

Journey towards a robust credit ecosystem

Boosting the microlending economy





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Current credit ecosystem in India

Providing credit access to the underbanked is the need of the hour and major efforts are being made to bring this segment into the formal banking system. Banks are constantly working on coming up with innovative solutions and products to reach out to the masses, and there has been an equal focus on creating the infrastructure backbone to support the large banking population under the financial sector. The central bank and the government have recently taken steps to address the issue of limited availability of credit information.



Credit information infrastructure in India

Prominent agencies that currently collect credit data in the country include:

- Reserve Bank of India (RBI):** RBI collates information through the Central Repository of Information on Large Credits (CRILC) and Basic Statistical Returns-1 (BSR-1) that cover a subset of credit institutions. CRILC is a borrower-level supervisory dataset with a threshold of 50 crore INR in total exposures. BSR-1 is a loan-level dataset without any amount outstanding limits.
- Credit Information Companies (CIC):** It is an independent third-party institution that collects financial data regarding loans, credit cards and more about individuals and shares it with its members. The four CICs—TransUnion CIBIL, Equifax, Experian, and CRIF Highmark—have a wide variety of users, ranging from credit institutions, insurers, telecom companies, credit rating agencies, registered stock brokers, SEBI, IRDA, resolution professionals and information utilities.
- Central Registry of Securitization Asset Reconstruction and Security Interest (CERSAI):** CERSAI makes the data of all equitable mortgages in the country available at one place to prevent frauds due to multiple financing against the same property.
- Information utility (IU):** An IU stores financial information that helps to establish defaults and verify claims.
- The Ministry of Corporate Affairs (MCA):** It is a company finance database that collects statutory information from registered companies.



Challenges in the current credit information system



India's credit information system faces the following challenges in its current form:

- **Lack of comprehensive data:** A complete debt snapshot of a borrower across all credit institutions is currently not available.
- **Fragmented information sources:** Currently, credit data has to be gathered from a host of agencies. The sources provide different sets of inputs and may not be updated on a timely basis, thereby providing different information for the same entity.
- **Dependency on self-disclosures by borrowers:** There is a risk involved in relying on self-certified data taken from customers. Also, the paying capacity of the borrowers cannot be determined based on this information.
- **Authenticity and reliability:** There is no reliable validation tool for a lender while taking credit decisions for a potential borrower. Inconsistencies in data cannot be easily identified and there is a high dependence on the information submitted by the borrower itself.
- **Time, dated information and cost:** There is a lot of time and cost invested by lenders to get uniform and updated information from multiple sources.
- **Multiple reporting:** Currently, multiple returns with similar information are filed across multiple agencies. This has direct implications on overall compliance costs.

Need for product innovation in the current banking scenario



India has a modest credit-to-GDP ratio that signifies poor penetration of the financial system in the Indian market. Therefore, the current focus is on initiatives that can help to gather and analyse credit data better. With robust credit information management, we can include more of the informal sector under the formal financial system to achieve holistic financial inclusion.

On the other hand, even borrowers' preferences are now shifting to formal credit from the earlier informal credit lending ecosystem. While the demand for these small-ticket loans has been increasing, the response of traditional banks in tapping these customers is slow. In the existing system, banks end up spending more on background checks and loan initiation processes than what they earn through interest and charges.

There are ample opportunities in terms of launching need-based products that address specific financial demands of borrowers such as the ticket size of the loan, tenure of the loan and customisation options across key features. Nano finance, micro investments, customised insurance packages and sachet-based¹ financial

Sachet-based financial offerings are a concept to provide borrowers with access to any financial product anytime, anywhere and in any quantity, according to their specific requirement. The resulting outcome will be beneficial to borrowers, who will get access to cheap credit, as well as to lenders, who will have an alternative source of revenue.

service offerings are a few such innovative products. The success of these innovative products requires a change in the mind-sets of providers from a push-based approach of offering specific products to a pull-based approach of meeting specific, context-based needs by modifying core product offerings.

Additionally, there is a need for the central bank to build a robust credit information system that can serve as a credible single source of credit data, thereby ensuring low acquisition cost, increasing market penetration and avoiding fraudulent cases.

