

REPORT OF THE EXPERT COMMITTEE ON HARNESSING THE INDIA POST NETWORK FOR FINANCIAL INCLUSION

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Department of Post
Ministry of Communications & IT
Government of India



Department of Financial Services
Ministry of Finance
Government of India



Department of Economic Affairs
Ministry of Finance
Government of India



**Invest India Economic
Foundation (IIEF)**

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June 30, 2010

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Report on Harnessing the India Post Network for Financial Inclusion

Dear Shri Samant,

I am very pleased to submit the Report of the Expert Committee on Harnessing the India Post Network for Financial Inclusion produced jointly by the Department of Financial Services, Department of Economic Affairs, Department of Post and Invest India Economic Foundation (IIEF).

This Report has had the benefit of ideas and inputs from a Committee that represents many potential users of the India Post outreach. This, coupled with our focus on a demand-side view of Indian finance has ensured that our recommendations for population wide banking, payments and emergency credit access are in line with both the Government's focus on financial inclusion and the India Post capacity and role in delivery of essential financial services to everyday Indians.

Many Expert Committee members and Technical Experts on the Committee have contributed background papers for the Report, and have drawn others from their organizations to help in the work. This has been truly a collective effort, and I would like to express my sincere gratitude to Dr. K.P. Krishnan, Sukriti Likhi, Dr. Shashank Saksena, Ashok Pal Singh, Dr. Viral Shah, A.S. Prasad, Manisha Sinha, Vijay Mahajan, Ashish Aggarwal, Ramesh Ramanathan, Dr. Kshama Fernandes, T.V. Seshadri, Sanjeev Kapoor, Anil Misquith, Karan Bajwa, Sushant Kumar and Sudeep Yadav. Gautam Bhardwaj who served as the convenor and member-secretary of the Expert Committee, and Dr. Viral Shah worked actively with me on putting together the final report and on obtaining valuable feedback and ideas from a variety of key stakeholders and potential users of the postal network.

I must acknowledge Anuradha and her team at IIEF for hosting the Committee's many consultations, and creating a resource secretariat to take care of the logistical arrangements. I particularly thank IIEF for making available data and analysis from Invest India's Incomes and Savings Survey 2007 (IISS07) that directed the Committee's thinking on the present gaps in financial inclusion.

The Committee is especially grateful to Citibank N.A., Intel Corporation, ICICI Bank, Infosys Technologies, Microsoft Corporation and MasterCard International for their support as co-sponsors.

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The Committee greatly appreciates also ongoing inputs from our “virtual” members: Gautam Bandyopadhyay, Khushnama Davar, Piyush Choudhary, Manish Gupta, Rajib Ranjan, Navneet Taneja, Vibha Mehra, Ambujam H, V. S. Radhakrishnan, Ganesh Vaidyanathan, Anirudh Srivastava, Manish Lodha and Nikhil Gahlot. Each of them contributed in the writing of significant portions of the Report, and greatly enhanced the intellectual quality and practical content of the Committee’s discussions.

The Committee is particularly grateful for your own time and ongoing guidance in our deliberations on the potential role for India Post in mitigating a range of insurable risks of India's excluded population and especially the poor.

Sincerely,



Ajay Shah

Chairman, Expert Committee

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section one

EXECUTIVE SUMMARY

The India Post network with over 155,000 branches is twice as large as the outreach of all commercial banks in India put together. Over the years, the Post Office Savings Bank (POSB) has emerged as significant component of India Post operations and its revenues from financial services as a share of its total revenue have steadily increased over time to 45 percent today.

While the phrase 'financial inclusion' is relatively new, it is obvious that post offices were working on problems of financial inclusion many decades before the phrase was coined. The National Postal Policy¹ also visualises an important continued role for India Post in delivering broad-based banking and financial services:

“Nearly 16 crore people use India Post to save Rs. 3,23,781 crore as on March 31, 2007. Out of this, deposits in savings bank account alone is Rs.16,789 crore. There is, therefore, a need for India Post to computerize and connect all its savings bank accounts so as to widen and deepen the level of financial transactions and offer banking services to the rural population. India Post sees a great opportunity for increasing the number of accounts and volume of savings.”

This Expert Committee was constituted to examine potential synergies between the efforts at broad-based banking and financial services delivery at India Post and the larger policy goal of financial inclusion. The Expert Committee examined the role for the postal network in financial inclusion in the context of the presently unmet demand for financial services, the core strengths and capabilities of India Post, as well as of the emerging policy, regulatory and business environment in this area.

Based on extensive finance consumer research and consultations with key stakeholders, the Expert Committee is of the opinion that succeeding with universal access to financial services will require a considerable role for post offices. In parallel, and as some traditional functions of the postal network are being supplanted by new technologies such as email, India Post is also in the process of carving out a larger role for itself. Therefore, there is a remarkable coincidence of needs between the twin problems of (a) charting the

¹ The National Postal Policy: http://www.indiapost.gov.in/National_Postal_Policy.htm

future for India Post, and (b) resolving India's challenges of financial inclusion.

The Recommendations of the Expert Committee are guided also by the role for the State in producing public goods and fostering public-private partnerships, and implementing vendor neutral and incentive compatible solutions. India Post will need a further expansion of its present financial services delivery strategy and capacity in order to perform public goods functions in the field of financial inclusion in an environment of modern technology. The Report sketches the contours of this strategy.

The primary building blocks of financial inclusion are storage of cash, payments and credit. Importantly, India Post already has several decades of experience in performing the first function through Post Office Savings Bank (POSB) accounts, and the second through money-orders. However, India Post does not yet deliver credit. This Report presents a unified approach and role for India Post in delivering these core elements of financial inclusion. It is feasible to harness broad-based banking and payments infrastructure in delivering a range of risk management tools including insurance, pension and credit, as well as a variety of government-to-person (G2P) payments targeted at the presently excluded population including the poor.

