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Foreword by CII



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Over the years, the CII Financial Distribution Summit has been focusing on themes related to financial inclusion, reaching out to rural India and the delivery of smart solutions. With the new wave of digitization, reaching out to our underbanked segments (with no credit scores or history), in the hinterlands of the country suddenly, seems attainable, and in fact lucrative. This is encouraging!

The profile of an Indian investor is diverse; ranging from being unaware to tech-savvy, when using financial products such as insurance, mutual funds and pension, with a majority of addressable investors needing trustworthy consultative advice on a continuous basis. New FinTech players are entering distribution markets, with new technology solutions. Their innovative propositions are very often, well addressing the needs of the Indian Investor.

India has a diversified financial sector undergoing rapid expansion, both in terms of strong growth of existing financial services firms, and new entities entering the market. This leads us to the crucial role of financial distribution ecosystem, in revitalizing growth in an inclusive manner. The capability of our financial distribution system is second to none, despite its many pertinent challenges. Efficiency gains presented by the underbanked segments, combined with those that can be seen in the more advantaged segments, stretches the relevance of our distribution ecosystem, beyond rural or urban India, to our society as a whole.

This brings me to the focus of the Summit & the CII-Deloitte Report which addresses some of these key dimensions of financial services distribution including: Regulatory Challenges & Reforms, Ethics in Distribution, Financial Literacy & Inclusion – Reaching out to Rural Markets, and The Future of Distribution by Digitization. The Report will focus on critical aspects of these dimensions in detail, justifying the Summit theme “Redefining Distribution: Converge, Digitize & Achieve”.

Foreword by Deloitte



Kalpesh J. Mehta

Business as usual will not resolve the pressing challenges faced in the distribution of financial services. These are not permanent paradigms and therefore the rhetoric of financial distribution, calls on the financial services ecosystem to build new capabilities.

For instance, there is a need for adequate regulations for all stakeholders to experience significant efficiencies, and for better supervision of adverse incidents that frequently occur in the distribution process. Regulators in India are already steering efforts in that direction. They are giving a voice to beneficiaries of financial services qua steps taken to prevent mis-selling, ensuring better quality of advice, enhancing trainings, and transparency. Areas of improvement do exist, and a lot can be learnt from supervisory practices in other countries.

As new participants enter the distribution network, the role of all players in helping customers make informed choices (leading to greater customer confidence), cannot be emphasized enough. Appropriateness, integrity, objectivity, and competence in providing financial advice to customers is key for a true capability building in distribution of financial services. The potential of technology in reducing susceptibility to unethical attacks, must also be explored.

Serving the truly excluded by the most efficient service providers presents a huge opportunity at both ends of the spectrum. To reach the excluded segments, organizations will have to adapt themselves, and build key capabilities by focusing on providing financial access, and building financial awareness (e.g. literacy, skills). Again, leveraging digital technologies in the process, can benefit both providers, and recipients. This is not to understate the need for coordinated action by the Government, Corporates and our Communities in building the required architecture. Organizations that have the ambition to take this path, and can be disciplined in the process, can emerge as the “go-to” platforms in the foreseeable future.

On the positive side, financial distributors are perfectly capable of restructuring themselves (as they stand to gain) with the emergence of the digital channel as a common platform across products and the channel is meeting many of their requirements, from generating leads to post sales service, and even cross-selling. On the other hand, the real-time insights provided by digital channels about products and themselves, is allowing customers to make better quality decisions.

Our report provides granular insights into the various dimensions of financial services distribution, the evolving environment within distribution, and the many opportunities for businesses to emerge with impactful, innovative solutions. We hope our readers can start coherent conversations within their organizations, and with clients to put things that matter to financial services beneficiaries, at the top of the agenda.



Regulatory Challenges and Reforms

Need for regulations on financial product distribution

The world of financial services has evolved over the past few years, with financial institutions exploring new and innovative ways to reach the consumer. Financial institutions are quickly adopting smart technology, to keep up with the evolving landscape of the financial industry.

In the new era of digital channels, there is an increase in customer touchpoints, including mobile and internet banking, video channels, chatbots, artificial intelligence based tools, and online robotic advisors. India is witnessing a paradigm shift to a digital environment from its conventional banking routes.

The financial distribution channels across banks, mutual fund houses, insurance companies and other NBFCs prioritize differentiation, customer service, efficiency, and convenience.

While the financial industry has migrated to several innovative distribution channels, the need for regulatory reforms takes higher precedence. The need for regulatory reforms is particularly required to address the following:-

- Prevention of mis-selling of products through various financial distribution channels

- Protection of customers that are drawn to the complex nature of financial products
- Financial institutions are defined by regulations and offer visibility and equal treatment to their customers
- Enabling complaint redressal, and ensuring customer protection

Recent events on regulatory penalties imposed on financial service

Regulators across the world have imposed penalties on Banks and other financial institutions on account of various incidents pertaining to financial product distribution. A careful analysis of these events, points us to violations by the financial institutions, particularly in the areas of selling suitable and appropriate products, transparency and disclosures. Few notable global such events are detailed below:

- A leading private sector Bank was fined for mis-selling products: A couple in the UK sued a foreign bank for mis-selling two complex interest rate hedging products. The products offered were not suitable to the risk profile of the customer, and the Bank failed to inform the customer of the risks involved in "Credit limit utilization", thereby incurring financial losses¹.
- Mis-selling of payment protection insurance in the UK, has had the biggest impact on customers, and further aggravates the need for stringent regulatory guidelines to prevent mis-selling of products. The banking industry in the UK began cross-selling PPI products extensively on realizing the profitability of the product. PPI was sold alongside mortgages, credit cards and other unsecured loans².
- A foreign Bank was fined for forceful cross selling: The foreign Bank was fined in penalties and compensation to customers that regulators say were pushed into fee-generating accounts that were not requested. According to the complaint, the bank's employees imposed on customers, buying costly financial products that they didn't require or request for³.
- In a recent incident, a senior citizen, invested his retirement benefits in Fixed Deposits with one Private Sector bank. While the bank representative convinced the customer to prematurely close his fixed deposit accounts, and invest in an insurance scheme, promising higher returns on maturity, the customer received lower returns, and on enquiry realized the representative no longer worked with the Bank⁴.
- Another case emulated from sale of insurance schemes by a third party. The Direct Selling Agent (DSA) promised the customer loans from a specific NBFC at very low rates, provided the customer bought a specific insurance policy. On receiving the compliant, and conduct of enquiry, it was noted that the NBFC did not exist under the said name.
- A customer availed a home loan from a Bank, and additionally took a life insurance policy as a result of cross-selling. The borrower's unfortunate death, resulted in the Bank contesting the claim, stating that no insurance documents were submitted by the borrower. However on enquiry, it was realized that though the customer paid the insurance premium, the Bank failed to process the insurance.
- Five leading broking companies were served show cause notices from the Securities and Exchange Board of India (SEBI). Investors who lent money using the exchange platform, incurred large losses when the borrowers defaulted on payments⁵

¹Indian-origin couple sues UK bank over costly mortgage: http://www.business-standard.com/article/pti-stories/indian-origin-couple-sues-uk-bank-over-costly-mortgage-117111300968_1.html

²PPI — hundreds of thousands could still claim compensation: <https://www.ft.com/content/2f03811a-5283-11e7-a1f2-db19572361bb>

³Wells Fargo Pulls Back on Cross-Selling After Fraud Scandal: <http://fortune.com/2016/09/13/wells-fargo-cross-selling-accounts-scandal>

⁴Bankers mistrust: <http://www.thehindubusinessline.com/catalyst/bankers-mistrust/article8650650.ece>

⁵Five brokers named in NSEL scam may not get unified licences: <http://www.moneycontrol.com/news/business/markets-business/five-brokers-named-in-nsel-scam-may-not-get-unified-licences-sources-2398129.html>

Current regulatory environment in India on distribution

The regulatory agencies/ bodies in India have released guidelines over the years with the objective of tightening their hold over banks and other financial institutions to ensure regulated and transparent distribution of financial products, and safeguard customers.

Reserve Bank of India:

- Master Circular on Customer protection – Limiting Liability of Customers in Unauthorized Electronic Banking transactions dated June 6th, 2017⁶: The Circular covers the need for the Bank to provide customers with 24x7 access through multiple channels (phone banking, SMS alerts, dedicated phone banking, email, IVR, reporting to home branch), allowing customers to immediately report mis-selling, unauthorized transactions, frauds through different financial channels.
- Master Circular on Para Banking activities dated July 1st, 2015⁷: The guidelines regulate Banks undertaking insurance Broking and Agency Business. The guidelines require the Bank to formulate a comprehensive Board approved policy regarding undertaking of insurance distribution. Further, the guidelines require the Bank to ensure Customer Appropriateness and Suitability, transparency and timely disclosures, as well as a grievance redressal mechanism.
- The Reserve Bank of India has amended the Banking Ombudsman Scheme, 2006, wherein the grounds for lodging of complaints has been modified to include activities such as sale of insurance, mutual funds and other third party investment products by Banks.

The penalty under the ombudsman has been doubled from the earlier penalty amount⁸.

Insurance Regulatory and Development Authority (IRDA)

- In 2007, the IRDA formed a committee to study the distribution channels. In 2008, a report on committee proceedings was released. The Committee discussed on the various distribution channels and intermediary systems including bancassurance and referrals/ introducers⁹.

The committee:

- Reviewed the system of licensing of corporate agents and suggested the criteria for the selection of the corporate agents, and qualifications for the functionaries of the corporate agents

- Reviewed the commission structure and recommended changes; examined the system of referral providers, and provided recommendations on the whole structure, including remuneration paid to the referral providers
- Examined the scope of direct marketing, e-marketing, web enabled sales points and other innovations, and recommended the terms and conditions to be prescribed to each mode of direct marketing, including the remuneration structure
- Reviewed payouts made to distribution channels and administrators of group businesses
- IRDA requires insurance agents to undertake trainings of about 100 hours and clear an examination from an approved institute.



- IRDA has a Grievance cell that caters to the complaints raised by policy holders.
- The Insurance Act, 1938 has laid out clear cut provisions pertaining to distribution across various channels including, licensing of insurance agents, privileges of agents, and code of conduct of agents¹⁰.

Securities and Exchange Board of India (SEBI)

- The master circular for mutual funds, requires all distributors/ agents/ persons employed or engaged in the sale of mutual fund products to undertake a certification examination conducted by the National Institute of Securities Markets¹¹.
- Additionally, mutual fund intermediaries are required to register with the Association of Mutual Funds, India¹².
- SEBI has defined a code of conduct for its stock brokers and mutual fund distributors. SEBI's guidelines for large mutual fund distributors, requires the Asset Management Committee to mandatorily conduct thorough due diligence on distributors, satisfying one of the following conditions:
 - Presence in more than 20 locations
 - Having raised AUM of over INR 1 billion in the non-institutional category, including high net-worth individuals
 - Received commission of over INR 10 million per annum across industry
 - Received commission of over INR 5 million from a single mutual fund
- SEBI runs a SEBI Complaints Redress System (SCORES) website, wherein investors can register complaints against the company and its intermediaries. The website also has

a list of issues investors should be concerned about while investing in products registered in SEBI¹³.

- SEBI has taken a decision to segregate sales from investment advice. SEBI has specified that Mutual fund distributors cannot give unsolicited advice to investors. Mutual fund distributors are required to register themselves as investment advisors. Investors seeking to invest in mutual funds, may buy the investment advisory services at a nominal price¹⁴.

Key challenges with the existing regulatory framework

- Absence of guidelines regulating digital channels: The financial services industry in India has been witnessing a shift towards digital channels such as online chatbots, online brokers, availing products and services through digital marketing channels, etc. However, there are very few specific regulations or guidelines currently regulating distribution or advice being provided through these online channels.
- Conduct Risk management: Currently the regulatory framework is still to evolve management of conducting risk by financial institutions.
- In-adequacy of advice on investments: Majority of the sale of mutual fund products/ insurance policies/ loans is done through third parties such as national distributors, corporate agents, direct service agents, business correspondents. Customer/ investors often end up purchasing a cross-sell product, due to the insistence of the distributor, with no research or information on the same. Additionally, there is no standard or governing guideline on which the distributor can be held responsible for what they sell.

⁶Limiting Liability of Customers in Unauthorized Electronic Banking transactions: https://www.google.co.in/url?sa=t&rct=j&q=&esrc=s&source=web&cd=2&cad=rja&uact=8&ved=0ahUKewiDKug9r_XAhUE3o8KHYYUA1kQFggvMAE&url=https%3A%2F%2Frbidocs.rbi.org.in%2Fdocs%2Fnotification%2FPDFs%2FNOTI15D620D2C4D2CA4A33AABC928CA6204B19.PDF&usq=AOvVaw088s3dB_PYeb4K18Cujj67

⁷Master Circular on Para Banking activities: https://rbi.org.in/scripts/BS_ViewMasCircularDetails.aspx?id=9837

⁸RBI amends Banking Ombudsman Scheme: https://rbi.org.in/Scripts/BS_PressReleaseDisplay.aspx?prid=40853

⁹Committee study on the distribution channels: IRDA/Life/Dist. Channel/ 037 /2007-08

¹⁰The Insurance Act, 1938: <http://moj.gov.jm/sites/default/files/laws/The%20Insurance%20Act.pdf>

¹¹Master Circular for Mutual Funds: http://www.sebi.gov.in/sebi_data/attachdocs/1337083696184.pdf

¹²SEBI mutual fund regulations: http://www.sebi.gov.in/sebi_data/commondocs/mutualfundupdated06may2014.pdf

¹³Scores website: <https://scores.gov.in/scores/complaintRegister.html>

¹⁴Is SEBI right in restricting mutual fund distributors from offering investment advice?: <https://economictimes.indiatimes.com/wealth/invest/is-sebi-right-in-restricting-mutual-fund-distributors-from-offering-investment-advice/articleshow/56536584.cm>

- Overlap of regulations: Several distributors sell both mutual fund products, as well as insurance products, leading to fragmented regulation applicability and overlap in regulations. For example: Mutual fund and ULIP products have similar features, however mutual funds are governed by SEBI and ULIP by IRDA.

Global Scenario on regulatory practices on financial product distribution

Regulators across the world have tightened their grip around financial service providers, to ensure customer protection. Some of the measures undertaken by regulators across various countries to curtail loss due to mis-selling, strengthen customer protection and provide transparency are summarized below.

United Kingdom

- The Financial Conduct Authority, (FCA) has a directive on “The Responsibilities of Providers and Distributors for the Fair Treatment of Customers (RPPD)”, wherein the responsibilities of the provider and distributor are clearly defined. The MIFID Implementation in 2018, shall replace the equivalent existing guidance in RPPD¹⁵.
- Revised Payment Services Directive by the FCA protects customers, by limiting payers’ liability at 35 pounds if unauthorized transactions take place, or incorrect transactions are made, or in the event of absence of complaint handling and unavailability of strong customer authentication¹⁶.
- To tackle the PPI mis-selling scandal, the Financial Conduct Authority (FCA) has imposed a deadline on Banks in UK to pay out to the impacted customers,

as per the compensation scheme. The regulator has also imposed penalties on the Banks for mis-selling¹⁷.

- The Financial Conduct Authority has proposed steps to eliminate pension mis-selling and protect customers ready to cash in their retirement savings. The regulator published a proposal to improve pension transfer advice and provide protection through a “defined benefit” pension, wherein a guaranteed income is provided, calculated on salary and length of service¹⁸.
- FCA has proposed that financial service providers pay 25% of the Financial Services Compensation Scheme to intermediaries. FSCS is a compensation scheme for customers of all UK authorized financial services firms. The scheme protects customers, in case the financial service provider goes bankrupt¹⁹.