¹ <https://www.pwc.in/consulting/financial-services/fintech/fintech-insights/the-time-is-ripe-for-the-sachet-model-in-financial-services.html>

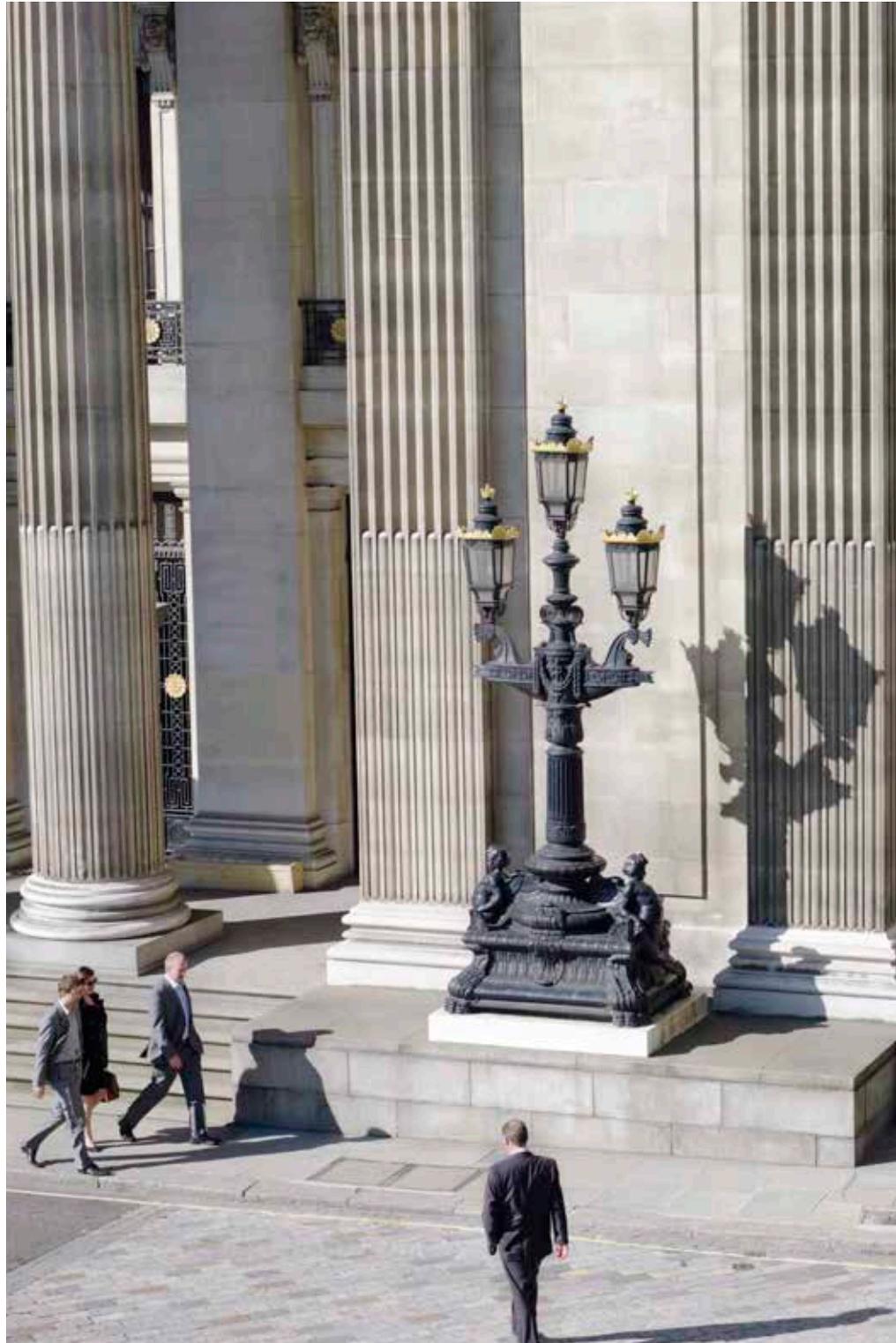
Initiatives by central banks around the world to improve the credit ecosystem

Credit registries have been set up across the world to make a borrower's credit history available for scrutiny to potential lenders. These registries help lenders to take better credit decisions and avoid giving loans to high-risk borrowers based on their repayment histories. For borrowers, this acts as a positive incentive for timely repayments, as they know that their information in the credit registry works as part of their 'reputation collateral'. Public credit registries (PCRs) and private credit bureaus are the two types of credit registries. Since the sharing of credit information is in public interest from a financial stability and supervisory perspective, in most countries, the credit registries are owned and managed by the public sector—generally, the central bank.