Access to banking services that permit citizens to receive and make payments in a secure environment is an important launch pad to financial inclusion. However, despite a prolonged attack on the problem, bank penetration rates around the country remain at only modest levels. India Post is well placed to actively assist universal banking coverage with a low cost, light-weight bank account for all excluded citizens. In an environment with rapidly evolving hardware and software solutions and a dynamic load requirement, India Post could achieve low costs, rapid implementation and technology risk minimisation through an outsourced model for delivering light-weight POSB accounts. In this model, India Post could invite competing service providers to bid a cost (or revenue-share) per transaction based on the service providers' assessment of the potential market size and growth, as well as the transaction price that the market will bear.

Recommendation 1: *India Post should deliver lightweight, low-cost bank accounts to all Indian citizens and especially to the financially excluded population.*

India Post can achieve this outcome by establishing contractual arrangements with multiple IT vendors who will provide an India Post specified application programming interface (API) and charge a stated low price per transaction (or deliver a stated revenue per transaction) to India Post. The underlying requirement for data centres, IT systems and operations management, and the potential for public-private partnerships in this area may

be examined and implemented by India Post in the context of its overall banking and financial services delivery strategy.

The impact of this proposed effort upon the larger financial inclusion agenda of the Government can be further amplified by adopting an open architecture and by opening up interface to business partners such as micro finance institutions (MFIs), mutual fund and insurance companies, telecom operators and other entities desirous of also reaching and serving the excluded population including the urban and rural poor. In this way, while the India Post IT systems for light-weight bank accounts shall deliver financial inclusion through post offices, such partners can further the overall inclusion agenda by using the India Post IT infrastructure at a fee charged by India Post for transactions.

Recommendation 2: *India Post should look for ways to leverage its low cost platform by providing India Post branded accounts to other strategic partners, such as MFIs, mutual fund and insurance companies, and telecom operators.*

By treating its IT capacity for light-weight bank accounts as a public good, India Post would increase its impact on financial inclusion. Also, adoption of the POSB infrastructure by partners would lead to increased accounts and transaction volumes and induce further economies of scale.

The second fundamental building block of financial inclusion relates to payments. The dominant role of the 'Postal Giro' in Europe suggests that India Post, which already provides money-orders across the country, can play an important role in payments.

Recommendation 3: *India Post should apply itself towards the challenge of achieving high volumes of money-orders where payments of as little as Rs.10 are achieved at a charge of less than Rs.0.1 while requiring no subsidy from the exchequer.*

Drawing upon the experience with the Postal Giro, this will require a tight integration between POSB accounts and money-orders. The payments transaction will involve a transfer of an account balance from one POSB account to another, without any human intervention.

Recommendation 4: *India Post should evolve the money-order to become a mechanism for transferring money from one POSB account to another, instead of just being a mechanism for delivering cash from one person to another.*

Given the ubiquity of mobile phones in India today, there is growing recognition of the utility of mobile-based financial transactions in the Indian context. For example, a person

with a POSB account should be able to use his mobile phone to make a real-time money-order of Rs.10 to a street vendor if the street vendor also has a mobile phone and a POSB account. India Post should charge Rs.0.1 or less for this transaction.

A pan-India mobile-based and web-based payments system linked to POSB accounts can be equally used for remittances and can effectively replace the traditional postal money-order. As with POSB accounts, the Expert Committee recommends an open architecture approach for payments under which India Post should sign contracts with all telecom operators. Similarly, all organisations that sign up to use the India Post IT infrastructure (for either offering POSB accounts or for offering their own accounts) should automatically be connected into this new money-order service of India Post.

Recommendation 5: *India Post must build a payments infrastructure, through an array of contracts with partners, connecting up all POSB accounts and accounts of its partners, to effectively become a person-to-person money-order capability (through mobile phones or web browsers) for a large swathe of India.*

Payments networks involve network externalities. The value of the platform which India Post is building is proportional to the square of the number of people participating in it. A network with twice as many people in it is thus four times as valuable.

Recommendation 6: *India Post must elicit a large number of partners in terms of financial inclusion players, mobile service providers and innovative new technological choices in order to increase the size of the network.*

This payments network integrally connects up with a key problem that government faces today: that of having a mechanism through which payments such as MGNREGS and IGNOAPS are directly delivered to citizens.

Recommendation 7: *India Post must work closely with a diverse array of government agencies so that their G2P payments requirements are met through a combination of POSB accounts held by citizens and money-orders delivered by government to those POSB accounts. The Ministry of Finance should work with India Post in rapidly rolling out this platform and network, given its important implications for direct, targeted delivery of government subsidies.*

The main body of the Report thus offers an integrated approach to POSB accounts and money-orders, and refashioning these to suit the financial inclusion needs of the 21st century. This is simultaneously of interest from India's viewpoint – that of achieving

financial inclusion and more efficiently running government programs – and also ensures that POSB accounts and money-orders are not made obsolete by technical and institutional change.

The Report also proposes a new model for delivering short-dated non-collateralised loans to the poor – an activity that is presently dominated by moneylenders. Recommendations on credit are based on some essential principles that should be applied. First, India Post must not give loans to individuals using public money. Second, India Post staff must exercise no discretionary judgement about the credit quality of a given individual who approaches a post office for a loan.

The Report presents a mechanism through which the India Post network can deliver short-duration, fixed-size, non-collateralised micro loans (of Rs.500 for one month) while adhering to these two principles. To achieve this, identification of an individual should be done through the UIDAI. Each individual loan would be sourced from a network of competing lenders who would bid an interest rate for the loan on the basis of risk measures for an individual. The individual would obtain a loan at the lowest interest rate offered by competing lenders. The successful bidder for the loan would carry the credit risk on its books. The risk profile of the individual would reside in a database controlled by India Post. Individual credit history linked to a UID would create a repayment incentive for each individual. India Post would derive a fee by the lenders for performing these services.