United States of America (USA)

- Consumer protection in USA is governed by the Dodd-Frank Wall Street Reform and Consumer Protection Act “To promote the financial stability of the United States by improving accountability and transparency in the financial system”.
- The Act established a civil penalty fund, wherein any person or company violating a federal consumer financial protection law, may have to pay a civil penalty²⁰.
- The US Consumer Financial Protection Bureau (“CFPB”), has proposed principles for when a third party accesses the financial data of the consumer, for certain financial products and services²¹.

- The Federal “Regulation E” Consumer Protection Act, allows the customer to recover all money that may be lost through a fraud (customer liability capped to 50 dollars), should the customer report the fraudulent transaction within 2 days of discovering the loss²².
- Mutual funds and Exchange Traded Funds (ETFs) are governed by the Investment Company Act of 1940. The investors in the US market, engage fee based financial advisors, wherein the fee is paid directly to the advisor.

China

- The China Banking Regulatory Commission, objective is to protect the interests of the depositors and consumers through effective supervision. The regulator issued a directive under “Guidance for the Banking Sector on the Protection of the Rights of Consumers”, wherein all banking institutions are required to adopt effective measures to protect the customers personal financial

details, and disclosure of the customers personal financial details to a third party is only with the consent of the customer²³.

- China has focused on consumer protection by setting up the following consumer protection departments: Insurance Consumer Protection Bureau in China Insurance Regulatory Commission, (CIRC); Investor Protection Bureau in China Securities Regulatory Commission (CSRC), Financial Consumer Rights Protection in People’s Bank of China (PBOC), and Banking Consumer Protection Bureau in CBRC.
- The Australian Securities and Investment Commission (ASIC) and China Securities Regulatory Commission (CSRC) have come to an understanding to share information related to emerging themes and trends in the fintech sector²⁴.
- China has introduced a cyber law, wherein all data relating to Chinese citizens shall be held on only Chinese servers²⁵.

Australia

- The Australian Securities and Investment Commission (ASIC) is the regulator for the Australian banking sector and has drafted the Australian Securities and Investments Commission Act 2001, to take care of customer protection²⁶.
- The ASIC has created a MoneySmart portal, which covers banking, investments, borrowings, insurance, retirement plans, etc. Information regarding the products and their sub variants, details of registered financial advisors, etc. are detailed on the website. The portal is linked to tools such as calculators for budget planning, retirement planner, mortgage calculator, etc.) which help customers make informed decisions²⁷.
- Scamwatch portal created by the Australian Competition and Consumer Commission, allows consumers across Australia to recognize, identify, report scams through an online form²⁸.

²²Electronic Fund Transfers (Regulation E); Amendments :<https://www.consumerfinance.gov/policy-compliance/rulemaking/final-rules/electronic-fund-transfers-regulation-e/>
²³The CBRC Issued Guidelines on Banking Consumer’s Rights Protection: <http://www.cbrc.gov.cn/EngdocView.do?docID=114FD30A25F545768CACD887A36A43E3>
²⁴China and Australia ink fintech deal to share information on new trends: <https://www.cnbc.com/2017/11/06/china-and-australia-ink-fintech-deal-to-share-information.html>
²⁵China’s new cybersecurity law takes effect today: <https://www.cnbc.com/2017/05/31/chinas-new-cybersecurity-law-takes-effect-today.html>
²⁶Australian Securities and Investments Commission Act 2001: http://www8.austlii.edu.au/cgi-bin/viewdb/au/legis/cth/consol_act/asaica2001529/
²⁷Moneysmart app: <https://www.moneysmart.gov.au/insurance>
²⁸Scamwatch app: <https://www.scamwatch.gov.au/>



¹⁵The Responsibilities of Providers and Distributors for the Fair Treatment of Customers (RPPD): https://www.handbook.fca.org.uk/handbook/document/RPPD_FCA_20130401.pdf
¹⁶Consumer protection and PSD2: <https://www.fca.org.uk/firms/revised-payment-services-directive-psd2/consumer-protection>
¹⁷PPI claims: <https://www.ft.com/content/f221941a-89b6-11e7-8bb1-5ba57d47eff7>; <https://www.theguardian.com/business/2016/aug/02/ppi-claims-all-you-need-to-know-about-the-mis-selling-scandal>
¹⁸FCA proposes changes to advice on pension transfers: <https://www.fca.org.uk/news/press-releases/fca-proposes-changes-advice-pension-transfers>
¹⁹Reviewing the funding of the Financial Services Compensation Scheme (FSCS): <https://www.fca.org.uk/publication/consultation/cp17-36.pdf>
²⁰“Dodd-Frank Wall Street Reform and Consumer Protection Act”: <https://www.sec.gov/about/laws/wallstreetreform-cpa.pdf>
²¹Consumer Protection Principles: http://files.consumerfinance.gov/f/201507_cfpb_consumer-protection-principles.pdf

- The Consumer Action Law Centre has launched a “DemandArefund.com” tool, which help Australians demand refunds for add-on insurances and warranties which were charged to customers who didn’t have need for them.

Europe

- Markets in Financial Instruments Directive II has empowered the European Securities and Markets authority to provide protection to investors by ensuring good conduct by firms that sell financial services and products. The ESMA has drafted the “investor protection policy” highlighting the need for consumer protection²⁹.
- G20 High level principles on financial consumer protection were developed by the G20 finance ministers and central bank Governors of Europe, where 10 principles have been drafted on consumer protection³⁰.
- The Insurance Distribution Directive, governing the distribution of insurance products in the EU has modified its directive to include the following:
 - All sellers of insurance products, including insurance undertakings selling directly to the customers are included in the directive
 - The Directive which previously covered only those acting on behalf of the policy holder, now includes any person assisting in the administration and performance of insurance contracts
 - Ancillary insurance providers and websites are included in the directive as well
- The Belgian government has increased its consumer protection and strengthened the supervisory powers of the Financial Services and Market Authority (FSMA)³¹,

through Twin Peaks II. The new guidelines further strengthen the rules of conduct for financial service providers and insurance companies and intermediaries. Additionally, the monitoring and supervision norms have been tightened by:

- Use of mystery shopping, by engaging representatives of FSMA to act as real customers, without disclosing their identity
- Access to those parts of the websites of financial intermediaries which are reserved for limited customers, commonly used to offer specific products and services

Singapore

- The Life Insurance Association Singapore (LIA) is currently reviewing its policies for recruitment of agents serving competitor service providers. The guidelines are expected to define the number of months under which migrated agents have to be accompanied by managers while at client meetings.
- Monetary Authority of Singapore (MAS) has drafted “Guidelines on Standards of Conduct for marketing and distribution activities by financial institutions”³². The guidelines take into account the following safeguards, which require financial institutions to protect consumers:
 - Conduct of call backs and surveys of customers, to ensure customers have understood their purchases
 - Conduct of regular mystery shopping and site visits that ensure that the marketing, sales and advisory practices of representatives are aligned to the standards and procedures of the financial service providers

- Track complaints arising from customers on third party distributors
- Maintain registers of all their third party distributors with key details
- Financial institutions and their representatives to be professional at all times, and not pressurize their customers into buying financial products or services
- Financial institutions engaging with third party distributors, should ensure that their representatives explain the financial institution – third party relationship to the customer
- Representatives to undergo adequate trainings on sales and advisory conduct
- Financial institutions to ensure representatives have a good compliance record before on-boarding them as third party distributors

Way Forward

The global regulatory framework on financial product distribution is evolving with an aim to ensure systemic health, better reporting, and disclosure and governance requirements. Further, the regulators are also placing emphasis on customer protection, transparency, product suitability and appropriateness.

In the Indian context, the regulators have in place, a basic framework on product distribution and code of conduct. However, the current regulatory framework needs to evolve based on the learnings from the global events, particularly in the areas of conducting risk management and product mis-selling.

In addition, with the emergence of digital channels, hyper personalization of financial products and introduction of robot advisors, it is critical that the regulatory framework also evolves to manage the aspects of customer suitability, appropriateness, transparency and ensures customer protection.



²⁹Investor protection policy <https://www.esma.europa.eu/regulation/mifid-ii-and-investor-protection>

³⁰G20 High level principles: <https://www.oecd.org/g20/topics/financial-sector-reform/48892010.pdf>

³¹Financial Services and Market authorities (FSMA), through Twin Peaks II : <http://www.allenoverly.com/publications/en-gb/Pages/Essentials-on-Twin-Peaks-II.aspx>

³²Guidelines on Standards of Conduct for marketing and distribution activities by financial institutions: http://www.mas.gov.sg/~media/resource/legislation_guidelines/insurance/guidelines/Guidelines%20on%20Standards%20of%20Conduct%20for%20Marketing%20and%20Distribution%20Activities.pdf



Ethics in Distribution

Financial products act as an investment avenue and provide financial security to investors. Traditionally, they have been primarily provided by banks (deposits and savings accounts), insurance companies and others like post offices, chit funds, etc. However, the advent of liberalization led to an increase in the number of financial products available, including but not limited to, open/ closed ended mutual funds, exchange traded funds, systematic investment plans, unit linked plans, education and retirement plans. Since the 1990s, the financial distribution industry in India has seen a rapid increase in the emergence of private banks, non-banking financial companies (NBFCs), and technology enabled brokerage platforms etc. – with an additional push received from the arrival of internet and mobile based services, to meet investor needs.

Over the last few years, India has been one of the world’s fastest growing economies, with banking and financial services companies being one of the key drivers of this growth. Despite a gross domestic savings rate of 28.9% (in 2016)³³, a significant portion of savings continues to be channeled into non-financial assets like real estate, gold, etc. While the introduction of varied financial products has increased avenues for investment, this appears to have been tapped into largely by the urban market. This pattern can be attributed to a number of issues such as: lack of awareness of financial products in rural India, concerns around mis-selling, and limited access to formal financial channels, among others.

In recent times, the financial services distribution landscape has also undergone significant changes as a result

of regulatory and technology related developments. As financial institutions aim to increase investor participation, steps such as launching regulations that allow investors to forge advisory-only arrangements with financial advisors, to the capping of mutual fund commissions, to prevent mis-selling, to special commissions for mutual fund distribution in “below 15” cities (B-15)³⁴ - have all been taken, to address issues and complaints made by consumers.

The last few years have seen a transformation in terms of the way financial services are delivered, especially with key developments such as the financial inclusion programs taken by the government, and new banking licenses for payment banks. The rapid development of mobile payments has also created a paradigm shift in the way consumers are accessing financial products and making payments. The push by regulatory bodies, initiatives driven by the government, as well as the digital revolution, have all been key drivers in transforming consumer expectations and experience. They have led to:

- Increased consumer reach – The addition of new banks in the recent past has led to an increase in the reach of the financial distribution network. It has helped tap into the unbanked segment and made strides in the country’s financial inclusion efforts. Increased competition in this space will in turn, improve transparency and assure fair treatment to the end customer. It will also help move more people from informal lending to increased access and reliance on formal banking channels, for their financial needs and security.
- Reorientation of customer agents – Over the years, there has been a decline in the number of distributors or agents, especially in the insurance and mutual funds industry. As technological disruptions increase, financial institutions and agents will need to overhaul their existing business models

and adapt. They will need to build their capabilities by leveraging technology and providing the consumer with up to date research/ information and options that will assist them in making well informed decisions. This in turn, will help institutions in reaching out to a larger consumer base, as well as help reduce operational costs.

- Alternate distribution models - With the significant growth in e-commerce and a large population in India being millennials, e-commerce and a significant population in India being millennials, e-commerce websites and online channels are increasingly gaining popularity, not only in terms of dissemination of information, but also as a channel for financial distribution. These channels, either on their own, or by teaming up with banks to facilitate transactions for investors, are providing detailed research on different kinds of portfolios, products and markets, to help the end consumer make informed decisions.

The importance of ethics in the financial distribution landscape

While issues around ethics are common and apply across all aspects of business conduct, the financial services industry involves certain distinctive ethical issues³⁵ that need to be looked at separately. Since financial activity is closely regulated, ethical issues tend to be viewed as legal breaches of conduct, rather than deeper behavioral concerns that need other remedial action. Therefore, to curb unethical conduct, one needs to go beyond just the operational aspects of financial markets and institutions, to include individual behaviors of financial intermediaries. Financial intermediaries commonly take decisions as agents for principals in an agency relationship, and can often assume fiduciary relationships. They have the obligation to act solely in the interest of the client, and be aware of the conflict of interest scenarios, and avoid mis-selling.

³³The World Bank Group, Link - <https://data.worldbank.org/indicator/NY.GDS.TOTL.ZS>

³⁴“How fund distribution is evolving in India”, BSE India: <http://bseindia.morningstar.co.in/posts/35579/how-fund-distribution-is-evolving-in-india.aspx>

³⁵Blackwell Companions to Philosophy - A Companion to Business Ethics”, edited by Robert E. Frederick, Published by John Wiley & Sons, 2008

Ethical conduct and behavior are pivotal to the ability of financial advisors to retain the trust and confidence of clients/ stakeholder groups, and to ensure quality outcomes³⁶. In a study released on ethical issues in 2010, some of the most common forms of unethical conduct that were found amongst financial advisors included unethical conduct associated

with misleading statements about the performance, features and risks of recommended financial products, or misleading statements about the business reputations of those responsible for the management and administration of financial products, or managed investment schemes.

Table 1. Some of the most common forms of unethical conduct in financial advice

S. No.	Theme	Summary of unethical conduct	Primary ethical principles
1	Integrity issues	Misleading statements as to performance, product features or security, business reputations	Integrity, Professionalism
2	Integrity issues	Using client funds for own purpose	Integrity, Professionalism
3	Appropriateness of advice	Advice did not meet client objectives or circumstances and had no reasonable basis	Competence, Objectivity
4	Research into product/ strategy	Lack of financial product research/ inadequate understanding of financial product recommended	Competence, Diligence
5	Disclosure obligations	Failure to disclose remuneration benefits and conflicts of interest	Objectivity, Integrity, Fairness
6	Disclosure obligations	Failure to disclose information relevant to client decisions	Objectivity, Diligence, Fairness
7	Recommendations/ Advice	Inadequate written advice or failure to tailor advice to client needs	Diligence, Fairness
8	Appropriateness of advice	Inadequate explanation and examination of risks associated with investment	Competence, Diligence, Fairness
9	Integrity issues	Inadequate explanation of the risks associated with financial product	Integrity, Professionalism

Source: "Ethics and Financial Advice: The Final Frontier", Copyright @ 2010 Dr. June Smith

In addition, using client funds for the advisor's own purposes was another issue. This could be in the form of falsifying documents and signatures, and/ or discretionary dealing in financial products without the consent of the client.

Diligence and competence in the provision of financial advice was another area that was found to be breached. This could include the failure to conduct appropriate and independent research into the

financial product being recommended, and inadequate explanations and examination of the risks associated with particular investment choices.

Objectivity issues, such as the failure to reveal conflicts of interest or fees and commissions earned, and the failure to disclose information relevant to the client's decision, were also prevalent situations.

Walking the ethical tightrope

Financial advisors require the ability to exercise professional and ethical judgment appropriately, in the identification and resolution of the often perplexing and complex dilemmas they face in the provision of advice to clients, and in their relationships with their peers and other stakeholders.

What can ethical dilemmas look like? Here are a few simple examples.

Case 1

You are a financial advisor and have recently joined a large multinational bank. Having been in the industry as a financial specialist for several years now, you have been able to develop trusted client relationships. There are clients that would like to continue to work with you, despite your professional shift. One such contact, meets with you in your office. After a short discussion, you decide to switch your new client's investments to in-house financial products, which will also satisfy your bonus and corporate objectives.

