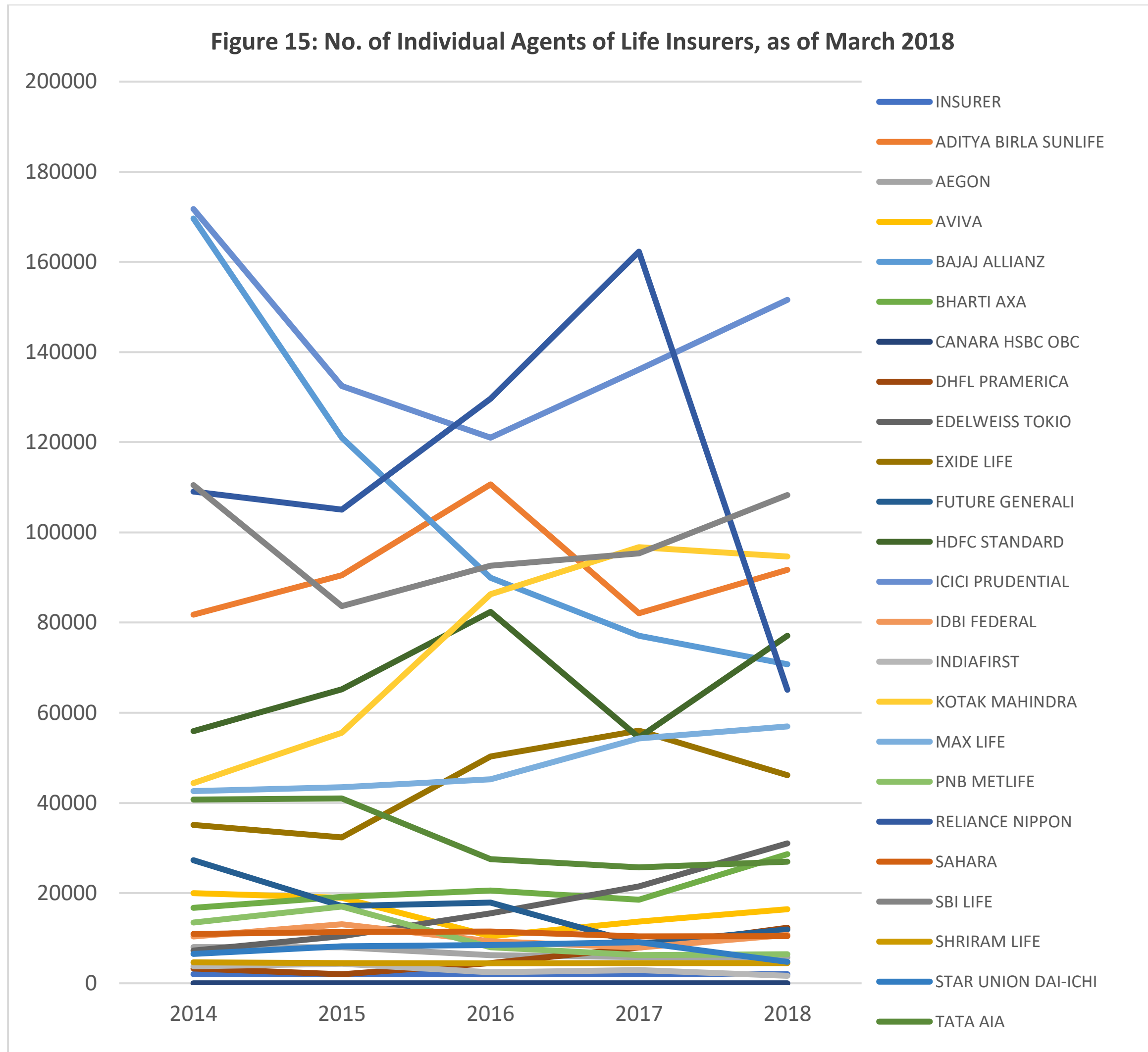
Function of credit: If the Financial Services Intermediary is dealing in a product that provides the function of credit to the retail customer, it has an obligation to ensure that it conducts, prior to making available the credit facility to the retail customer, adequate due diligence on the retail customer to ascertain the ability of the retail customer to meet his/her repayment obligations when they are expected to fall due (both unique repayment obligations as well as the total repayment obligation under the credit arrangement), out of own income and savings without having to realise security or assets. Where credit is expected to be used for increasing income-earning capacity of the retail customer's livelihood by means of self-employment, then the financial service provider must carry out adequate due diligence to ascertain, to its satisfaction, the ability of such investment in increasing the income-earning capacity of the livelihood such that it can generate cash flows that would be adequate to meet his/her repayment obligations when they are expected to fall due (both unique repayment obligations as well as the total repayment obligation under the credit arrangement). Any due diligence of the retail customer must not be based primarily or solely on the value of any security that the retail customer is willing to furnish.