With a combination of UIDs, mobile phones, payments infrastructure and POSB accounts, it should be feasible also to design a seamless process by which an individual is able to source an emergency loan at any point using a micro-ATM or a mobile phone.

Recommendation 8: *India Post should play a role in the emergency credit aspect of financial inclusion, through a platform-building approach where private lenders deliver credit to the poor through a competitive framework.*

Implementation of the recommendations of the Expert Committee would involve preparation of certain bid documents by India Post. These would cover the specifications of lightweight POSB accounts, mobile-based payments, and the credit-enabling framework. Once these documents are prepared, procurement can proceed.

Recommendation 9: *India Post should request the addition of its financial inclusion project into the Terms of Reference of the recently announced Technology Advisory Group for Unique Projects, and the leadership team of the India Post financial inclusion project should closely engage in the work of this Group, so as to bring in the best practices for*

project management.

The 2010 budget speech envisaged an expert group, led by Mr. Nandan Nilekani, chairman of UIDAI, to examine implementation issues for complex IT projects in government. The terms of reference of this group focuses on the projects presently being implemented by the Ministry of Finance: National Treasury Management Agency (NTMA), Goods and Services Tax (GST), New Pension System (NPS), Expenditure Information Network (EIN), Tax Information Network (TIN). The implementation challenges of these projects are identical to those that will be faced in activating post offices for financial inclusion.

Recommendation 10: *The role of the Post Office Savings Bank as an agent of the Ministry of Finance should be revisited and expanded to enable India Post to play a larger, direct role in financial inclusion and build appropriate enabling architecture.*

As per the current Allocation of Business Rules, the Government Savings Banks Act, 1873 is housed within the Ministry of Finance. India Post should engage with the Ministry of Finance to re-examine and expand its presently limited agency function to enable the postal network to more serve effectively as India's financial inclusion platform. This may require a significant change and expansion in the Allocation of Business Rules for India Post. Specific recommendations in this regard are beyond the scope this Expert Committee.

section two

CONTEXT

Indian economic policy emphasises achieving high growth rates coupled with ensuring that the poor are able to participate in the market economy. This inclusion agenda has many implications for the field of finance. It involves creating a business environment through which the poor across the country have easy, secure and affordable access to critical risk management products.

In the book “Portfolios of the Poor”, the authors describe how the poor in India pay a lot to access low quality and unreliable financial products. The complex financial needs and risks faced by the poor require sophisticated financial solutions and risk management tools. These cannot be scaled down versions of existing products for the rich.

Microfinance institutions (MFIs) in India have shown how credit products can be restructured to meet the needs of the poor, so that loans can be made at lower interest rates while still being profitable.

Access to the formal financial system starts with a bank account, and the ability to make secure payments through that account. Once the ability to make payments is available ubiquitously, other financial products such as credit, insurance, pensions and mutual funds can be delivered using this infrastructure. From the 1960s onwards, policy makers have attempted a variety of initiatives in order to achieve financial inclusion. Major policy statements of the government in the recent past on this subject include:

1. The [Report of the Committee on Financial Inclusion](#)² chaired by Dr. C. Rangarajan describes a comprehensive 179 point strategy for building an inclusive financial sector.
2. The Committee Report – [A hundred small steps.: Report of the Committee on Financial Sector Reforms](#)³, chaired by Prof. Raghuram Rajan devotes a full chapter to financial inclusion. As a simple first step, it advocates a national goal of ensuring in three

² http://www.nabard.org/report_comfinancial.asp

³ http://planningcommission.nic.in/reports/genrep/report_fr.htm

years that 90 per cent of households have access to a deposit account and to a payments system, and that government transfers under various schemes be implemented through this system.

3. The Report of the Inter-Ministerial Group on a [Framework for Delivery of Banking Services Via Mobiles](#)⁴ proposes a payments solution with mobile-linked no-frills accounts. India Post was part of this group and the recommendations of this report are in harmony with those of the IMG report.
4. A vision document by the Unique Identification Authority of India (UIDAI) – [From Exclusion to Inclusion with Micro-payments](#)⁵ – provides a comprehensive solution to achieve this through the use of technology and UID authentication.

Each of these Reports share a common theme: they all emphasize the role of technology in creating ubiquitous access to savings accounts and a payments network. But the most recent household survey evidence shows many gaps and that the financial inclusion agenda for India is far from complete. For example, of India's 321 million strong earning population aged 18 to 59 years, less than half (45 percent) have bank accounts. In the case of women earners, penetration rates are even lower at a mere 28 percent. Importantly, and as can be seen in *Table 1*, the issue is not only a rural one, for although bank penetration rates are indeed lower in rural India, in urban India they stand at only 63 percent for male earners and at 47 percent in the case of women.

Table 1: **Bank Penetration Rates among India's Working Age Paid Workforce**

Workforce Category	Total	Rural	Urban
All earners aged 18-59 years	45%	38%	62%
Shopkeepers	72%	65%	79%
Dairy farmers	59%	59%	62%
Traditional farmers	45%	45%	51%
Street vendors	39%	35%	45%
Semi & skilled wage labourers	34%	32%	37%
Artisans & craftsmen	26%	22%	37%
Home-based workers	25%	20%	38%
Agricultural wage labourers	14%	14%	12%
Other daily wage labourers	18%	15%	26%

Source: *Invest India Incomes and Savings Survey, 2007* (IISS07)

⁴ <http://www.mit.gov.in/content/government-approves-framework-provision-basic-financial-services-through-mobile-phones>

⁵ http://www.uidai.gov.in/documents/Exclusion_to_Inclusion_with_Micropayments.pdf

The Post Office Savings Bank (POSB) already is the largest bank in the country by number of customers, and number of branches, handles a large volume of government benefits payments, and does not distinguish between rich and poor customers. Thus, given its size and reach, India Post can lead the way for financial inclusion. By doing so, it can bring together a number of stakeholders on a common platform: central and state governments, microfinance institutions, technology providers and most importantly, the presently excluded individual citizens.