Would this represent a breach of trust? Have you provided the true picture to your client and provided him with a portfolio of products that would be best suited for him? Are you perhaps, prioritizing your professional goals over your client's financial goals?

Case 2

You are a financial planner and part of a firm that has witnessed successful growth over the last few years. This has allowed you to get a good grasp of the market and forge a trusted relationship with your clients. A client asks you to take a look at his 80 year old mother's random portfolio of investments.

You drop by her residence, spending the large part of the day looking through her photo albums and assisting her in the kitchen. While she was a very pleasant lady, she had little knowledge about her

investments. At the end of the meeting, you decide to take matters into your own hands and make her sign forms that consolidate most of her portfolio into equity funds that may fetch her potentially higher returns - which you feel would be the best option for her. The funds recommended also provides you with a higher commission.

Do you think you have acted in her best interests? Have you perhaps failed to properly understand her attitude to risk, and to fully explain the product you have recommended to her? While you may believe you are acting in her best interests, are you instead, perhaps acting in your own?

Case 3

You are a financial planner at a well-known financial planning firm and have been in the business for quite a while now. You have an opportunity to attend a training on a new line of pension products that a global company ABC is introducing (this training will also bring together others in the pensions business).

The training was able to provide you great insight into ABC's products and you were also able to wine and dine with other financial planners. A few days later, you receive a case of wine bottles of one your favorite brands (delivered to your residential address) from the contact at ABC that had invited you to the training.

Do you believe there are any ethical risks associated with a situation like this? Do you think that this 'business gift' was intended to influence your judgement? What would be the right thing to do in a situation like this?

Common Ethical pitfalls to avoid

While there are several justifications that can influence an individual's decision making process, provided below are some common rationales that have been observed.

³⁶"Ethics and Financial Advice: The Final Frontier", Copyright @2010 Dr. June Smith

Image 1. Common ethical issues and key points to consider:

Justification/Rationale	Consideration
Everybody does it	Are you doing what you promised/ are expected to do?
We have always done it, so why change now	Are you using your best knowledge and intention in doing it?
This is how this business works	Are you doing what public authorities, regulators and business partners expect you to do?
If I don't do it, somebody else will	Are you conforming to the values of your company or business partners?
It works, so let's not ask too many questions	Will your actions enhance public confidence in the financial sector?
Nobody will notice and nobody will be hurt	Would you behave similarly if your actions were made public?

Source: Based on Deloitte Forensic experience in India

Ethical Decision Making process

To help guide the decision making, we recommend a five-step process that can be used when there is no surety about what action to take, or to test a decision which has been made.

Step 1. When faced with a situation, identify the problem or issue, and describe the situation in your own words

Step 2. Assess its potential risks – to the firm, colleagues, others and oneself. Does this situation involve an ethical dilemma? To help frame the issue, ask:

- What values are involved? Are they in conflict with each other?
- What topics from the code of conduct are involved?
- Is someone being fair and honest?
- What group or individual may be affected by the outcome and how?

Caution: Circumstances can sometimes blind us to the ethical consequences of our decisions and actions.

Step 3. Consider the alternative actions and the potential outcomes and consequences of each action. Some of the aspect to consider:

- What facts does one actually know?
- What is someone assuming?
- What additional information does someone need to know to make a good decision?
- How does someone verify the accuracy of what someone know?

Step 4. If someone is unsure about the alternatives, he should obtain consultation, if required.

Step 5. Does someone still view the situation or ethical dilemma the same way? If yes, decide on the best course of action and implement it. If no, return to Step 1 and restate the problem.

A code of ethics should ideally apply to all financial transactions³⁷, without regard to the product category, the type of intermediary, or the means by which the purchase of a product or service is transacted.

Ethical principle	Good practice to follow
Integrity and Professionalism	A financial advisor should necessarily place his/ her interests and needs of the client ahead of all other interests. Any form of advice or recommendation should only be provided after a thorough understanding of the client's needs, objectives and circumstances, and to then offer products or services to fulfill them.
Competence and Diligence	<ul style="list-style-type: none"> • A financial advisor should possess an appropriate level of knowledge relating to his/ her particular business and meet high standards of professional ethics, including acting with honesty, integrity, fairness, due diligence and skill. It is also the responsibility of the advisor to keep him/ herself educated and up to date in terms of keeping skill and knowledge levels current, so that all regulatory requirements are met. • At no point of time, should a financial advisor misrepresent his/ her education, qualifications, or experience. He/ she should ensure that all references to his/ her business activities, services, and products are clear, descriptive, and not misleading.
Objectivity	<ul style="list-style-type: none"> • Any situation/ advice or recommendation that may result in a conflict of interest should be disclosed by a financial advisor to the prospective client/ buyer. This would in turn help the client make an informed decision i.e. to either halt the transaction, to seek additional professional advice, or complete the transaction. • A financial advisor should always protect the privacy and confidentiality of a client's personal information that he/ she might be privy to.
Fairness	<ul style="list-style-type: none"> • When recommending a transaction to a client, a financial advisor must disclose all relevant facts, considerations, costs and risks necessary for an informed decision (which are reasonably available to the financial advisor).

³⁷Independent Financial Brokers of Canada. Code of Ethics and Statement of Principles: <https://ifbc.ca/code-ethics-statement-principles>, Copyright @2017

The use of technology to help deter unethical behavior

While no one solution will ever work across all institutions, provided below are some cases that could help drive ethical behavior by leveraging technology.

- Mandatory self-registration of the sales lead (customer) before the financial advice is offered. The registration information, apart from prospect research, could be used for the following:
 - Automated analysis across social media and other data sources to ascertain any personal relationship between the financial representative (FR) and customer.
 - At the time of sale, artificial intelligence and correlations can be used to judge if the advised product is in the neighborhood of the products that typically would be advised for customers in the same profile. This would be based on the self-registration data.
 - Capture the pattern of the customer enquiry and meetings with the financial representative, by capturing technology footprints. These could be mapped with patterns for similar customer segments and financial representatives, to help raise alarms for possible anomalies.
- Have a mandatory questionnaire for the sales representative to record their judgement
- Real-time analytics can also be performed on the KPIs of the FRs and the type of sale made. Indicators and thresholds can be used on the performance curve.
- Mandatory declaration should be made by FRs on the source of the sales lead. Automated searches on publicly available data can be programmed, to help validate the information. Any deviation can help raise an alarm for further review.

As a detection effort, the track record of the financial representative (FR) can be matched to his/ her success in the customer segment and product category to the current sale. In case there is a deviation from the normal, an automated audit can be initiated to help understand the factors.

Case in Action:

As a distributor is closing the sale, the system can be programmed to present three surprise questions specific to the sale that have to be answered satisfactorily, in order for the sale to proceed. For example - In the case of a mutual fund purchase, the questions raised, could be:

- What is your margin on this sale?
- Is it less or more than the margin on another similar financial product providing similar returns?
- If more, do you have a satisfactory response to validate your decision to recommend this mutual fund to your client? – Yes/ No option (Choosing 'Yes' would lead to a further review by the fund manager/ company/ regulator as part of a routine process)

Confidence and trust are crucial to the financial services sector, and in turn can affect an economy and consumer confidence. Apart from training and inculcating ethical obligations to be upheld by a financial advisor, we recommend that the industry leadership³⁸ demonstrates and establishes an industry framework to practice and monitor ethical conduct. The suggested initiatives can include the following:

- Develop an industry point of view and ethical standard – Initiate a discussion with various participants from the financial services industry, and develop an ethical guidelines document detailing the guiding principles and expectations from each participant in the industry, with specific focus on financial intermediaries. This should provide specific dos and don'ts, as well as details on doing the right thing, instead of propagating a philosophy of conducting business at any cost. As the next step, an industry ethics panel can be created, comprising of representatives from across regulatory bodies and industry participants which can define and develop the framework, and establish initiatives to be taken by the industry.
- Customer outreach - This would include regular newsletters highlighting key ethical or quasi ethical issues/ topics, and the industry response to these initiatives. Further, contributing media articles, and organizing events and seminars to discuss such issues, can also help demonstrate commitment to ethical conduct.
- Ethical dilemma workshops - Designing specific workshops for agents and practitioners can help reinforce good ethical conduct.



³⁸"Ethics in Banking and Finance Report 2009", Undertaken by Claire Payne, St. James Ethics Centre, Sydney



Financial Literacy & Inclusion – Reaching out to Rural Markets

Background

The former RBI Governor Raghuram Rajan defined Financial Inclusion as:

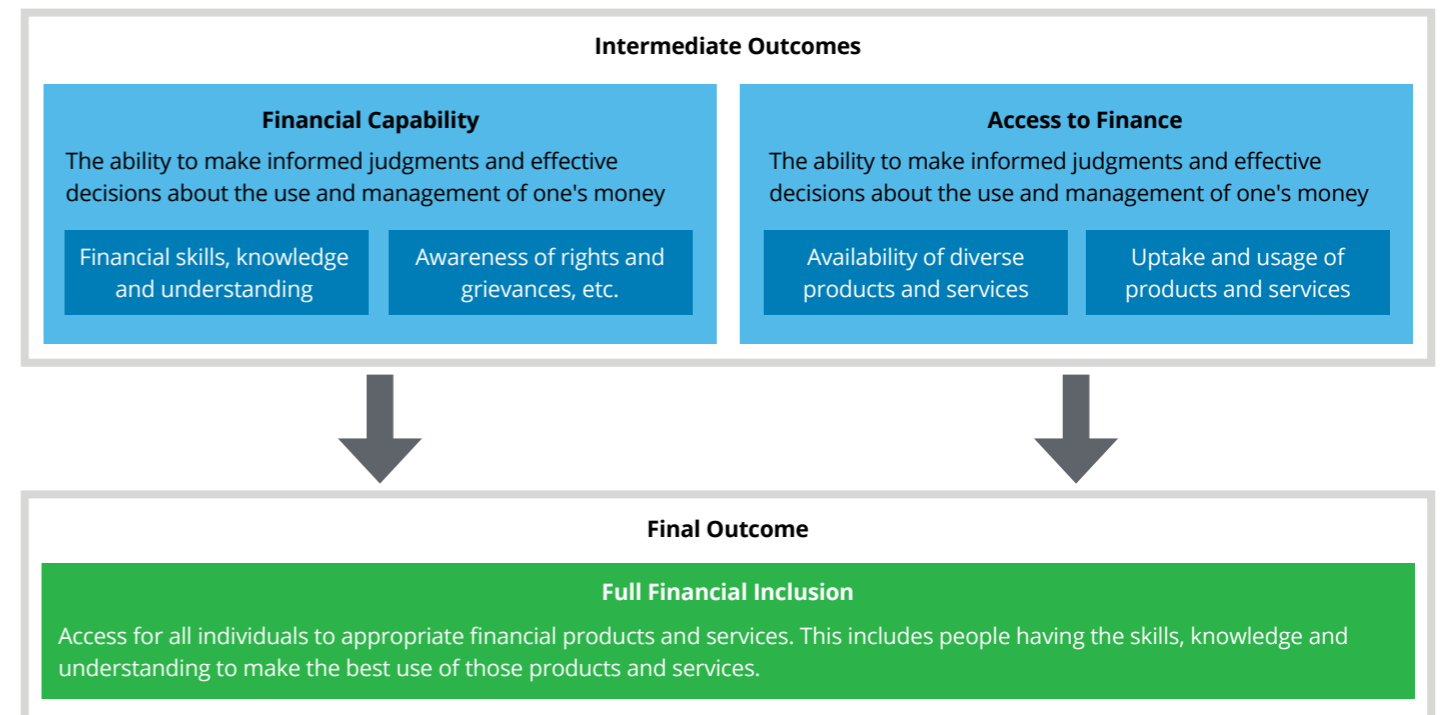
- Broadening Financial services to those with no access i.e. unbanked
- Deepening Financial services to those with minimal access i.e. underbanked

- Greater literacy and protection for consumers

While the first two tenets of this construct focus on the “Access” aspect, the third tenet focuses on the “Capability” aspect of inclusion.



Financial Inclusion and its component parts



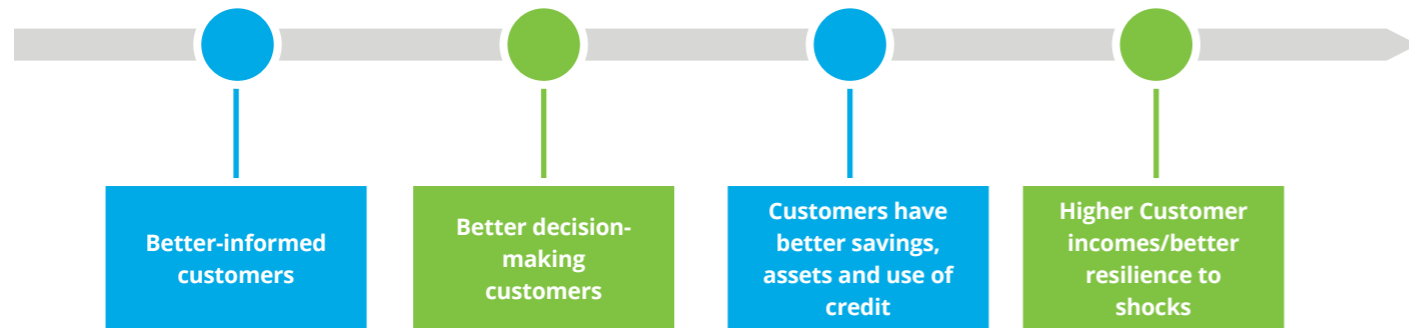
Source: Monitor

Mandates that have made headway in recent years, moving the field of Financial Inclusion forward, include: Priority Sector Lending, Branch opening, Credit expansion, Pradhan Mantri Jan-Dhan Yojana (PMJDY), Mudra Scheme (for small loans), Small Finance Banks, Payment Banks, etc. Alternately, the market based approach holds promise to break the cycle of financial distress. For instance, “Base of Pyramid (BoP) Sourcing” as a market approach, has been contemplated as a strong solution to poverty. Information

based outsourcing that benefits the BoP by providing higher income employment opportunities can enhance the quality of life of the financially excluded. The beneficiaries of this model, are likely to see multi-fold increase in income, and the approach may even stem urban/rural migration. Roadblocks to market forces such as inadequate infrastructure and regulation could however, fail to generate development gains that were originally expected from these initiatives.

However, advancing progress on the “Access” front, without adequate focus on building Financial “Capability” in the system will only result in improper dissemination of the financial inclusion effort. Education models need to keep pace with the growth in access to finance. Not only must these be targeted at customers, but also at sellers (e.g. to avoid mis-selling).

Implicit Results Chain in Financial Education



Source: Monitor

Barriers to growth for inclusion

We believe the following factors majorly constitute the nature of the systemic inclusion problem:

- Financial Literacy – Very often, the financially excluded consumer does not understand the product he is sold, or is mis-led into purchasing a product unsuitable to his/her risk profile. He has the freedom of choice and should therefore, be in a position to select the most suitable product. Literacy in India took a long time coming and we cannot have the same repeat itself for Financial Literacy. Low cost, high quality distance financial education, where customers are taught basic financial management, and can put in place plans to reach their financial goals, is currently missing. It is no-doubt imperative that we find solutions which can help us deliver exponential progress on Financial Literacy.
- Lack of information exists at 2 levels – First, customers do not have credit information, reducing their access to credit. They get pushed into predatory lending and get caught in a cycle of dependence. This also creates a sense

of not being able to get out of debt and becomes a perpetual cycle. Second, the banker does not have information on the local poor, or very often does not even have local staff to serve them (who are fully capable of understanding the customer). The financially excluded do not typically have records or signed documents that can be leveraged by a Bank for due diligence. Combined, these again reduce the consumer’s access to credit.