Function of insurance: If the Financial Services Intermediary is dealing in a product that provides the function of insurance to the retail customer, it has an obligation to ensure that it conducts, prior to enabling a transaction in relation to insurance, adequate due diligence on the retail customer to ascertain, including through information obtained from the retail customer about his/her financial situation, that the transaction is appropriate and adequate for the customer's interests and needs, and that the customer has the ability to make payments for the premiums due.

Function of investment: If the Financial Services Intermediary is dealing in a product that provides the function of investment to the retail customer, it has an obligation to ensure that it conducts, prior to enabling a transaction in relation to investment, adequate due diligence on the retail customer to ascertain, including through information obtained from the retail customer about his/her financial situation, risk profile and capacity, that the transaction meets the customer's investment objectives. Such due diligence must ensure that the customer is able to bear any investment risks related to such transaction in line with his/her investment objectives. Such due diligence must not be based primarily or solely on the risk appetite of the retail customer for a specific product.

In demonstrating compliance with the Obligations, the Financial Services Intermediary must invest in efforts that are proportionate to the complexity that the financial product or service can introduce in the financial life of the customer. Such a demonstration of compliance should reflect the risk of harm to the customer, considering the nature of the customer, and the nature of the financial product or financial service provided.

Annexure 4: Changes in the number of individual agents and corporate agent partnerships of life insurers, 2013-2018 (Excluding LIC)