Commercial banks are leading the charge for financial inclusion today. They are opening no-frills accounts for poor customers. Central, state and local governments are increasingly preferring government benefits payments to be routed through banks rather than using money-orders. Banks are increasingly offering remittance products to their customers and installing ATMs in rural areas. In a world that is fast becoming electronic and connected, India Post needs to innovate and change with the times. It must offer customers products that can be used effortlessly and instantaneously through the use of technology. By playing a dominant role in financial inclusion, India Post can increase its relevance and improve its profits.

Products that use cash implicitly pass on the costs of cash management to the customer. This makes many of financial products infeasible. The costs of storage and transportation of cash are very high. It is estimated that 1% of all microfinance loans go towards the cost of cash management today. The poor often pay a large sum for safekeeping of money, either directly, or indirectly through occasional theft. A savings account provides safety at low cost, while at the same time bearing interest. Modernising the POSB accounts offering with technology will form a basic building block of India Post's offerings for financial inclusion.

India Post also already offers a money-order facility. While this product is expensive in its present form, an electronic money-order can become low-cost and competitive. Worldwide, post offices offer the Postal Giro as a means of sending payments electronically, and a mechanism for paying utility bills. Once a payments system is set up, India Post can deploy this infrastructure in elegant ways to become a market leader in micro-loans to the poor for emergencies. It will be able to offer much cheaper loans to its customer by harnessing the power of technology and innovative product design.

This Expert Committee therefore recommends that India Post implements the following three building blocks for financial inclusion:

1. A savings account solution,
2. A payments solution, and
3. A micro-credit solution.

2.1 Principles

Extensive use of technology is the only realistic way to achieve economies of scale and deliver a range of financial services in a secure environment at a low cost to the poor. At present, IT skills and capacity at India Post are relatively limited although the Department is rapidly incorporating technology into its processes and acquiring new IT skills. Its core competencies are its outreach, credibility and brand strength among everyday Indians.

India Post should actively embrace the financial inclusion agenda and harness both modern technology and innovations in distribution and outreach. In this process, it should not displace private initiative. Instead, it should proceed in a spirit of public-private partnership that harnesses the trust and outreach of India Post and the technology skills and innovations of private technology and financial services firms to deliver the core building blocks of financial inclusion to every citizen of India.

The Expert Committee's recommendations in this Report are therefore based on the following guiding principles:

1. **Focus on public goods:** The government should largely focus on providing public goods. Government investment should not displace private investment, but create an environment conducive to private investment.
2. **Public-private partnership:** The Government should undertake activities that are difficult for the private sector to provide and simultaneously encourage a competitive ecosystem, free of any vendor lock-in, and provide a level playing field.
3. **Incentive compatible solutions:** A solution must be incentive compatible. All participants should participate willingly, and based on self-interest. There must be

a positive gain for all participants: India post, customers, and private sector partners.

4. **Vendor neutrality:** Any solution deployed by India Post must be vendor neutral both in the technology acquisition phase, and in the selection of partners. Open standards based solutions must be deployed, so that India Post cannot be held hostage by any specific vendor in the future.

section three

SAVINGS ACCOUNTS

The post office savings bank (POSB) account is well placed to serve as the basic building block of all financial inclusion activities that India Post undertakes. The system for issuing and managing POSB accounts should however be modernized by implementing a customised and scalable lightweight technology solution.

Commercial banks that host lightweight, no-frill accounts on a traditional CBS find this an expensive option as it involves high fixed costs for software licenses and hardware. For the purposes of offering a limited set of well-defined services to a very large base of customers with modest savings capabilities, and in an environment with dynamic transaction loads, India Post should aim to acquire a tailor-made technology solution that can adapt itself to changing capacity forecasts and needs.

In this context, the Expert Committee recommends that India Post create a public-private partnership through a competitive process under which a technology services vendor builds and operates a hosted, lightweight CBS platform for India Post. The technology solutions provider should be expected to establish capacity for delivering a range of specified services based on its own estimate of transaction volumes and growth. India Post should either pay a fixed annual fee per account and a modest fee per transaction or derive a revenue share from the technology solutions provider on the basis of a charge that the IT vendor believes the market will bear. The technology services vendor should be chosen through an auction.

This model aligns the incentives of the IT vendor with those of India Post while ensuring optimum software and hardware capacity and deployment. In parallel, this model mitigates the technology risk for India Post, facilitates rapid deployment and does not impose significant up-front technology investment. This will free India Post to focus on its core competencies of delivering banking services throughout the country, whereas the IT vendor would focus on its core competency of running a large IT system. A classic example is that of Airtel, where Airtel saved a significant sum of money by outsourcing

its IT and network operations. The IT management of NPS and TIN are examples of government projects that have been successfully outsourced in a public-private partnership mode.

In its vision document for financial inclusion, the Unique Identification Authority of India (UIDAI) has proposed a bank account for everyone in the country. The Thirteenth Finance Commission has proposed a budget of Rs.3,000 crore to be used for delivering an incentive of Rs.100 into the bank account of each BPL resident who enrolls for a UID. This creates a pan-India demand for light-weight bank accounts. India Post, with its ubiquitous reach should actively position itself to offer a low cost lightweight bank account to anyone enrolling for a UID. Simultaneously, India Post should accept a UID as a sufficient KYC for opening a POSB account.