- Unwilling lenders – Lenders are willing to lend only if there is a collateral (which is most often missing in this segment), or the legal system imposes payment. The financially excluded are as a result, forced into borrowing from local moneylenders.
- Products – Easy to use products that go beyond credit (those that allow funds transfer from bank account to non-bank recipient, payments, savings instruments, etc.), are missing. Products are also not compatible with simple prepaid mobile, which is the pre-dominant mode of delivery in rural areas.

- Inadequate cash out – Rural customers are actively seeking cash outs. A Business Correspondent (BC) network that can provide them this, or other methods of cashing out have been lacking in our current financial distribution system.
- Stringent Know Your Customer (KYC) – Despite best efforts, banks have been reluctant to relax KYC requirements, fearing liabilities in case of some eventualities. This is a double edged sword, pushing up servicing costs at the Bank’s end, and making it unviable for illiterate customers to fulfil these requirements.
- Small size transactions – Are pushing up costs of servicing the unbanked/ underbanked (due to fixed costs involved).
- Political Interference/vested interests of service providers – is another impediment to financial inclusion.

Opportunities for growth, for inclusion
01. Attractiveness of the Rural Segment

As per World Bank estimates, India’s rural population in 2016 stood at 66.86%³⁹ of the total population. India’s total population living below the poverty line (below USD 1.9 a day), at 2011 PPP was 21.2% of the population⁴⁰. Of the total rural population, 25.7%⁴¹ itself, was living below the national poverty lines, in 2011. Many living below the poverty line can be pulled out of poverty with basic access to financial services such as payments, insurance and savings.

The rural segment has basic financial needs – daily expenses, medical, education, and entertainment, social obligations such as festivals and weddings, and retirement savings. Given the systemic barriers to inclusion, efforts to serve this very attractive segment will require fundamentally different business models. Innovative approaches will help achieve the desired social progress (not just economic progress). Innovation (both, technology and non-technology), across all areas of impact in product and delivery of financial services (classroom, on the job, bank account, mobile, tablets, local language, videos, plays, lectures, teachers, etc.) will be desirable in making the rural segment attractive to service providers, in a way that providers of financial services in-fact, compete for these customers.

02. Leveraging Social, Mobile, Analytics, and Cloud (SMAC) and Information and Communications Technology (ICT)

SMAC and ICT are enablers and powerful accelerators of economic activity, and have the ability to create, as well as sustain demand. They can help us achieve our economic and social objectives, and lift people out of extreme poverty, as they raise average incomes, and bring them out of financial distress.

A case in point is the application of internet and mobile in raising awareness of potential dangers for farmers, how to prepare for them and supporting farmers with early warning systems (e.g. weather conditions). Farmers can also compare wholesale prices and get constant updates on market prices and demand. Digital platforms can thereafter be used for basic banking services such as investing savings generated by these farmers in basic products e.g. crop insurance, savings products. By mitigating certain elements of risk, and investigating aspects of price to better serve markets, a farmer formerly in financial distress, is no longer likely to be financially excluded, owing to SMAC and ICT. Another example is of the application of data analytics and cloud by FinTech companies that have lately been seen disaggregating distribution. By frontloading payments for small businesses (at a discounted price) and addressing their usual “late payment problem”, these FinTech companies are providing financial flexibility to the small seller (earlier in financial/distress). These companies can alter traditional factoring by: improving time to market, by digitizing the process; and enhancing security, as well as providing better access via cloud infrastructure.

It is important we bear in mind that dividing focus between SMAC and ICT, along with exploring non-traditional methods such as building financial literacy on the back of “Mobile Device Fluency”, is important to drive exponential adoption of financial services, especially in our rural population. With 4G, rapid mobile device penetration, and falling prices of smartphones, using financial literacy tools on mobiles can ensure rapid adoption of financial services.

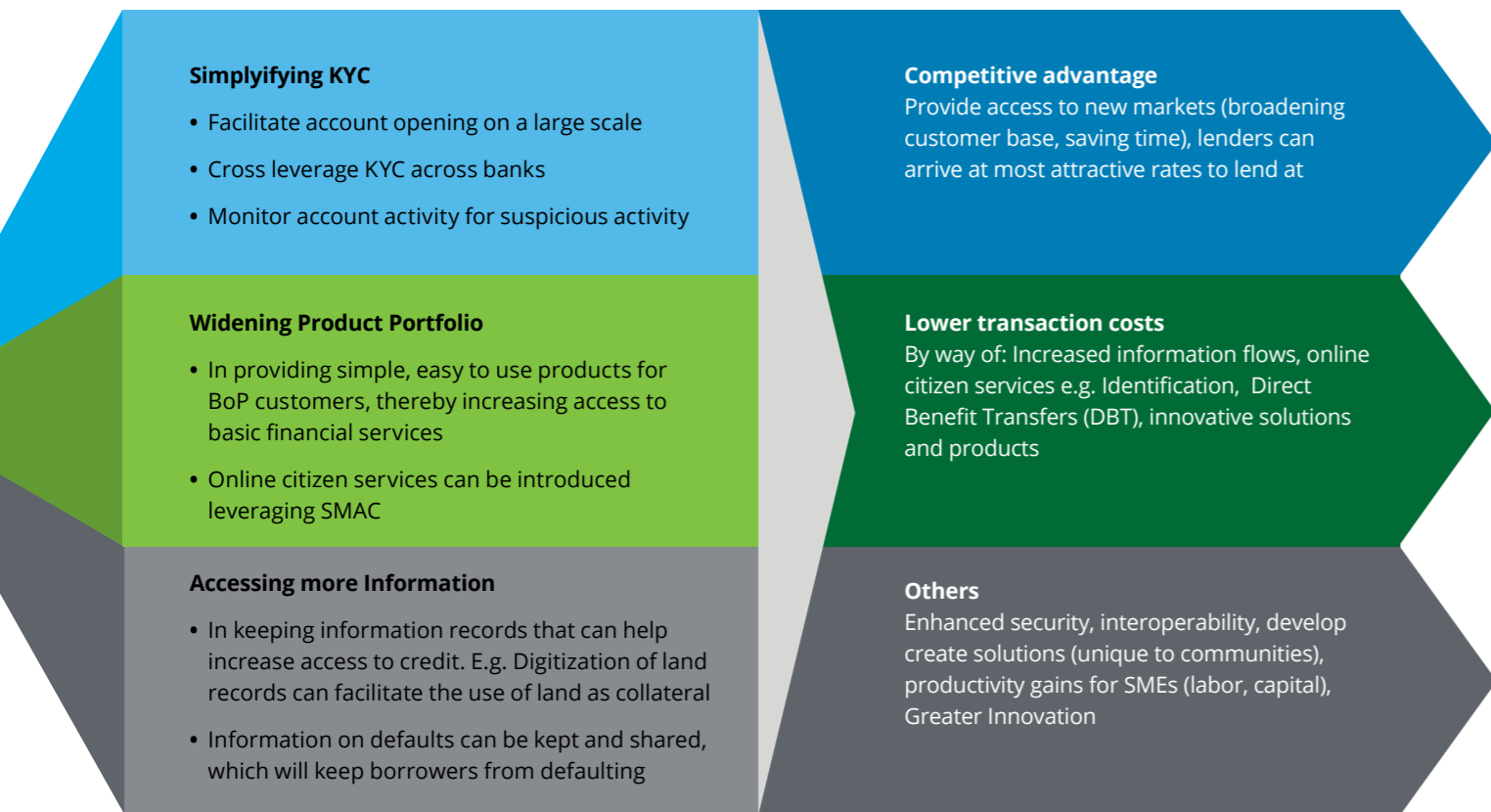
³⁹ World Bank, <https://data.worldbank.org/indicator/SP.RUR.TOTL.ZS?locations=IN&view=chart>

⁴⁰ World Bank, https://data.worldbank.org/indicator/SI.POV.DDAY?locations=IN&name_desc=false&view=chart

⁴¹ World Bank, <https://data.worldbank.org/indicator/SI.POV.RUHC?locations=IN&view=chart>

The use of digital channels therefore allows increased access and reach to the financially excluded, builds trust among the segment by raising incomes, provides jobs, and eventually translates into higher GDP for the country.

Examples of Applications of SMAC and ICT



Source: Deloitte Analysis

03. Role of the Government. and Corporates

In order to build trust in the establishment from the customer's end, and to ensure better financial literacy and inclusion, it is required that the Government and Corporates develop policies, frameworks and actions. A few examples include:

- Simpler, basic norms/requirements for KYC, therefore for account opening

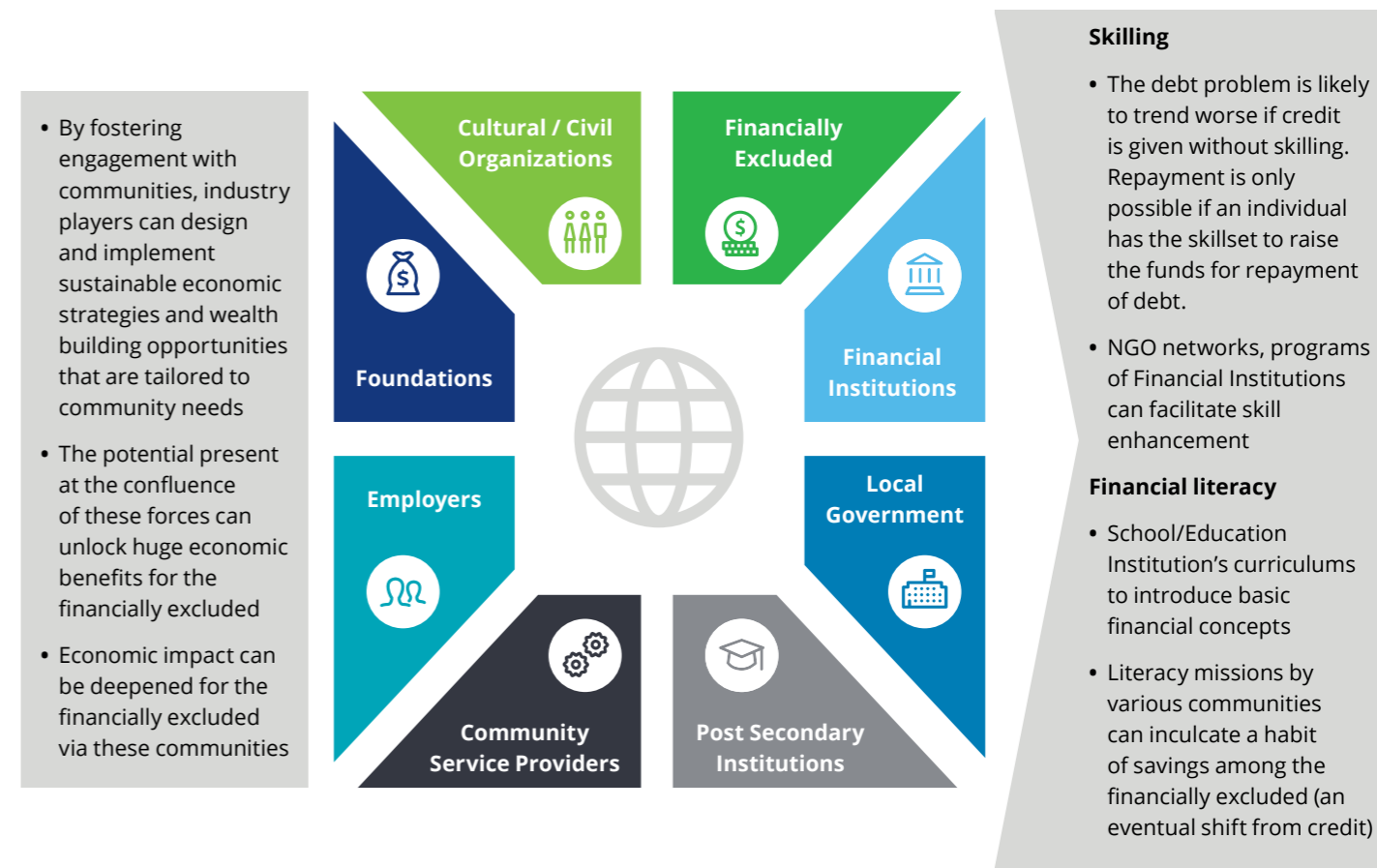
- Allocate certain % of loans from the Priority Sector targets i.e. Priority Sector Lending (PSL) in a focused manner, such as the sectors operating on the fringes of inclusion
- Trading of PSL certificates for better efficiencies
- Programmes such as PMJDY that were a stepping stone to financial inclusion, as they will generate the network effects of having bank accounts

- Opening a certain percentage of Automated Teller Machines (ATMs) & branches in rural/semi-urban areas
- Putting in place a network of BCs that is well positioned to facilitate financial distribution via easy cash-outs
- Telecom kiosks as financial points as Telcos with Payment Bank licenses start operations
- Inter-person transfers via Unified Payments Interface (UPI) and cheaper smartphones
- Credit Bureaus in rural areas, that can provide at least one free report to individuals and address the information problem
- Client protection by putting in effect grievance redressal mechanisms
- Flexibility in repayment to provide relief, which is much needed in this segment, without allowing mis-use
- Encouraging competition among the financial service providers to prevent financially excluded population from being exploited by money-lenders.
- Policies to facilitate access to innovative technologies for Small & Medium Enterprises (SMEs)

04. Role of the eco-system

Other stakeholders need to be brought into future field building efforts.

Financial Inclusion Ecosystem



Source: Deloitte Analysis

Conclusion:

Financial inclusion can be better achieved once we steer towards the G-20 principles⁴² for developing Digital Financial (DF) products/services, support innovation, and manage risk to leverage the potential offered by digital technologies. The key principles include:

- Adopt a digital approach to inclusion
- Balance innovation and risk for Digital Financial inclusion
- Enabling and proportionate legal and regulatory framework for Digital Financial inclusion
- Expand DFS infrastructure ecosystem for safe and low cost provision of DFS, especially in rural areas
- Establish responsible digital financial practices to protect customers
- Strengthen Digital and financial literacy and awareness
- Facilitate customer identification for DFS, for a risk based approach to DFS
- Track Digital Financial inclusion progress through a data measurement and evaluation system to assess demand for DFS, and progress and impact of key reforms

Many of these principles communicate the priorities expressed in the vision statements of the Committee on Comprehensive Financial Services (CCFS) for Small and Low Income Households, under Dr. Nachiket Mor⁴³. These include:

- A Universal Electronic Bank Account by January 2016 for every Indian citizen above the age of eighteen
- Ubiquitous access to payment services and deposit products at reasonable charges, by 2016 for every resident
- Sufficient access to affordable formal credit, by 2016 for every low income household
- Universal access to a range of deposit and investment products at reasonable charges, by 2016 for every low income household
- Universal access to a range of insurance and risk management products at reasonable charges, by 2016 for every low income household
- Right to Suitability of financial services/ products

⁴² Global Partnership for Financial Inclusion, <http://www.gpfi.org/sites/default/files/documents/G20%20High%20Level%20Principles%20for%20Digital%20Financial%20Inclusion%20%20Full%20version-.pdf>;

Inclusive Finance India Report 2016, <file:///C:/Users/grabani/Desktop/CII%20Financial%20Distribution%20Summit/Financial%20Literacy/Inclusive%20Finance%20Report%20.pdf>

⁴³Committee on Comprehensive Financial Services for Small and Low Income Households Report, <https://rbidocs.rbi.org.in/rdocs/PublicationReport/Pdfs/CFS070114RFL.pdf>





Future of Distribution by Digitization

Overview of Financial Services Distribution

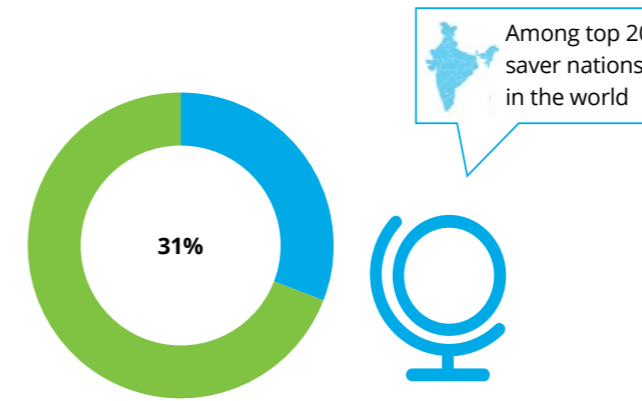
01. Saving and Investing Trends

Indian economy is witnessing a rebound after a brief period of slow down. Despite the marginal decline in household savings ratio (% of GDP) from 22% to 19%, the household savings has grown nearly 5 times in the last fifteen years, as the GDP grew from INR 23 lakh crore to INR 152 lakh crore⁴⁴. For the overall savings, India has been ranked among the top 20 savings nations in the world with the gross savings rate of 31% (% of GDP)⁴⁵.