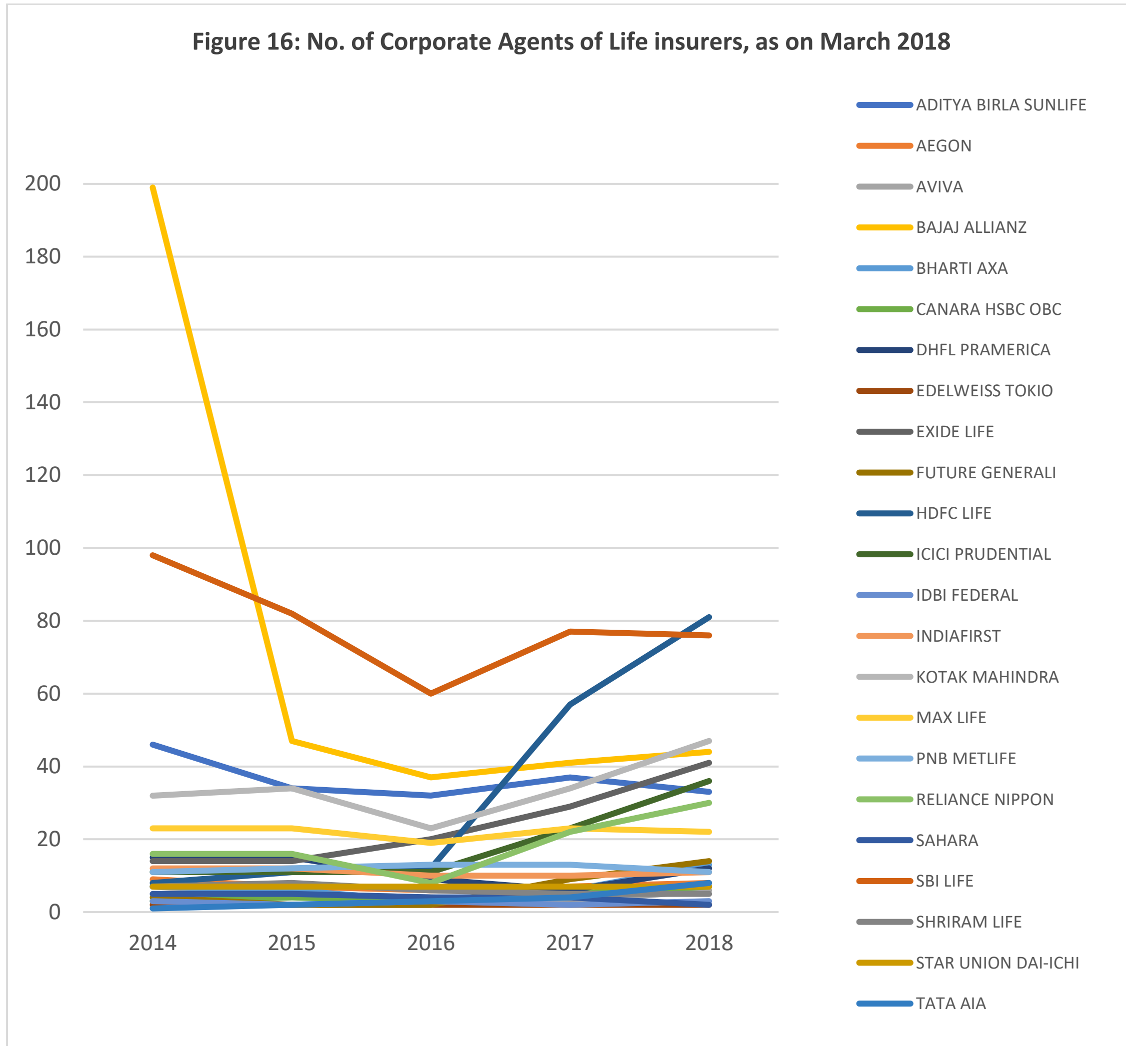


Figure 16: No. of Corporate Agents of Life insurers, as on March 2018
200
180
160
140
120
100
80
60
40
20
0
2014
2015
2016
2017
2018
ADITYA BIRLA SUNLIFE
AEGON
AVIVA
BAJAJ ALLIANZ
BHARTI AXA
CANARA HSBC OBC
DHFL PRAMERICA
EDELWEISS TOKIO
EXIDE LIFE
FUTURE GENERALI
HDFC LIFE
ICICI PRUDENTIAL
IDBI FEDERAL
INDIAFIRST
KOTAK MAHINDRA
MAX LIFE
PNB METLIFE
RELIANCE NIPPON
SAHARA
SBI LIFE
SHRIRAM LIFE
STAR UNION DAI-ICHI
TATA AIA

Annexure 5: Total Expense Ratios across AUM slabs for Mutual Funds

<table>
<tr><th colspan="5">Table 8: Base Total Expense Ratio for Mutual Funds[162]</th></tr>
<tr><th>AUM Slabs (Rs.cr)</th><th>Equity Oriented Schemes</th><th>Debt Oriented Schemes</th><th>Exchange Traded Funds (ETFs) (including Gold ETFs)/Index Funds</th><th>Fund of funds (FoF) (Both Domestic and Foreign)</th></tr>
<tr><td>Upto 100 cr</td><td>2.50%</td><td>2.25%</td><td rowspan="4">1.50%</td><td rowspan="4">Maximum of 2.5% including the TER of underlying schemes.</td></tr>
<tr><td>Next 300 cr</td><td>2.25%</td><td>2.00%</td></tr>
<tr><td>Next 300 cr</td><td>2.00%</td><td>1.75%</td></tr>
<tr><td>On balance AUM</td><td>1.75%</td><td>1.50%</td></tr>
<tr><td colspan="5">The additional expenses over and above the base TER are as under:
• Additional expenses, not exceeding 0.30 percent of daily net assets, subject to new inflows from B30 cities;
• Additional expenses, not exceeding 0.05 percent of daily net assets, due to credit of any exit load to the scheme.
• Goods & Services Tax (GST) on Management Fee is charged over and above the TER limit.</td></tr>
</table>

[162] Proposal for review of Total Expense Ratio (TER) of Mutual Fund (MF) Schemes, SEBI Board Memorandum, accessible at: https://www.sebi.gov.in/sebi_data/meetingfiles/oct-2018/1539576106009_1.pdf