A streamlined POSB account that can be operated at any post office in the country, and can be accessed through a mobile phone can have huge positive network externalities. Several stakeholders will benefit: Customers will be able to access their accounts ubiquitously; Financial firms providing credit, insurance, pension, and other innovative financial products to the poor will have a lower barrier to entry, and lower operational costs; Central and State governments will be able to deliver benefits and subsidies directly into the accounts of target beneficiaries; and India Post will be able to further increase its customer base and more effectively increase its foot-print in financial inclusion.

Additional revenue streams can be created by India Post by allowing other strategic partners such as MFIs, insurance and mutual fund companies to use these lightweight POSB accounts for delivering a range of financial services to citizens. This would in turn lead to high transactional volumes and increased revenues for India Post.

The Report of the Inter-Ministerial Group on the “Framework for Delivery of Basic Financial Services using Mobile Phones” recommends the creation of a national infrastructure - Interoperable Infrastructure for Accounting Small Transactions (INFAST). It calls for all banks to create no-frills accounts on a centrally hosted and managed IT infrastructure to lower costs. This presents a unique strategic opportunity for India Post and the Department should play a proactive, leadership role in creating INFAST. By linking its proposed lightweight bank accounts to UIDs and by opening this platform to other strategic partners, India Post can lead the charge in implementing INFAST and effectively emerge as India's financial inclusion platform.

section four

PAYMENTS

The domestic money-order (MO) is an India Post product that has huge brand value. India Post has delivered on the promise behind this brand for over a century, and continues to do so. A payment can be sent by a person to any other person in the country through an MO. In the age of the internet, it would not be unreasonable for a customer to expect that MOs be delivered within seconds into their postal savings accounts.

Towards this objective, the Expert Committee recommends that India Post establish a low cost payments platform. A low-cost, nation-wide payments platform will foster an ecosystem that offers several pro-poor financial and non-financial products as all financial products require a robust payments mechanism. A loan involves a payment to a customer followed by periodic interest repayments by the customer over time. In insurance products, premiums are paid periodically, with a possible payout in the future. A pension product requires contributions over several years, followed by a pension payout at retirement. Mutual funds require an up-front payment to buy the product, with periodic dividend payments to investors.

A payments system thus plays a major role in the delivery of financial products. A mass market for pro-poor financial products, and for financial inclusion, requires a reliable, low-cost, low-value payments platform that is available ubiquitously.

4.1 EuroGiro – A case study

EuroGiro, a payments system that originated in and continues to be run by post offices, is a global network for electronic exchange of low-value international remittances between members. It is a gateway providing connectivity across several financial services alliance members and partners in almost 50 countries. More importantly, it brings together post offices and banks on a common interoperable network. It's offerings include three classes of products.

1. Account to account payments,
2. Cash sent as MOs – cash to cash payments, and account to cash payments, and
3. Bulk and pension payments

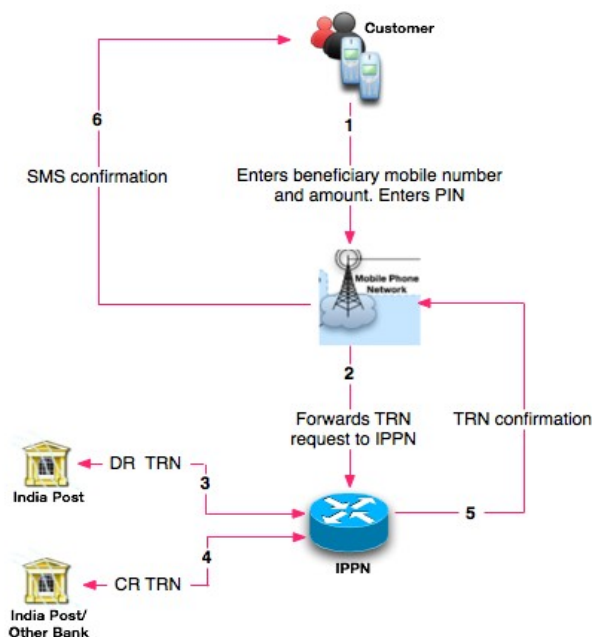
Eurogiro focuses largely on low value payments for corporate, retail and institutional customers. It is able to achieve good economies of scale since it processes a large volume of transactions by paying special attention to standardization and sub-contracting several operations. India Post can certainly match and surpass the achievements of EuroGiro.

4.2 India Post Payments Network (IPPN)

India Post should aim to create the country's first large-scale small-value payments network – the “India Post Payments Network” (IPPN) that is capable of electronic transfers of Rs.100 at a charge of less than Re.1. The need for such a network, and an overview of its design is put forth in the UIDAI's vision document – “*From Exclusion to Inclusion with Micropayments*” as well as in the Inter-Ministerial Group's Report on “*Framework for Delivery of Basic Financial Services using Mobile Phones*”.

Both Reports call for a tight integration between bank accounts and payments linked through mobile phones. Thus a POSB account should be tightly integrated with the MO. A

Figure 1: **Mobile transactions on the India Post Payments Network**



customer must be able send and receive payments into their accounts, or as cash, through all channels – the post office, the postman on the beat, mobile phone, internet, or a franchised location.

One important distinction between payments and other financial services is that they are fundamentally different businesses. They require different kinds of business planning and focus. Most financial products are about financial intermediation. Financial intermediaries bring together lenders and borrowers using a variety of financial instruments that match the consumption and

savings needs of both classes of agents. The organization needs proficiency in financial tools such as building credit models, actuarial models, building networks of customers and clients, risk management models, etc. Payments systems are fundamentally about building efficient IT systems, building a platform, operating retail networks, and making sure that all service providers gain a little something on each transaction. Thus, IPPN will require a team that is tuned to the requirements of building a payments system rather than one that is focused on delivering financial products.