However, the channelization of savings in the financial services sector continues to be very low at 8% and presents large opportunity for incumbent financial services providers. Awareness and financial literacy remain two of the stumbling blocks for Indian consumers to transition to financial products. Within financial products, the awareness remains high for bank deposits and life insurance as compared to the Mutual funds, Equities, Bonds and other securities.

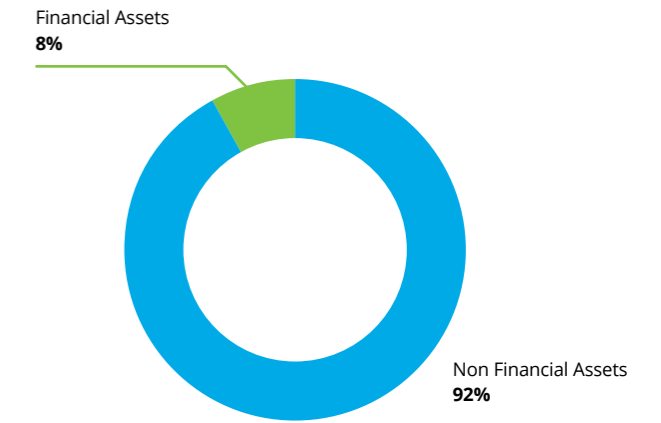
Indian households are aggressive savers, however, a larger portion of savings are held in the form of physical assets

01. Gross Saving rate (% GDP)¹



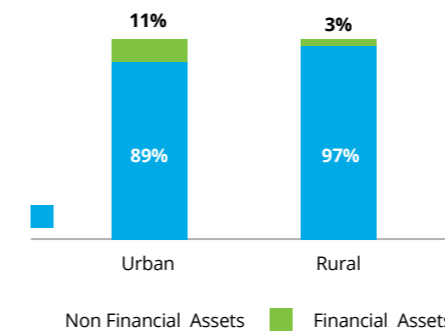
Gross savings rate declined from a peak of 37% to 31% over 2008-2017

02. Assets held by Indian Consumers²



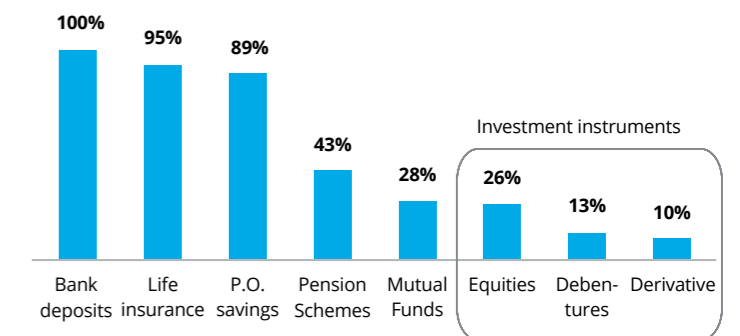
Indian consumers invest a large portion of their wealth in assets like real estate, precious metal and durable goods.

03. Assets held by Urban and Rural Consumers²



Urban customer hold more financial assets compared to their rural counterparts

04. Urban households awareness of financial Instruments³



Urban awareness about investment instruments remains very low in a sharp contrast to awareness about savings instruments

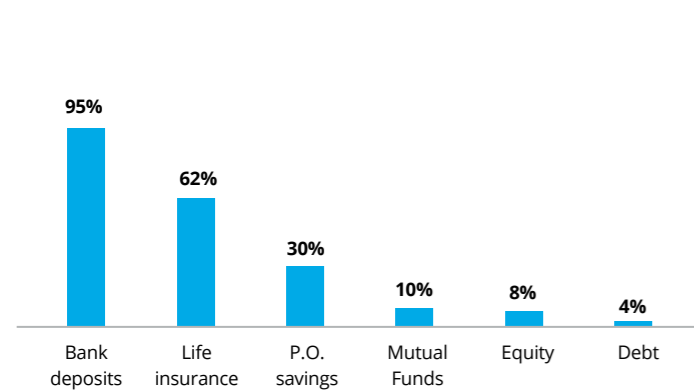
Source:

1. 2014 - World Bank Report 2. National Council of Applied Economic Research, 2016 3. SEBI Investor survey 2015

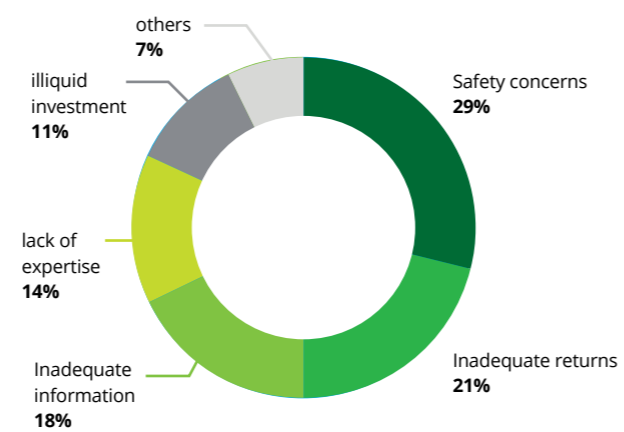
⁴⁴ RBI, Handbook of Statistics on Indian Economy

⁴⁵ 2014- World Bank Report

Instruments held by Urban Customers⁴⁶



Reasons for not investing⁴⁷



02. Distribution Channel Trends

The Indian financial services industry is rapidly expanding and transforming at the same time. While the incumbent providers are transforming their offerings by aligning with the changing customer behavior and expectation, the introduction of new players including small finance banks, payments banks, FinTechs, digital aggregator platforms etc., is causing a paradigm shift by providing disruptive offerings and enhanced user and service experience, at the doorstep of customers.

Within distribution, similar innovative entrants focusing on digital and mobile channels have been introduced to the arena of traditional distribution players. Additionally, technology is playing a vital role in transforming the way financial services are distributed and used by the individuals throughout the value chain.

- Current Distribution Channels – Overall Landscape - Indian financial sector is undergoing a transformational change with technology advances, entry of new players, changing regulatory norms, changing customer behavior, and integration of traditional financial players with the emerging technology players, to provide end to end service offerings to the customers.

Besides traditional distributors, new players are entering financial services distribution, offering accessible and convenient services through digital channels.

Current distribution channels for 4 segments – mutual funds, insurance, broking, and pension funds, have been summarized below.

Distribution channels across various products⁴⁸

Products	Regulator	% household savings	Distribution Channels	Key Observations
Insurance	Insurance Regulatory Development Authority	17%	<ul style="list-style-type: none"> Individual Agents (36%, 36%) for life and non-life Corporate Agents (12% for life and 10% for non-life) Brokers (1.3% for life and 22% for non-life) Direct (49% and 31% for life and non-life) Banks Digital channels 	<ul style="list-style-type: none"> ~11,000 branches, 22 lakh agents and ~700 corporate agents for life ~9,800 branches, ~600 corporate agents for non-life, ~350 brokers Life insurance sold primarily through agency channel Bancassurance model has picked up. Open architecture for bancassurance introduced recently
Mutual Funds	SEBI	3%	<ul style="list-style-type: none"> Organized distributors (18%) Banks (21%) Independent Financial Advisors (IFAs) (21%) Direct sales (40%) 	<ul style="list-style-type: none"> 1600 branches, 85-100K IFAs, ~500 corporate distributors, ~2000 Certified Financial Planners SEBI removed upfront commission in 2009 which resulted in IFAs exiting the market Focus on online selling and digital platforms is increasing
Broking	SEBI	3%	<ul style="list-style-type: none"> Discount Brokers Offline Brokers and Sub brokers Hybrid (Online + Offline) 	<ul style="list-style-type: none"> ~14,000 brokers, ~42,000 sub brokers, ~360 depository participants, ~515 investment advisors, ~2000 Certified Financial Planners Brokers have diversified into other products such as credit due to declining margins on account of market disruption by discount brokers
Pension and Provident Funds	EPF, Pension Fund Regulatory Authority of India	12%	<ul style="list-style-type: none"> Banks NBFCs MFIs Insurance companies Agents Digital channels Mutual Funds 	<ul style="list-style-type: none"> NPS has majority AUM from government employees Personal pension schemes by MFIs, Insurers and NPS have seen limited penetration

⁴⁶ SEBI investor survey 2015, published May 2017

⁴⁷ SEBI investor survey 2015, published May 2017

⁴⁸ Deloitte Analysis

A common distribution channel which has emerged across all the segments is the digital channel. With the widespread penetration of computers and mobile phones in India, customers are shifting from physical channels to digital channels for searching and buying financial products. Digital channels provide a platform for enhancing customer engagement and a seamless customer experience, throughout the value chain.

- Technology based disruptions in distribution channels - With the entry of new distribution players and technology disruptions, sophisticated tools are being used to provide customized and low cost services through digital channels. These new offerings/tools have the potential to transform the entire distribution landscape and revolutionize the traditional way of distribution across various financial products.

- E-KYC, C-KYC and E-sign - Aadhaar based EKYC, centralized KYC, and E-sign have a deep impact on distribution of financial products. These capabilities enable digital on-boarding of customers in banking as well as financial products including mutual funds, insurance etc., hence enabling seamless and efficient distribution of these products through digital channels. The E-KYC capability enables the paperless processing of applications within minutes and also minimizes the occurrence of identity theft, fudged signature and fake documents. The entire process also reduces the cost of application processing by making it paperless. The reduction in costs can be 2-3% for banking products and as high as 20%-30% for insurance products. Central KYC reduces the need of doing KYC for the same person while purchasing different financial products by maintaining centralized repository of KYC records of customers engaged in various financial market segments. Electronic signature (E-sign) provides an online electronic signature capability to facilitate an Aadhaar holder to digitally sign a document. The capability provides an easy and convenient way of digitally signing documents without the need of a physical signature.
- E-KYC capability is widely used for opening new accounts for mutual funds, insurance, broking, and pension products like NPS.
- Mobile apps - With the changing customer behavior and their increasing preferences for the digital channels, financial players are increasingly adopting tools to provide digital offerings for both distributors and clients, creating an enriching and customer-centric user experience.

Several apps have been developed which can be accessed through mobile/tablet apps or web browsers and enable investors to compare and assess various product features, increase awareness, make transaction and track and manage the performance of their investments. These features not only increase customer awareness, but also empower customers to perform transactions at their own convenience in a way preferable to them.

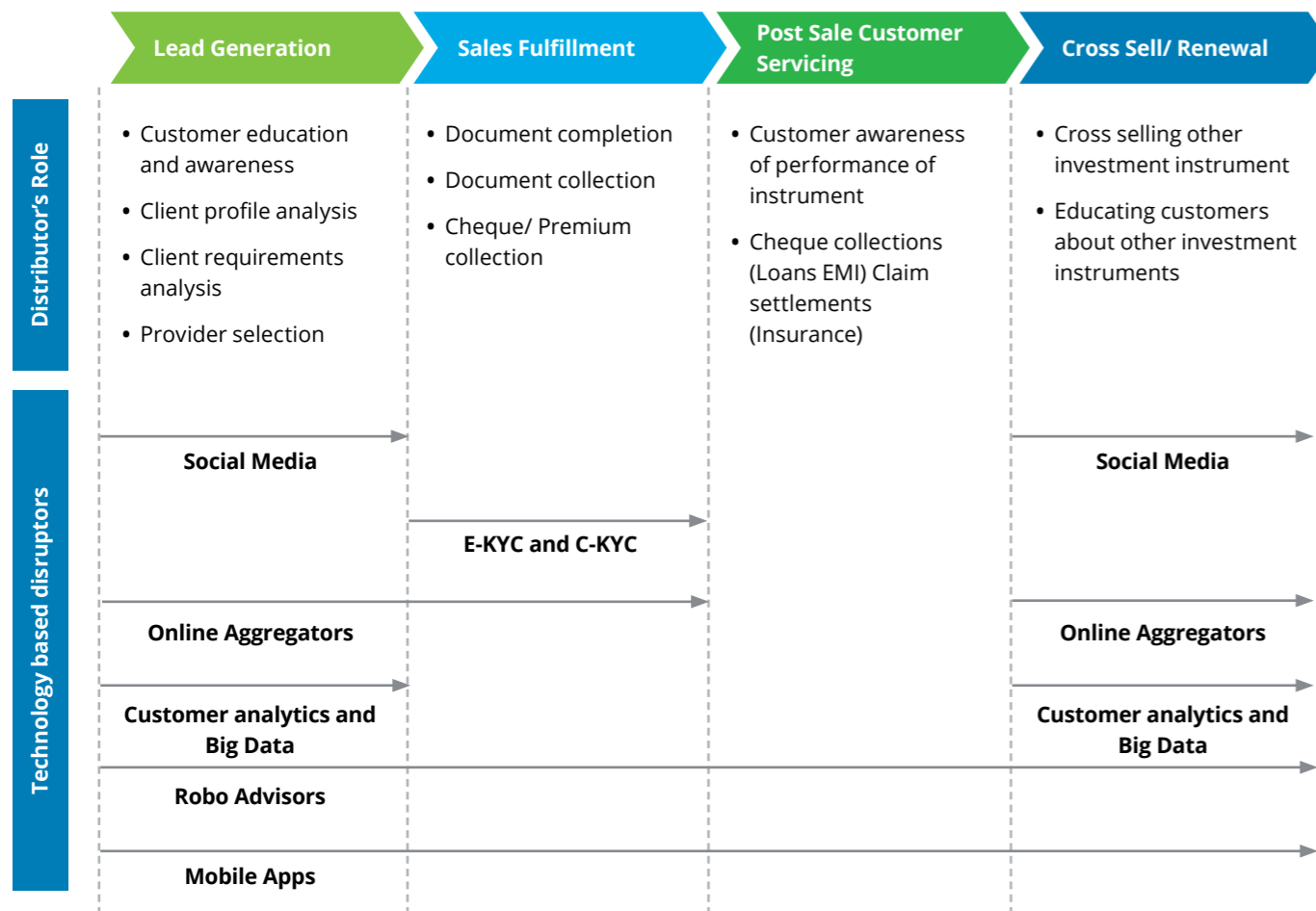
Example of mobile apps – Mutual Funds: myCAMS by CAMS, KTrack app by Karvy, InvesTap by SBI Mutual Fund, HDFCFM Mobile app by HDFC etc.