PCRs had their genesis in Europe. As per a survey conducted by the World Bank in 2012, out of the 195 countries surveyed, 87 had a PCR.²

More recently, the European Central Bank initiated a project called AnaCredit to set up a dataset containing detailed information on individual loans in the Euro area, harmonised across all member states. For compliance with the reporting requirements of this project, the countries without a PCR are also setting up some form of a central credit registry. The countries which already had a PCR are either enhancing their own PCR in the process (e.g. Spain, Portugal) or establishing a separate information system to fulfil reporting requirements to AnaCredit (e.g. Italy, Germany).

RBI has taken a similar step in this direction to build a robust credit ecosystem. It constituted a High Level Task Force (HTF) which studied the views and expectations of stakeholders for working towards setting up a PCR in India. A PCR is an extensive database of credit information that can help in addressing challenges due to information asymmetry.



² <https://rbi.org.in/scripts/PublicationReportDetails.aspx?ID=895>

Indian regulator's push towards a robust credit ecosystem: PCR and GSTN



Proposed PCR structure in India by RBI

Leveraging the developments on PCR the world over, the HTF set up by RBI has proposed the following for the Indian context:³

- **Single point of reporting:** The PCR should be a single point for reporting of data by all credit institutions in a standard format to avoid multiple versions of the same data.
- **No minimum threshold:** All credits, regardless of size, may be captured by the credit registry. It would also provide data on the extent of financial inclusion.
- **Complete information:** Data pertaining to the entire life cycle of loan will be collected by the PCR. The PCR should capture the entire borrowing footprint of the entity in terms of all credit relationships.
- **Validation of data:** It is essential that whatever data goes into the PCR be validated to ensure that it is accurate and harmonised to remove inconsistencies.
- **Unique identifier:** A unique borrower ID must be ensured across all financing agencies along with a unique account ID. This will enable the PCR to comprehensively integrate its database with other sources of information.
- **Confidentiality and privacy:** The PCR design should ensure that the data is not compromised at any point of time.
- **Standardisation and consolidation of information:** The PCR should have a data feed from various regulatory websites and databases for a consolidated view of customers on tax compliances, regulatory orders and sanctions, credit defaults, ECBs, market borrowings, and all contingent liabilities.
- **Alternative credit data:** Data pertaining to utility payments (e.g. mobile, Internet, electricity bills) in respect of societies/corporate entities is to be collected. In addition, information related to individual borrowers above a certain threshold must be incorporated in the PCR.
- **Default reporting:** Defaults by borrower and alerts regarding other negative behaviour must be thrown up in the data made available to the PCR on a real-time basis. The PCR should include linkage to available caution/advisory/defaulters' list.
- **Technical compatibility:** A uniform format is to be adopted for furnishing of data by commercial banks, cooperative banks and NBFCs. Suitable coding must be introduced for BSR returns. All types of financing by cooperative banks should also have BSR codes, to enable uniformity in data reporting to the PCR and ensure quality of data. The PCR should also ensure interoperability and linkages with other information systems.
- **Reciprocity principal:** The PCR would function on the principle of reciprocity and the credit institutions submitting data would in turn receive regular reports at fixed intervals.
- **Grievance redressal:** The PCR system should include a grievance redressal mechanism to address the legitimate concerns of borrowers regarding their credit history.
- **Set up unit:** The PCR would be set up within RBI followed by the setting up of a fully owned subsidiary to host it.