This retail-like nature of a payments system means that high volumes and ubiquity are necessary for success. All possible markets must thus be tapped to build volumes. The possibilities include but are not restricted to the following channels:

1. Person-to-person payments
2. Government benefits payments
3. Micro-finance, micro-insurance, micro-pensions
4. Mobile prepaid top-ups
5. Recurring bill payments
6. Railway tickets
7. Other merchant transactions

Of the channels above, India Post should play an active role in the creation of the electronic MO, linked to lightweight POSB accounts. This will enable person-to-person payments, and G2P payments. For all other channels, India Post should nurture the creation of an ecosystem, where other public and private enterprises integrate the India Post Payments Network (IPPN) into their own businesses, along with creating innovative payments products. For example, mobile operators will welcome the idea of providing their customers an ability to top-up their mobile accounts through their phones, and the ability to send mobile payments to others through the IPPN. Similarly, Indian Railways will be able to use this network to expand its ticketing system to franchised agents. MFIs will be able to bring down their operations costs when they no longer have to manage cash. A variety of businesses will develop solutions and target all sections of the Indian population. India Post can thus nurture innovation, without taking any business risks itself, and instead charge a transaction fee for every transaction that its platform processes.

As India Post already operates a mass-scale MO network in the country, it already has much of the cash management infrastructure in place to take payments to the next level.

India Post also already works with several other public and private enterprises, and successfully operates a number of rural post offices through a franchisee model. Thus, ecosystem creation is not a new concept for India Post. With IPPN, India Post can nurture this ecosystem on a much larger scale, with much bigger impact.

To make this work, India Post will need a modern, electronic savings account, and a modern electronic payments network. Banks already offer an electronic savings account without a ubiquitous low-cost low-value payments solution. An electronic payments network is also offered by a variety of payments processors. By themselves, neither solution has had a significant impact on financial inclusion. A low-cost combination of the two products however, can be an important stepping stone to meaningful financial inclusion. This point is emphatically made in the report “*A hundred small steps, Report of the Committee on Financial Sector Reforms*”, chaired by Prof. Raghuram Rajan.

4.3 Technology

The Expert Committee recommends implementing the UID-enabled micropayments solution as described in the UIDAI vision document “*From Exclusion to Inclusion with Micropayments*”, and the Report of the Inter-Ministerial Group on a “*Framework for Delivery of Banking Services Via Mobiles*”. The technology must use open standards, and architectures to the extent possible. India Post will need to put in place the following three essential pieces of infrastructure:

1. A low-cost repository of accounts (INFAST in the IMG report)
2. A payments interface among these accounts (G2P and P2P)
3. PoS (Point-of-sale) devices operated by post-offices, postmen, and merchants (MicroATMs in IMG and UIDAI reports)

Each of these pieces of infrastructure will be required for the POSB accounts and the MO. However, all of this infrastructure should also be exposed as software interfaces for partners to create accounts, process payments, and withdraw cash at frontends. It is recommended that the infrastructure must be light and efficient, so that it can be deployed on mobile networks, and must not require high bandwidth internet access. An example of a mobile-based transaction initiated by a customer is shown in *Figure 1*.

The Expert Committee stresses the importance of building a payments platform and

cultivating an ecosystem around that platform. We draw an analogy with the Google Maps platform. Google provides maps on its own websites, but allows others to also customize and integrate maps in their own websites. Thus, a number of websites have integrated their own data with maps provided by Google to offer customers a superior experience. These websites do not have the capability to create a product like Google Maps on their own. However, once Google provides this service, customers create unique new services that not even Google could have imagined. Everyone benefits: Google Maps gains a number of users that otherwise would not have used their service, while the websites incorporating Google Maps gain more customers. The sum of parts here is greater than the whole.

Open access to India Post's payments platform for partners can create large positive network externalities by increasing the number of customers, driving volumes, and bringing costs down for everyone.

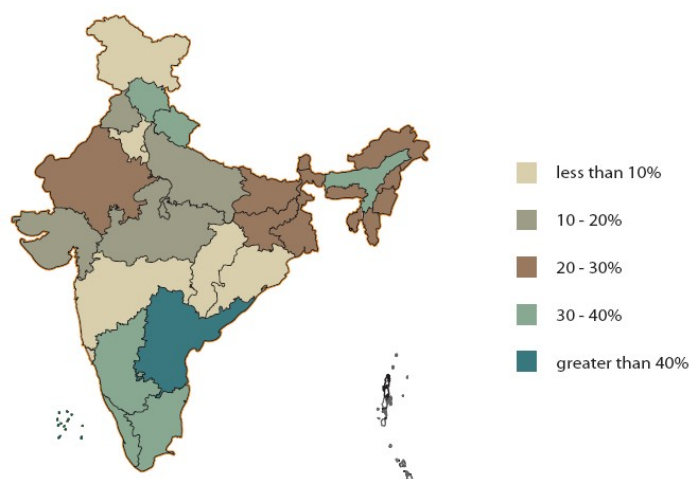
section five

MICRO LOANS

Agricultural laborers, subsistence farmers and other marginal primary producers in rural India account for around 60 percent of all debtors, with an additional third or so of debtors being own account workers involved in non-agricultural activities. Medical and financial emergencies were the main reason for household borrowing accounting for 42 percent of all loans made in the past two years. For the lowest

income quartile population, the incidence of emergency loans was highest at almost 50 percent, with the top three loan sources being moneylenders, friends/ relatives and SHGs. Nearly half these loans carry an interest rate of above 36 percent per annum. Loans taken for emergency purposes created an unsustainable amount of debt for the lowest income segment with outstanding debts out of emergency loans resulting in debt on average exceeding a full year's earnings.