Insurance: LIC Mobile, Aviva Life Insurance, HDFC Life Insurance

- Robo advisors - Robo advisor is an automated advisory system or online portal which provides automated, algorithm driven financial advisory services with little or no human supervision. Customers can get online investment services, and can easily manage their portfolio with the help of a robo advisor. These advisers offer automated, personalized investment plans at a low cost by assessing the customer's risk profile. They automatically rebalance the investment portfolio according to market conditions, keeping in view the investor's needs, and also deliver transparent, real-time and on-demand reports. Most importantly robo advisors give unemotional and unbiased advice, as compared to human advisors who can give advice based on the fact that they earn high commissions when they recommend costly products to their clients.

Examples: Arthyantra, Bigdecisions

Role played by distributors and the impact of technology disruptors



Source: Deloitte Analysis

- **Social media** - With the increasing penetration and engagement of customers on social media, it has emerged as one of the most effective platforms for customer engagement. For financial services, social media enhances customer engagement in two ways. Firstly, it helps in dissemination of information amongst investors in a faster and convenient way and thus impacts brand perception of various financial products. Investor decisions are also impacted by the products and services endorsed by other people known to them. Secondly, financial players can make use of the immense data available on the social profiles of the investors, to understand their investment and financial need patterns and hence, recommend the products and services most suitable for them.

- **Online aggregators** - Online aggregators help customers make informed decisions by combining and comparing all the products, for a financial stream, in a single window. For customers, it means easy access to product information and readily available comparisons for different products in a specific category. However, it has an even deeper impact for the physical distributors and the financial advisors, as it empowers customers to make their own investment decisions by providing them the information about various products. Hence, online aggregators enable direct customer-to-digital set up.

Examples of aggregators for Insurance: Coverfox and Policy Bazaar

- **Customer Analytics** - Analytics helps in enhancing both the distributor and the customer experience. Advanced analytics such as trends in Assets Under Management (AUM) growth, client acquisition trends and AUM mix, client's recent financial activities, specific industry behavior etc. can help distributors suggest the right financial product to the customers which they may/ may not be aware of. At the same time analytics may also help customers understand their own requirements of the financial products as per their financial behavior and the trends of the industry they are operating in.

03. Operational challenges in Distribution

Following are some of the operational challenges that limit the penetration of the financial products amongst the consumers and investors:

- **Low customer literacy and awareness** - Lack of financial awareness and literacy plagues the distribution of the financial products. Investors perceive several investment options as risky, and lack the basic knowledge about concepts such as risk-return, diversification, asset allocation, equity etc.
- **Risk perception of customers about several financial products**- There are specific perceptions amongst the investors about different investment products which limit them from investing in these products. These perceptions often create situations of miss-selling where financial products are sold to investors without explaining their true purpose or implication.

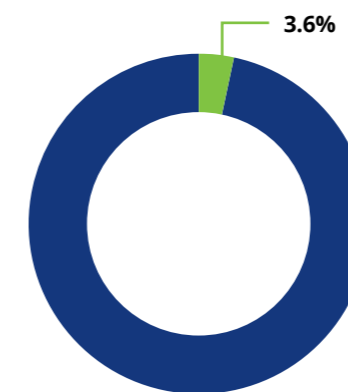
- **Lack of focus in Tier 2 cities** - Most of the distributors focus more on the Tier 1 cities and lack distribution focus in Tier 2 and the rural cities. This is primarily because these players want to avoid the comparatively high costs needed to penetrate the rural cities, given that they would have to invest enormously to increase investor awareness and distribution channels in these cities, as compared to the more educated investor base and established distribution channels in the urban areas. Another reason is that the margins are perceived to be lower from the low amount of investments made in the rural cities.
- **Low distribution focus by Public Sector Banks** - Public Sector Banks, having a strong distribution and reach in the rural areas have low focus in the distribution of other non-banking financial investments products such as mutual funds, insurance etc.
- **Changing customer behavior** - With the changing customer behaviors and their increasing inclination towards

the digital channels and customized products, distributors need to keep a strong track of the customer preferences, and keep pace with changing customer requirements. Financial distributors are considering adoption of better technology tools and processes to increase customer convenience and provide customized products, and are moving towards mobile/ tablet app based and browser based, paperless investments.

Products Deep Dive 01. Mutual Funds

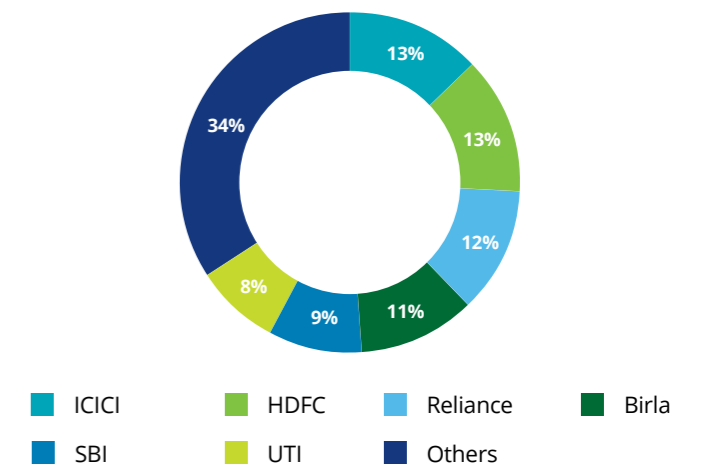
- **Current Landscape** - The mutual fund industry in India manages approx. INR 19.5 lakh crore (March 2017) in Assets under management (AUM). While the industry has been growing at a CAGR of 28% from March 2013 to March 2017, it only accounts for 3.6% of individual⁴⁹ wealth in India based on Financial Assets.⁵⁰ The industry is dominated by six asset management companies⁵¹ accounting for around 2/3rd of the total industry AUM.

Mutual Funds contributes only 3.6% of the individual wealth in Financial Assets



Source: Karvy, India Wealth Report, 2016

Top 6 players contribute around 66% of the market share by AUM



Source: AMFI

⁴⁹ Individual wealth is calculated by collating private wealth in all assets classes in which individuals make their investments, it does not consider government and institutional investors

⁵⁰ Karvy, India Wealth Report 2016

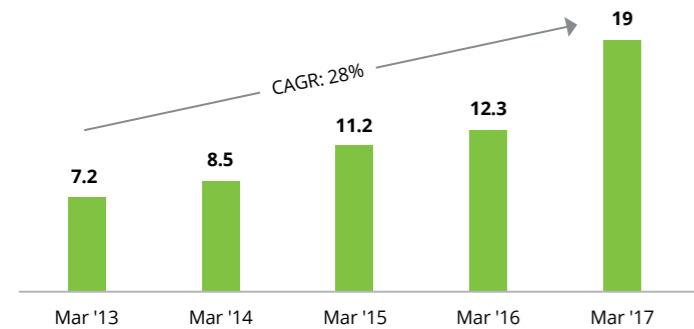
⁵¹ AMFI March 2017

The AUM in the mutual fund industry has seen a significant growth in the last few years. The expectation is that the growth is likely to continue as both SEBI and AMFI are making substantial efforts to increase investors' awareness and penetration of mutual funds. Measures have also been taken to improve transparency in the disclosure of distributors' commission expenses, improve investor education and awareness, implement pro-investor

measures and for overall expansion of the distribution base.

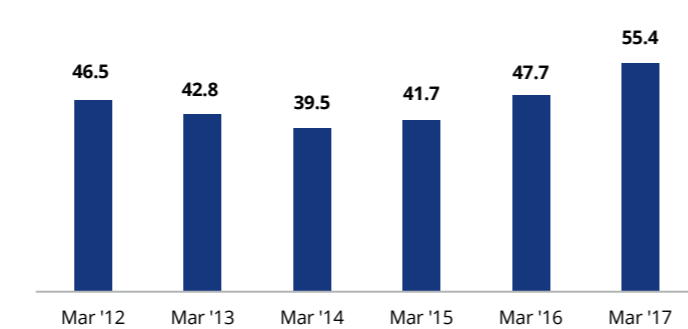
AMFI is also evaluating the possibility of a single window registration process for distributors that could eliminate the requirement of empaneling with each fund house. On the same lines, AMFI is also evaluating introduction of a common/standardized application form, to ease the transaction process for investors.

Mutual Fund AUM Trend (in INR Lakh Crores)



Source: AMFI

Number of Folios (In Mn)



Source: AMFI

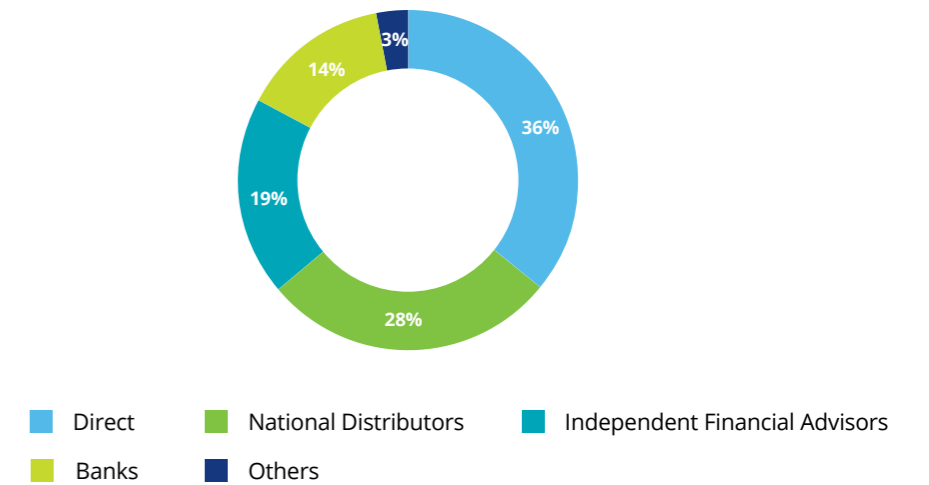
Over the past few years, the distributors mix for the mutual funds industry has been changing with increase in direct channels, and decrease in national distributors.

Direct channels have been increasing owing to the upcoming digital channels. This trend is going to continue as young internet-savvy customers are more inclined towards the digital channels. With the increasing use of mobile apps, tablets, and browser based apps, customers are shifting from the physical way of undertaking transactions to digital channels.

Though Banks remain a primary distributor, there is a huge potential for the banks to further increase penetration due to their strong distribution network.

Individual financial advisors (IFAs) have increased their share in mutual fund distribution over the past ten years, however their share has recently declined because of the cap on the upfront commission and removal of service tax exemption status.

Segmentation of Distributors by AUM



Source: AMFI

With the emerging digital wave, the current modes available⁵² for both web and online app based platforms are:

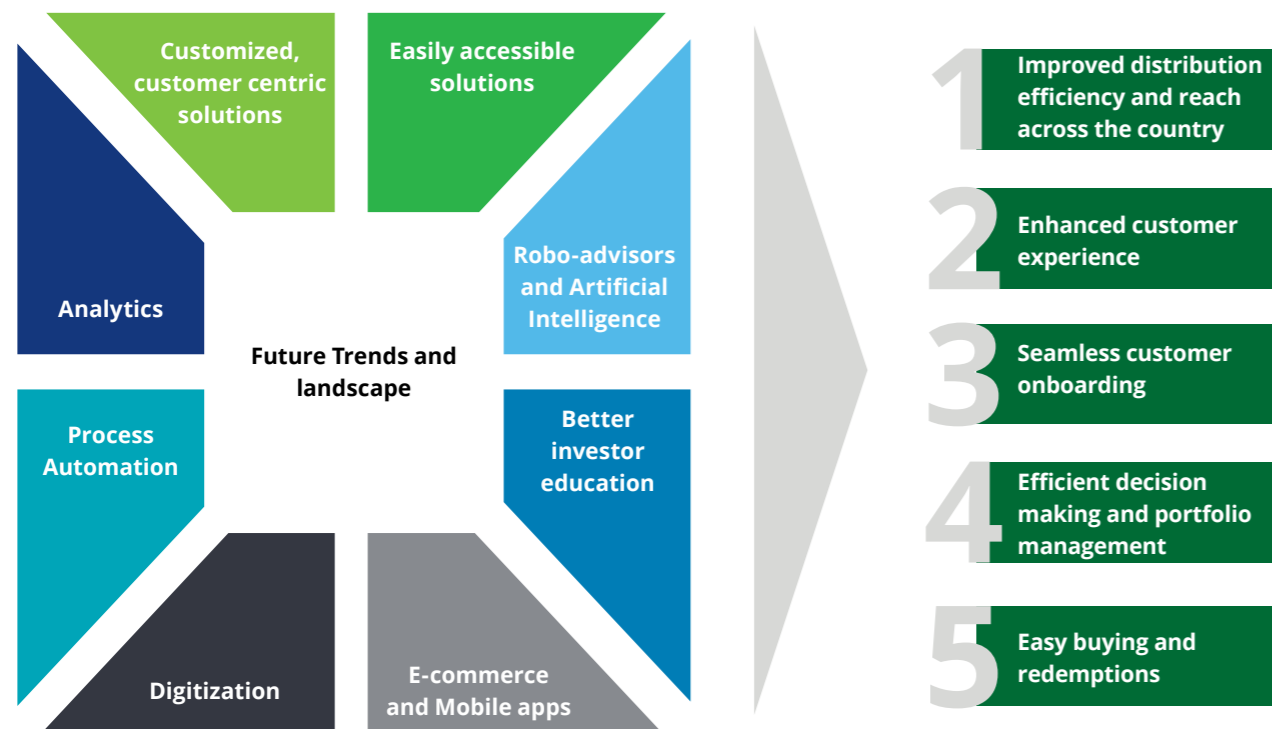
- Mutual Fund websites: Mutual Funds have enabled online investment on their respective websites, which allows investors to seamlessly invest in/redeem/switch their mutual fund units in the schemes of the respective fund house.
- RTA platforms: The Registrars & Transfer Agents (RTAs) of mutual funds (such as CAMS and KARVY) have also enabled online investment in mutual fund units and tracking facility thereof, on their respective websites, in respect of the mutual funds serviced by them.
- MF Utility (MFU): MFU is a technological platform promoted by the Indian Mutual Fund Industry under the aegis of AMFI, as a not-for-profit, shared infrastructure for investor & distributor convenience,

operational efficiency and reduction in transaction processing cost of the MF industry. The prime objective of MFU is to consolidate all transactions received from multiple sources and transmit the same to the Registrars, bringing in operational efficiency by reducing multiplicity and duplication of activities. The MFU portal operates as a "Transaction Aggregating System" for the Mutual Fund Industry as a whole. MFU is established on a co-operative model, with all participating AMCs being equal shareholders of the MFU. Being a browser based utility, MFU promotes industry level self-service for investors/distributors/ registered investment advisors (RIAs), and provides multiple modes of access and transaction submission options. Investors and distributors/RIAs can submit transactions either online, or physically, and make physical and

e-payments. MFU provides broad and neutral "Points of Service" (POS) for enhanced coverage and geographical reach, investors and distributors/ RIAs enjoy the convenience of submitting transactions in a single place, irrespective of the Mutual Fund in which they transact. This is likely to save a lot of time, effort and cost to the distributors/RIAs.

- Stock Exchange platforms: Customers can also buy mutual fund units through BSE - StAR MF and NSE Mutual Fund Service System (NSE-MFSS). These are primarily online order collection systems provided by BSE and NSE to eligible members, for placing subscription or redemption orders.
- Online aggregators/ third-party platforms: Portals of aggregators or distributors also allow customers to invest in schemes of multiple mutual fund houses.