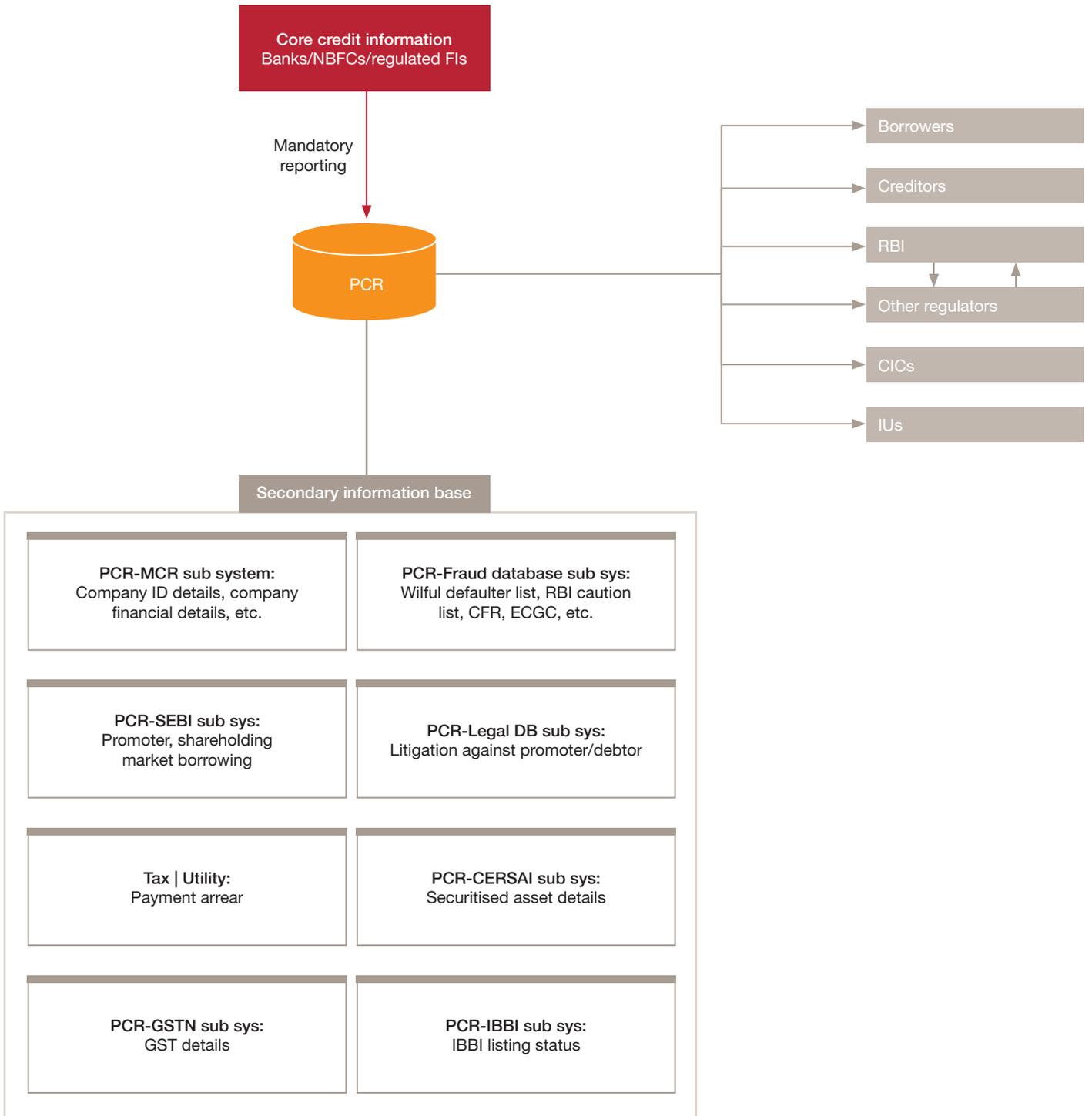
³ <https://rbi.org.in/scripts/PublicationReportDetails.aspx?ID=895>

High-level information architecture of the PCR

The envisaged Indian PCR will mandate recording of all material events for all loans extended by all credit institutions, such as commercial banks, cooperative banks, NBFCs and MFIs, and from other sources

and centralised credit information reporting. Relevant stakeholders will have access to information according to the allowed access level. The proposed information architecture of the PCR is depicted below.

High-level information architecture of PCR



Enabling objective credit decision making

The creation of the PCR will result in an extensive database holding comprehensive information of borrowers in a single portal. The PCR aims to fill gaps due to unavailability of credit information and eradicate scenarios of adverse selection wherein low-risk borrowers are charged increased prices, while high-risk customers pay reduced prices on their loans. With full coverage of credit market information, the PCR will result in benefits for the lender, borrower and regulator.

Stakeholders with access to the PCR will be equipped with full information on the profile of the borrower, enabling them to take sound credit decisions at low cost:

- As the single point of mandatory reporting of credit information, the PCR will reduce the reporting burden on credit institutions. This will in turn remove inconsistencies due to multiple reporting and lead to improvement in data quality.
- The PCR would help creditors to price loans appropriately and lend at more attractive rates once they can assess the credit risk of borrowers and also prevent inefficient allocation of credit.