Incidence of Indebtedness Among Earners in Different States



IISS07 data show that there are other considerations (apart from the interest payable) in the minds of borrowers that can drive a borrower towards one lender rather than another. The attitudes of formal sector lenders are often seen as a root cause of low income workers being driven into the arms of less affordable informal credit providers. In addition, the formalities of the loans process followed by formal lenders and the time taken to issue loan approvals obviously are seen by borrowers as deterrents to using formal loan channels – especially for emergency loans. According to the Report of the Committee on Financial Sector Reforms (CFSR) established by the Planning Commission, over 70% of loans taken by those in the lowest income quartile in India are from informal sources – moneylenders,

relatives and friends. Other sources support the CFSR's conclusion that large segments of India's poor households continue to be shut out of formal credit mechanisms. *Table 2* provides sources of loans by income groups.

The Expert Committee believes there is a large latent demand for consumption and emergency loans. Thus a simple product – a Rs.500 loan with repayment at the end of the month, if available ubiquitously, may have a huge impact.

Table 2: **Sources of Loan by Income Group**

Loan sources	Percentage of persons in income quartile who have taken loan from these sources in the last 2 years			
	Lowest income quartile	Second income quartile	Third income quartile	Highest income quartile
Relatives / friends	39.2	34.4	33.2	32.0
Moneylenders	39.8	33.2	25.8	14.8
Banks	9.6	20.7	33.3	45.8
Self help groups	9.7	8.4	3.3	3.4
Co-operative societies	5.4	4.9	6.5	7.4
Chit funds / NBFC	1.6	1.9	1.5	1.2
Microfinance Institutions	1.1	1.4	1.2	0.9
Others	1.0	0.9	0.8	1.4

Source: Committee on Financial Sector Reforms (Invest India Incomes and Savings Survey 2007)

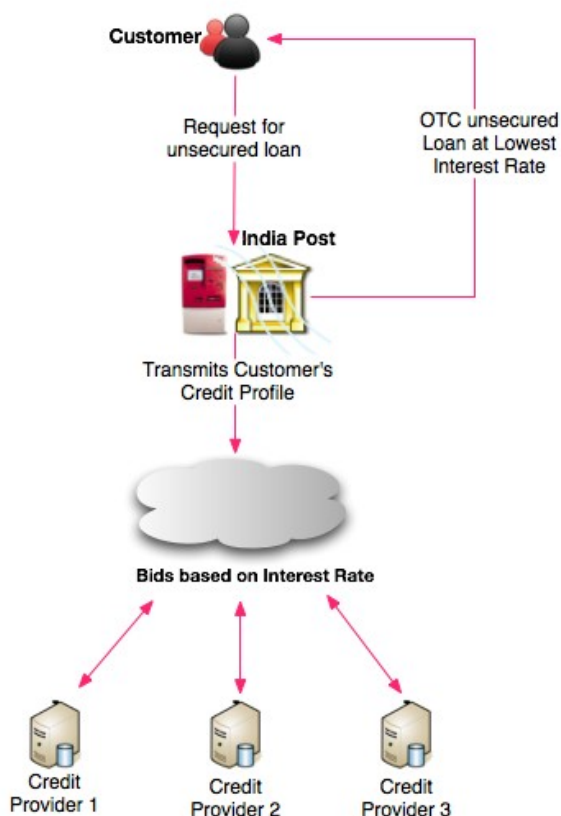
5.1 Principles

The Expert Committee recommends that India Post establish a mechanism through which the post offices can be harnessed into delivering short-duration, fixed-size, non-collateralised micro loans (of Rs.500 for one month) while adhering to the following principles:

1. India Post must not undertake credit risk using public funds,
2. India Post should serve as a facilitator for a mass-market for micro-loans without running the market,
3. India Post must not displace private investment,
4. Vendor neutrality and transparency must be maintained in selecting eligible credit providers, and
5. India Post should not perform any activities that may damage its reputation.

5.2 Mechanism for Micro Loans through India Post

Figure 3: **Unsecured micro-loan delivered by India Post to a customer**



A process of extending instant credit to a customer is described in *Figure 3*. The role that India Post should play in the space of micro-loans is that of an enabler and a facilitator. Only one simple product should be offered – a Rs.500 individual, unsecured loan with a maturity of one month. Under the proposed framework, a person wanting a loan will provide his postal savings bank account information and identification (UID) to India Post through a post office (or a micro-ATM at a postal branch).

The India Post staff (or ATM) will relay the information to the India Post data centre which will run an auction for the loan in real-time. Pre-authorized credit providers will bid for the loan on the basis of an interest rate and the information on the customer. The lowest

interest rate produced through this auction will be extended to the customer. The customer will receive the loan through an MO, and will pay it back using an MO. The credit provider will pay India Post a fee for processing the loan, and a fee for the money-orders. Should a person want a larger loan, he may apply for multiple Rs.500 loans, and the firms that are bidding in the backend will make the decision on approving additional loans, based on the credit profile of the customer.

5.3 Comparative Advantage

India Post is in a unique position to offer the above mentioned auction-based micro-loan product for the following reasons:

1. The country-wide network of over 155,000 post offices minimizes geographical risk for lenders, as the defaults among borrowers will be un-correlated, except for

the business cycle.

2. With an existing cash management process, and given its scale and volume, India Post can process cash and non-cash payments at much lower costs than any other public or private institution. It can also facilitate both loan disbursement and recovery.
3. It can enable credit scoring, based on each customer's savings account information, and knowledge of a customer's other assets with India Post.
4. When the credit risk is mitigated or reduced using good quality credit information linked to UIDs, India Post can harness existing credit capacity and competition to further drive down the cost of consumption credit.

5.4 Implementation of Micro-Loans

The following must be considered while implementing the proposed auction-based micro-loan product:

1. India Post should use the UIDAI's authentication mechanisms for identifying a person.
2. Any regulated credit provider with sufficient capital must be allowed to participate in the auction. Eligibility rules must be transparent and well-defined.
3. India Post must never release individual customer data to anyone. Instead, institutions participating in the auction should upload their credit scoring and decision making models to the India Post data centre. These programs must process the information and arrive at a decision, with no human intervention.
4. By applying for a micro-loan, the customer would authorize India Post to release his information to the credit models running at the India Post data centre.
5. When a loan request is received, India Post would release the customer's credit history to the credit models of the participating credit providers, who will process this data and post their best interest rate within 60 seconds.