- Future Outlook - Technology has become an integral part of the MF industry, and is expected to play a pivotal role in the distribution, specifically catering to the challenges from India's vast geography and servicing smaller locations which are commercially unviable. With the increasing use of smartphones, tablets, and internet, there is a huge potential to directly reach the customers and pass on the benefits of commission to the end customer. It is expected that in future the mutual fund industry will primarily depend on the technology and digital innovations to understand client requirements, their risk ability, future goals, and spending behaviors, and accordingly make calculated suggestions to them with the right products. Further, the performance of the customer's portfolio will be automatically tracked and the customers will be informed.



Source: Deloitte Analysis

Towards the digitization of financial services, SEBI has already allowed the use of e-wallets for making investments of up to INR 50,000 in mutual fund schemes, in order to make it easier to purchase these instruments. Asset management companies (AMCs) have also been allowed to provide instant online access facility to resident individual investors in liquid schemes.

02. Insurance

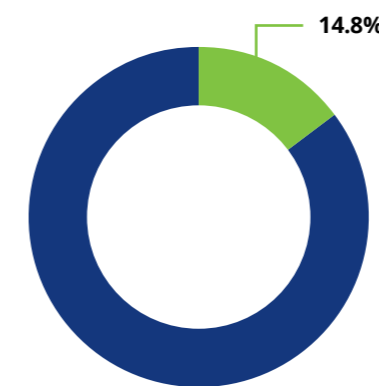
- Current Landscape - Over the last decade, there have been various transformational and regulatory changes in the insurance industry. The insurance industry is primarily dominated by the life insurance segment, which constitutes around 79% of the industry size by premium⁵³. The industry consists of 57 insurance companies, of which 24 are in the life insurance business, and 33 are non-life insurers.⁵⁴ In the year 2015-

16, the total premium generated by the insurance industry was INR 4.7 Lakh Crore of which INR 3.7 lakh crore was contributed by life insurance, and INR 0.97 lakh crore by non-life insurance⁵⁵.

Contribution of the insurance sector towards the total individual⁵⁶ wealth in financial assets is 14.8%⁵⁷, primarily because of relatively high penetration of life insurance.

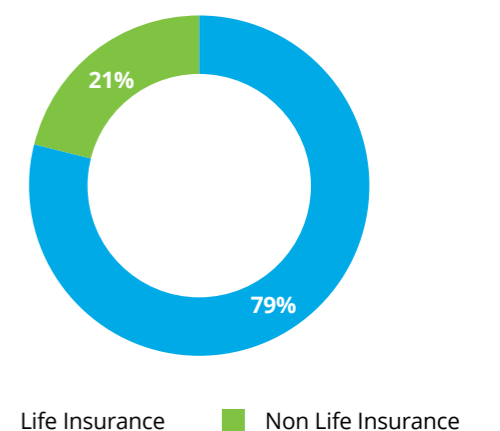
The insurance penetration rate, defined as the ratio of premium underwritten in a particular year to the GDP, stands at 3.4% in FY16 which is far below the global average of 6.2%. However, insurance penetration is expected to increase and reach 4% by the end of FY17, owing to the increasing household savings, and increasing awareness and requirement of life insurance.

Insurance contributes 14.8% of the individual wealth in Financial Assets



Source: Karvy, India Wealth Report, 2016

Life Insurance constitutes around 79% of the insurance industry (by premium)



Source: IRDAI Annual Report, 2015-16

⁵³ IRDAI, Annual Report 2015-16

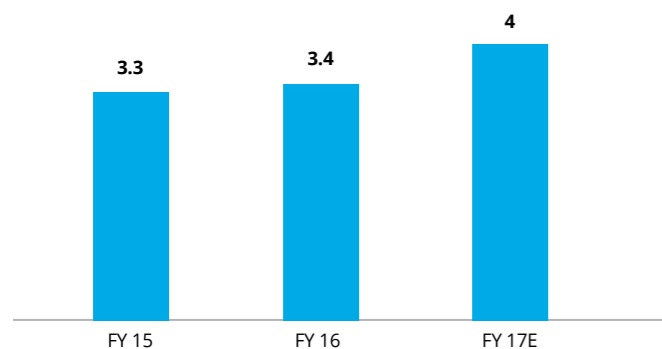
⁵⁴ IBEF Insurance report, November 2017

⁵⁵ IRDAI, Annual Report 2015-16

⁵⁶ Individual wealth is calculated by collating private wealth in all assets classes in which individuals make their investments, it does not consider government and institutional investors

⁵⁷ Karvy, India Wealth Report 2016

Insurance Penetration* (%)



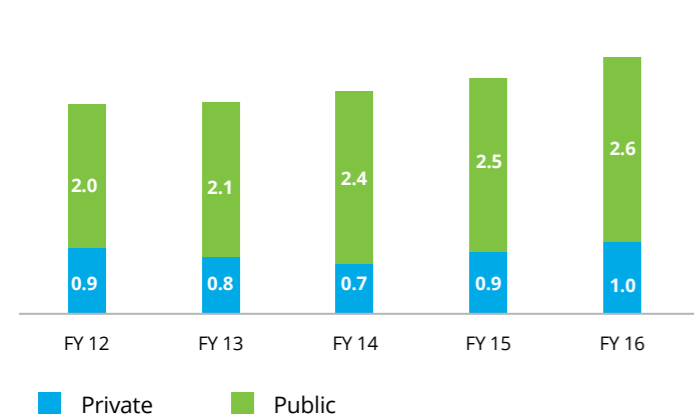
*Penetration defined as the ratio of premium underwritten in a particular year to the GDP
Source: IBEF Insurance report, November 2017

Life Insurance – India’s share in global life insurance market was 2.24% during 2015, where as it was 2.08% in 2014. However during 2015, the life insurance premium in India (Inflation adjusted) increased by 7.8%, when global life insurance premium increased by 4%. As of March 2016, the combined AUM of the life insurance industry is INR 17 Lakh crore. The total premium of the life insurance segment stood at INR 3.7 Lakh Crore in the year 2015-16⁵⁸. The life insurance segment is expected to increase with a CAGR of 12 to 15% over

the next five years, as the advances in medical sciences are expected to increase life expectancy, and the regulatory framework is expected to give companies more incentives to come with customer favorable and affordable insurance policies.

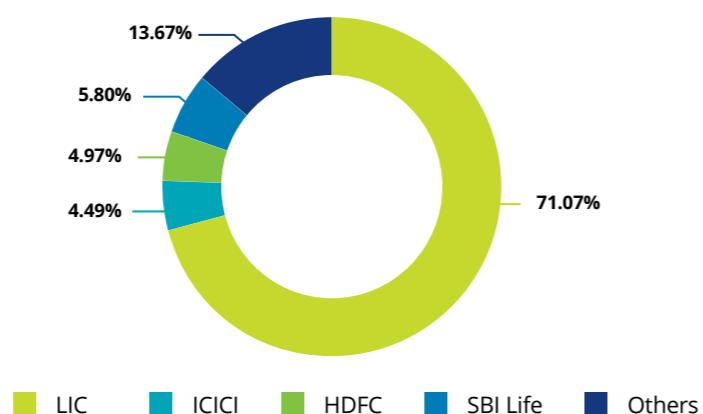
The life insurance market consists of 24 players, 23 private and 1 public sector company. Life Insurance Corporation is the sole public sector company which dominates the market, having 71% market share.

Growth in Life Insurance Premium (INR Lakh Crore)



Source: IRDAI, Annual Report 2015-16

Market Share of Major Companies in terms of first year life insurance premium collected (FY 17)



Source: IBEF Insurance report, November 2017

Non-Life Insurance – The non-life insurance industry underwrote total direct premium of INR 0.96 lakh crore in India for the year 2015-16, as against INR .085 lakh crore in 2014-15, registering a growth rate of 13.81%, as against 9.20% growth rate recorded in the previous year⁵⁹.

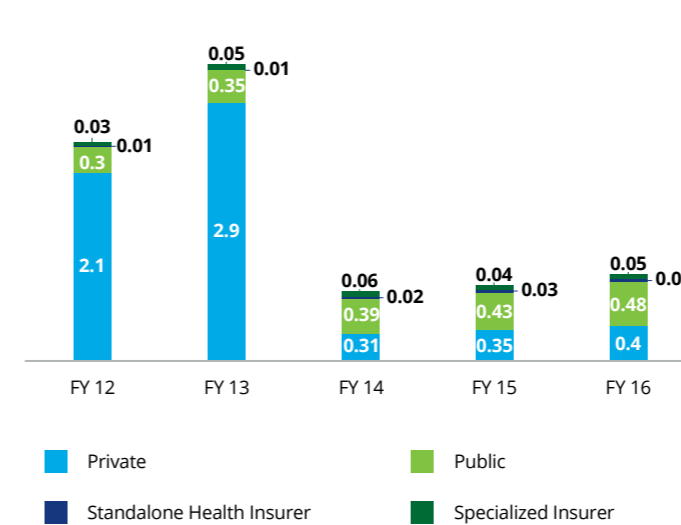
Amongst the non-life insurance segment, motor insurance and health insurance

constitute the majority of market, with 44% and 29% share respectively⁶⁰.

From the perspective of distribution in the life insurance segment, direct selling contributes the maximum share of 56.92% in 2015-16, compared to 49.67% in 2014-15. The second highest share is of individual agents contributing 29.68% in 2015-16, which has decreased from 36.44% in 2014-15. The online channel

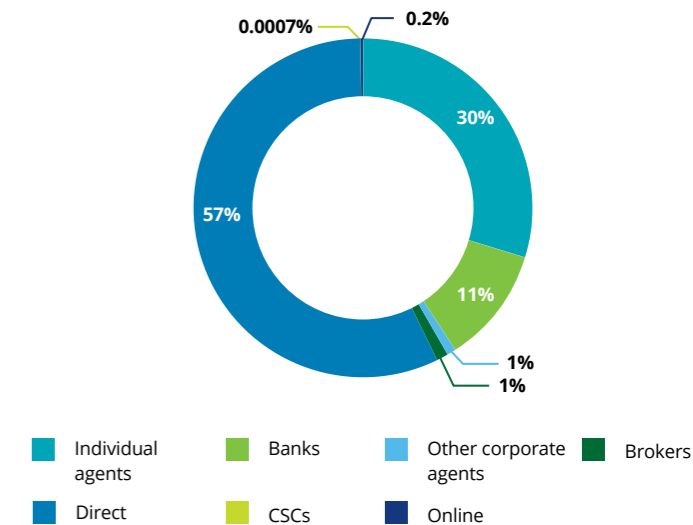
only accounted for 0.22% for new business premiums⁶¹. With changing customer preferences and digitization of the entire financial ecosystem, it is expected that online channels and other alternative channels such as Customer Service Center’s (CSCs) will have increased share of distribution in the coming years, thereby increasing the entire size of the life insurance industry.

Growth in Non-Life Insurance Premium (INR Lakh Crore)



Source: IRDAI, Annual Report 2015-16

Share of various channels for new business premium of life Insurers (2015-16)



Source: IRDAI annual report 2015-16

Amongst the non-life insurance segment, the analysis below depicts the channel contribution of various distribution channels in health Insurance. Among the various channels of distribution, individual agents continue to contribute a major share of health insurance premium at 33%. Direct sales - other than online is the second major channel for distribution of health insurance business (by premium) at 28%. Another

important channel was brokers, which contributed 24% of the total health insurance premium. Bancassurance contributed only 7% and online sale of health insurance policies contributed only 2% of the total health insurance premium.

Considering the channel distribution in both, the life insurance and health insurance industries, it is evident that

digital channels currently have low penetration of distribution of insurance. However, with recent initiatives from Government of India, as well as the industry, thrusts including emergence of aggregators, simplification of KYC procedures, introduction of online insurance channel etc., it is expected that usage of digital channels is likely to increase in the coming times.

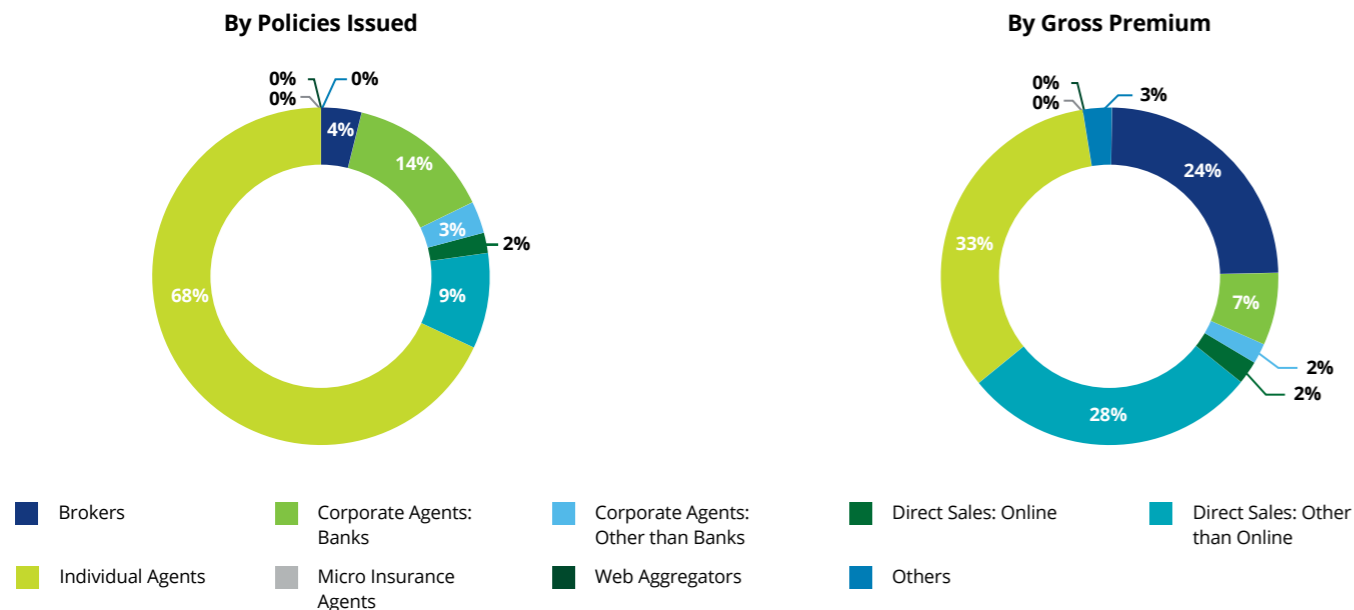
⁵⁸ IRDAI, Annual Report 2015-16

⁵⁹ IRDAI, Annual Report 2015-16

⁶⁰ IRDAI, Annual Report 2015-16

⁶¹ IRDAI, Annual Report, 2015-16

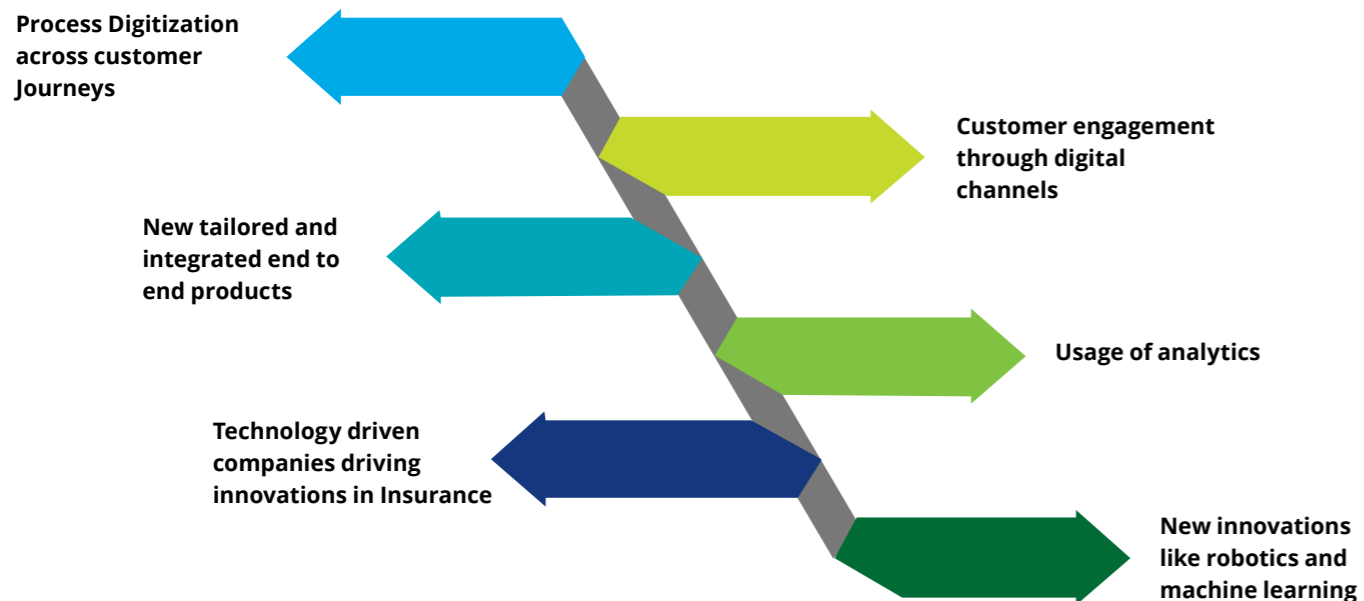
Share of various channels of distribution in Health Insurance (2015 -2016)