- Lenders will be able to take objective credit decisions and shift from pure collateral-based lending policies to more information-based lending policies.
- Availability of data will be for the public good, enabling increased credit access for smaller borrowers and enabling sachet-based financial service offerings.
- India's ranking on the ease of doing business index will improve due to a more transparent credit system.
- The PCR will add value to policymaking and financial stability, enabling lenders to take timely corrective steps to prevent delinquencies.
- The PCR will provide a consolidated view of the borrower, enabling better fraud management/prevention and strengthening NPA monitoring systems.



GSTN accelerating expansion of financial services

The Goods and Services Tax Network (GSTN) has been the technology backbone for the implementation of GST. GSTN provides a platform where sellers upload their invoices that can be approved by the buyer. Therefore, in a way, GSTN has also become a trusted repository of matched invoices.

Following the roll-out of GST, it has been observed that small firms, who generally buy from large enterprises, are actively registering with GSTN to gain the incentive of input tax credit. As small and medium businesses are getting integrated with GSTN,

we see formalisation and inclusion of the SME sector. In time, banks and lending institutions will be presented with a unique proposition to leverage technology infrastructure such as GSTN and PCR to calculate the creditworthiness of SME players at a reduced cost.

Banks are also providing GST filing services to their users that again provide credit information for both customers and their suppliers. As small businesses provide secure and verifiable details of transactions, lending institutions will get more authentic data on the health of SMEs.

Therefore, when reliable data on transactions, derived from GSTN, is coupled with available credit information from other sources, the lending ecosystem will be empowered with robust insights on creditworthiness across SMEs. This is expected to reduce the entry barrier for credit businesses in the SME segment and provide an opportunity to all lending players to develop a new market.

Opportunities presented by GSTN

Credit information at low cost

Traditionally, banks had to rely on a 'feet on the ground' approach to gather credit information. With the roll-out of GST, this information is available online at a much reduced cost.

Data-based lending

Contrary to traditional lending, which is asset or collateral based, lending institutions can leverage consented data provided by GSTN users to assess creditworthiness based on credit payment history and can provide customised, small-ticket, small-tenor loans to SMEs.

New business opportunity

Historically, the SME sector has been deprived of funding from the mainstream financial sector. Informal lending has also been costly and limited. GSTN has provided an opportunity to banks and lending institutions to tap into this new target customer set comprising SMEs and expand their business operations.



Emergence of a robust microlending economy

Together, the PCR and GSTN are expected to improve information access and quality by utilising modern technological advances.⁴ The PCR will create a unique identification of borrowers across databases and systems. A combination of PAN, Aadhaar, CIN and LEI could be used as the unique identifier of entities, since most of the existing reports are based on either of these identification codes. Linkage can be established between other systems such as UIDAI, SEBI, GST systems, government records, EPFO, CBDT, stock statements, NCLT and e-courts.



A holistic profile of the borrower can be built by putting together PCR information on attributes such as GSTIN and tax filed, date of filing of first tax return, date of last income tax filed, last annual gross income, legal and suits details, credit score, debt details, insurance premium payment arrears, utility bill payments arrears, and debt and collateral details.



While the credit institutions, the borrowers and ultimately the economy will gain immensely from this data platform, credit institutions will also have to significantly enhance their data reporting. This, in turn, will require them to upgrade and maintain their existing infrastructure and systems to implement and support the PCR reporting requirements—that is, report credit information more comprehensively.

Credit institutes will have to gear up for automation of the list of dataset requirements for PCR reporting. This list will include data elements already

automated in the existing reporting set-up as well as the new set of elements. Reporting entities will also have the onus to create and maintain the architecture and solution to generate a universally unique identifier (UUID) key for every new loan request in accordance with the approach finalised for the PCR. Similarly, unique identification of borrowers across databases would be vitally important to establish a linkage between the PCR and other systems holding financial information. Credit institutions will also have to manage customer consent in order to access data from the platform.

The good news is that availability of borrower information from trusted sources is likely to ensure ease of lending and greater financial inclusion. Moreover, with FinTech start-ups developing innovative approaches to customise offerings according to the needs of borrowers, the hit ratio of these products will be high. Sachet offerings will be a step in the right direction since they meet the exact requirements of borrowers and there is a shift in the concept of lending from traditional banking. In sum, the PCR programme along with GSTN will be a big boost to the maturity and stability of the country's credit market.

⁴ https://rbi.org.in/Scripts/BS_SpeechesView.aspx?Id=1061





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