6. The originator of the loan should be allowed to sell the loan to another institution, provided that the owner of the loan is always on file with India Post. India Post may charge a small fee for updating ownership records.

section six

IMPLEMENTATION RELATED ISSUES

6.1. Scope of POSB Role and Functions

The Post Office Savings Bank is included in the Union List vide item No. 39 of the Seventh Schedule of the Constitution of India. It operates under various frameworks defined by the Government Savings Bank Act, 1873, Government Savings Certificates Act, 1959, Public Provident Fund Act, 1968. Small savings schemes were designed to provide safe and attractive investment options to the public and at the same time to mobilise resources for financing public debt. India Post performs this function as an agent of the Ministry of Finance, and is funded by the Ministry of Finance for doing so.

The environment under which the POSB was set up and operated in several decades ago is quite different from the present policy and business environment. Thus, given the challenges of inclusive growth and financial inclusion, the role of India Post must be reviewed from first principles. As per the current Allocation of Business Rules, the Government Savings Banks Act, 1873 is housed within the Ministry of Finance. India Post should engage with the Ministry of Finance to re-examine and expand its presently limited agency function to enable the postal network to more serve effectively as India's financial inclusion platform. This may require a significant change and expansion in the Allocation of Business Rules for India Post. Specific recommendations in this regard are beyond the scope this Expert Committee.

6.2 AML / CFT Compliance

India Post is a regulated entity under the Prevention of Money Laundering Act. The underlying provisions related to customer due diligence, recordkeeping and reporting, as well as the requirements of Anti Money Laundering (AML) and Countering Finance of Terrorism (CFT) are mandatorily applicable to POSB balances and domestic remittances. While implementing the above recommendations, and especially when India Post enables

private and public sector organisations to use its platforms for savings accounts, payments and delivery of financial products, the relevant AML and CFT provisions mandated from time to time by the Government of India, and applicable to India Post, should be mandatorily applicable to such partners also. The relevant provisions in this context should accordingly be included in all contracts between India Post and its partners.

section seven

SUMMARY RECOMMENDATIONS

Recommendation 1: *India Post should deliver lightweight, low-cost bank accounts to all Indian citizens and especially to the financially excluded population.*

Recommendation 2: *India Post should look for ways to leverage its low cost platform by providing India Post branded accounts to other strategic partners, such as MFIs, mutual fund and insurance companies, and telecom operators.*

Recommendation 3: *India Post should apply itself towards the challenge of achieving high volumes of money-orders where payments of as little as Rs.10 are achieved at a charge of less than Rs.0.1 while requiring no subsidy from the exchequer.*

Recommendation 4: *India Post should evolve the money-order to become a mechanism for transferring money from one POSB account to another, instead of just being a mechanism for delivering cash from one person to another.*

Recommendation 5: *India Post must build a payments infrastructure, through an array of contracts with partners, connecting up all POSB accounts and accounts of its partners, to effectively become a person-to-person money-order capability (through mobile phones or web browsers) for a large swathe of India.*

Recommendation 6: *India Post must elicit a large number of partners in terms of financial inclusion players, mobile service providers and innovative new technological choices in order to increase the size of the network.*

Recommendation 7: *India Post must work closely with a diverse array of government agencies so that their G2P payments requirements are met through a combination of POSB accounts held by citizens and money-orders delivered by government to those POSB accounts. The Ministry of Finance must work with India Post in rapidly rolling out this platform and network, given its important implications for direct, targeted delivery of*

government subsidies.

Recommendation 8: *India Post should play a role in the emergency credit aspect of financial inclusion, through a platform-building approach where private lenders deliver credit to the poor through a competitive framework.*

Recommendation 9: *India Post should request the addition of its financial inclusion project into the Terms of Reference of the recently announced Technology Advisory Group for Unique Projects, and the leadership team of the India Post financial inclusion project should closely engage in the work of this Group, so as to bring in the best practices for project management.*

Recommendation 10: *The role of the Post Office Savings Bank as an agent of the Ministry of Finance should be revisited and expanded to enable India Post to play a larger, direct role in financial inclusion and build appropriate enabling architecture.*

section eight

CONCLUSION

India Post is the largest and most credible outreach infrastructure in the country. It has several decades of experience in delivering bank accounts and payments across the country and especially to the poor. India Post is already in the process of reinventing itself and has implemented several innovative products for its letter and package delivery business. However, while India Post has also introduced new financial products, its own basic banking and money-order products have remained unchanged for several decades.

A combination of the India Post outreach and credibility, with its extensive experience with delivering savings accounts and payments on a pan-India basis can serve as a critical building block for broad-based financial inclusion. This Report recommends that India Post harnesses the rapid IT and telecom capacity expansion to deliver three basic, integrated products to every Indian citizen: a savings account hosted on a lightweight banking platform, a broad-based payments network, and a competitive mechanism to deliver micro-loans to the poor.

In this process, India Post would create essential public goods in the form of low cost banking and payments capacity that reaches every Indian citizen. In parallel, India Post should aim to build an ecosystem where several public and private sector partners can design and deliver new innovative products using its low cost banking and payments infrastructure. In this way, India Post would drive innovation in financial inclusion and increase its own revenues without assuming significant technology or credit risk.

A well functioning public-private-partnership model provides a sound business case for India Post. For the Government of India and the Ministry of Finance, this squarely addresses the core policy goals of financial inclusion. For the public at large, and especially for the poor, this will be an critical window to a range of sophisticated and affordable financial products and risk management tools.

annexure

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