Source: IRDA annual report 2015-16

• Future Outlook - Technology innovations are transforming the insurance industry at an ever-increasing pace. These advances will have an impact across the different aspects of the insurance business including distribution, underwriting, claims and customer service. Additionally, the rapidly evolving

macro-economic landscape with lower interest rates, changing customer behavior, increasing digital adoption, evolving competitive landscape, and dynamic regulatory norms are likely to transform the way the insurance industry is operating. Key upcoming trends in the insurance industry are:



Source: Deloitte Analysis

Additionally, alternate distribution channels for insurance are going to grow. The Insurance Industry has witnessed emergence of the following distribution channels in the recent past:

- Direct Channels: Direct selling of insurance through digital channels including: online, mobile/ tablets apps. Additionally, regular payment of premiums, and also filing of claims can be carried out through these digital channels.
- Customer Service Center (CSC): CSCs were set up by Government of India for the purpose of financial inclusion. CSCs enable distribution of government, private and social sector services to citizens to India.
- Insurance Marketing Firms (IMFs): IMFs are allowed to distribute policies of two insurance firms in the same

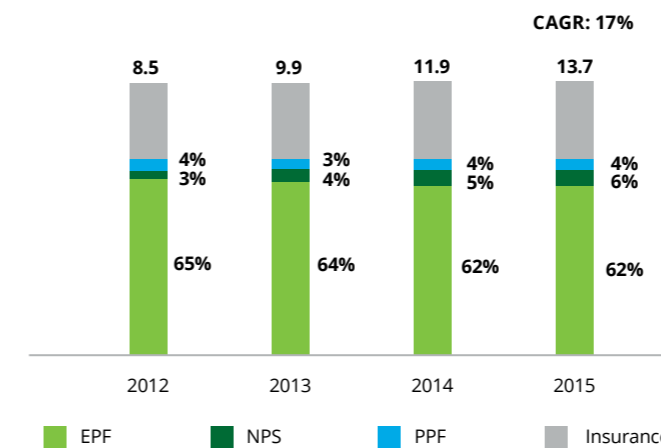
line of business, and distribute other financial products such as mutual funds, National Pension System (NPS), banking and financial products of banks, and non-banking financial companies. Under IMF, there are two kinds of licensed individuals: first, an insurance sales person responsible for selling insurance and second, a financial service executive who distributes other financial products.

03. Pension Funds

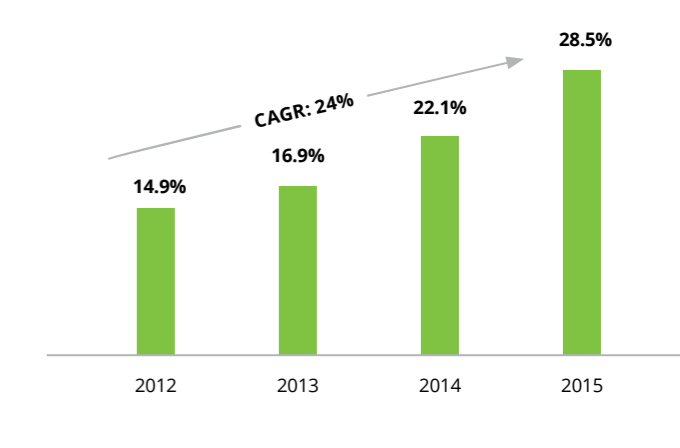
- Current Landscape - India has witnessed a constant growth in the number of pension subscribers with a CAGR of 24%, from 2012 to 2015. Similarly, assets under management has grown from INR 8.5 lakh crore in 2012 to INR 13.7 lakh crore in 2015.

Composition and Growth of India's Retirement Corpus, and Growth of Pension Subscribers

Pension Fund AUM Split, India (INR Lakh Crore)



Pension Fund AUM Split, India (INR Lakh Crore)



Note*-No. of subscribers for EPF, NPS, ULIPs and APY. Does not include number of subscribers of PPF and MFLRPs. Sources: EPFO, PFRDA, Finance Ministry, LIC, and Deloitte Analysis

Despite steady growth in subscribers and pension AUMs, Indian market still remains highly underpenetrated, with only 7.4% of the working age population being covered by any pension scheme⁶².

There are a number of structural issues specific to the Indian pension market such as: a large share of workforce employed in the unorganized sector (which is not covered by any workplace pension scheme), limited awareness about pension products, but most importantly, the limited distribution network.

- 82.7% of the Indian workforce is employed in the unorganized sector⁶³
- 54% of the workforce in the organized sector is informal (temporary workers who are not entitled to social security benefits provided by employers such as pension)⁶⁴

Primarily three models are used for the distribution of pension products⁶⁵:

- Direct Aggregator Model - The pension products are sold by organizations as additional products to their existing product portfolio. Aggregators already have an existing client base (e.g. NGOs, MFIs, banks, regional rural banks etc.)
- Promoter Model - Aggregators work with client-facing partner organizations to promote subscription to pension schemes. (e.g. LIC in partnership with its micro-insurance agents and corporate agents)
- Independent Agent Model - Agents are engaged by an aggregator with the purpose of providing last-mile outreach to rural customers, and making pension schemes accessible to these customers (e.g. LIC appointing facilitators with Confederation of NGOs in Rural India).

- Future Outlook - Owing to the increased focus towards the pension industry, significant changes are expected in

the coming years with regards to regulations, to introduce interoperability, design and structure of NPS, pension plans offered by life insurance companies, and retirement plans offered by mutual funds.

Additionally, macroeconomic changes and demographic changes are likely to drive the demand for pension products, with sophisticated distribution mechanisms.

Currently the following factors limit the distribution of pension products:

- Low distributor commission for pension products as compared to other financial and investment products.
- Limited distribution capacity and product focus: Banks have multiple financial products that generate higher fee income for them, limiting their interest in actively promoting pension products. Pension is a complex product and warrants subscriber handholding throughout the process. Banks do not seem to be willing to invest time and effort due to lower incentives.
- Issue of limited skill set of last mile staff: Last mile employees have limited understanding of pension products, to be able to handhold the customer in his pension journey

To cover these challenges, the following trends are anticipated to impact the pension industry in India:

- Increased engagement with distributors to highlight long term benefit of distributing NPS
- Expanded distribution network to include other categories of players such as small finance banks, payments banks, FinTech companies
- Empowered and well trained distributors
- Increased usage of digital channels for pension distribution

Unfavorable commission structure for pension products as compared to other products for Banks

Products	Incentive to distribute
Mutual Fund	<ul style="list-style-type: none"> • Recurring Charges (Annual): 1.5% – 2.5% • Exit Load: 0.5% - 3.0% • Product part of end to end wealth management offering- Demand pull / customer awareness
Insurance	<ul style="list-style-type: none"> • First Year Commission: Upto 40% • Subsequent Years Commission: Upto 5% • Corpus formation that can be used to generate income through investment activities
Saving Bank Account	<ul style="list-style-type: none"> • Low cost deposits that can be used to generate higher interest through lending activities • Bank branches are closely tracked against Saving Bank Deposit targets
NPS	<ul style="list-style-type: none"> • Registration: INR 125 • Contribution Processing: 25% • Non-financial transaction processing: INR 20
PPF	<ul style="list-style-type: none"> • Transaction charges: .055%
APY	<ul style="list-style-type: none"> • INR 100 per account • Additional incentive: Upto INR 50 per account

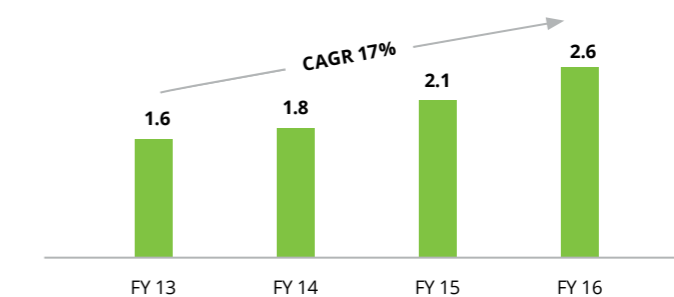
Source: Industry Discussions

04. Broking Industry

- Current Landscape - The broking industry in India is estimated to have a

revenue of INR 0.17 Lakh crore in FY16, which has grown at 17% in the last four years.

Broking Industry Revenue (USD Bn)



Source: SEBI Annual Report 2015-16, Deloitte Analysis

⁶² Global Human Capital Report 2017, World Economic Forum

⁶³ Ministry of labour and employment

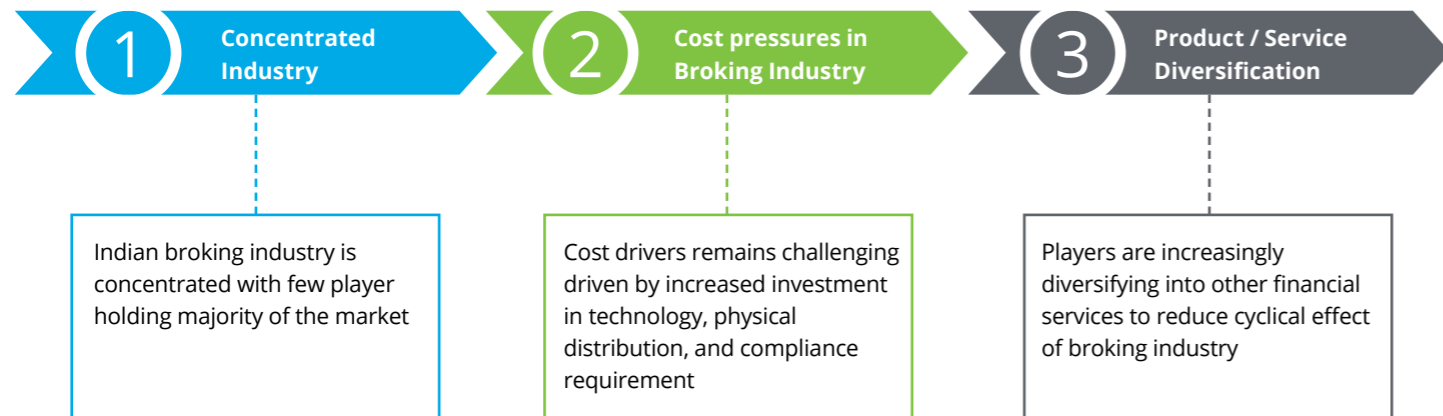
⁶⁴ CII - An Analysis of the Informal Labour Market in India, 2011-12

⁶⁵ The India story of Micro Pension, Microsave, 2013

The industry is in the midst of structural transformation driven by change in customer preferences, technology and

competition. The key characteristics of the industry are mentioned below.

Current State of Broking Industry

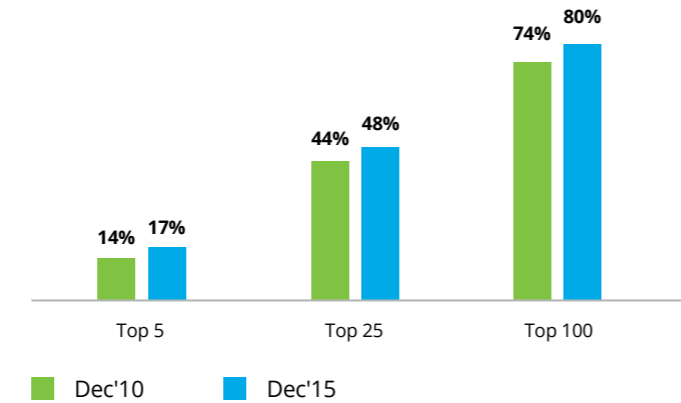


Source: Deloitte Analysis

– The current market for broking is highly concentrated, with Top 25 brokers commanding half of the market turnover. The broking industry is increasingly getting further concentrated with consolidation. Smaller brokers are finding it tough to compete in the market, and are either gravitating towards the sub-broker model or are closing down business.

– Faced with increasing pricing pressures, smaller brokers are finding it tough to profitably compete in the market. Key revenue drivers have weakened over the years for the broking industry, as services become commoditized, resulting in pressure on the topline, and profitability. Even though the overall market turnover has increased over the past few years, the trading turnover has shifted to derivatives, with increased participation from institutional / proprietary traders, leading to an overall lower brokerage yield for the broking industry. Additionally, cost drivers remain challenging driven by increased investment in technology, physical distribution, and compliance requirement.

Percentage share of Top 'N' members in Equity cash turnover, NSE



Source: NSE , *as on 31 March 2017

Distribution Network

- In addition to online presence, Broking houses are also expanding their offline distribution network, which is adding to their cost of doing business
- HDFC Securities has presence in 189 cities through 262 branches at the end of FY16, compared to 200 branches in 160 cities at the end of FY14

Technology Investment

- In order to maintain their competitive advantage, large broking houses are investing significantly in technology development to enhance customer service and increase operational efficiency
- Development of online channels (mobile/internet), robo-advisory, etc. are result of some of these tech-investments

Compliance Cost

- SEBI regulations – such as the need to provide basic service demat account to retail investors – is adding to the cost of servicing these small investors
- Increased reporting requirements as a result of scams such as NSEL scam, penny stock scam
- The increase in Base Minimum Capital requirement to Rs. 50 Lakhs (USD 0.75 Mn) from earlier Rs. 10 Lakhs (USD 0.15 Mn) added to the cost component for brokers

Employee Cost

- Increasing complexity of the business needs higher skilled people, which has increased the cost of high skill people
- High employee turnover adds to the cost

Source: Company Website, Deloitte Analysis

– Large full service brokers are evolving from a pure transaction business, to provider of larger gamut of financial services solutions. While few brokerage houses have expanded into adjacent business lines such as research and advisory to manage cyclical earnings, other large brokerage houses have moved into higher margin lending businesses.



- MOFS, one of the top 10 broking houses in India, was established in 1987 as primarily broking house
- **Currently, broking revenue constitutes 43% of the group's revenue**
- The group has diversified interest in multiple business lines – Private Equity, Institutional Equities, Investment Banking, Asset Management, Wealth Management, Advisory and Housing Finance

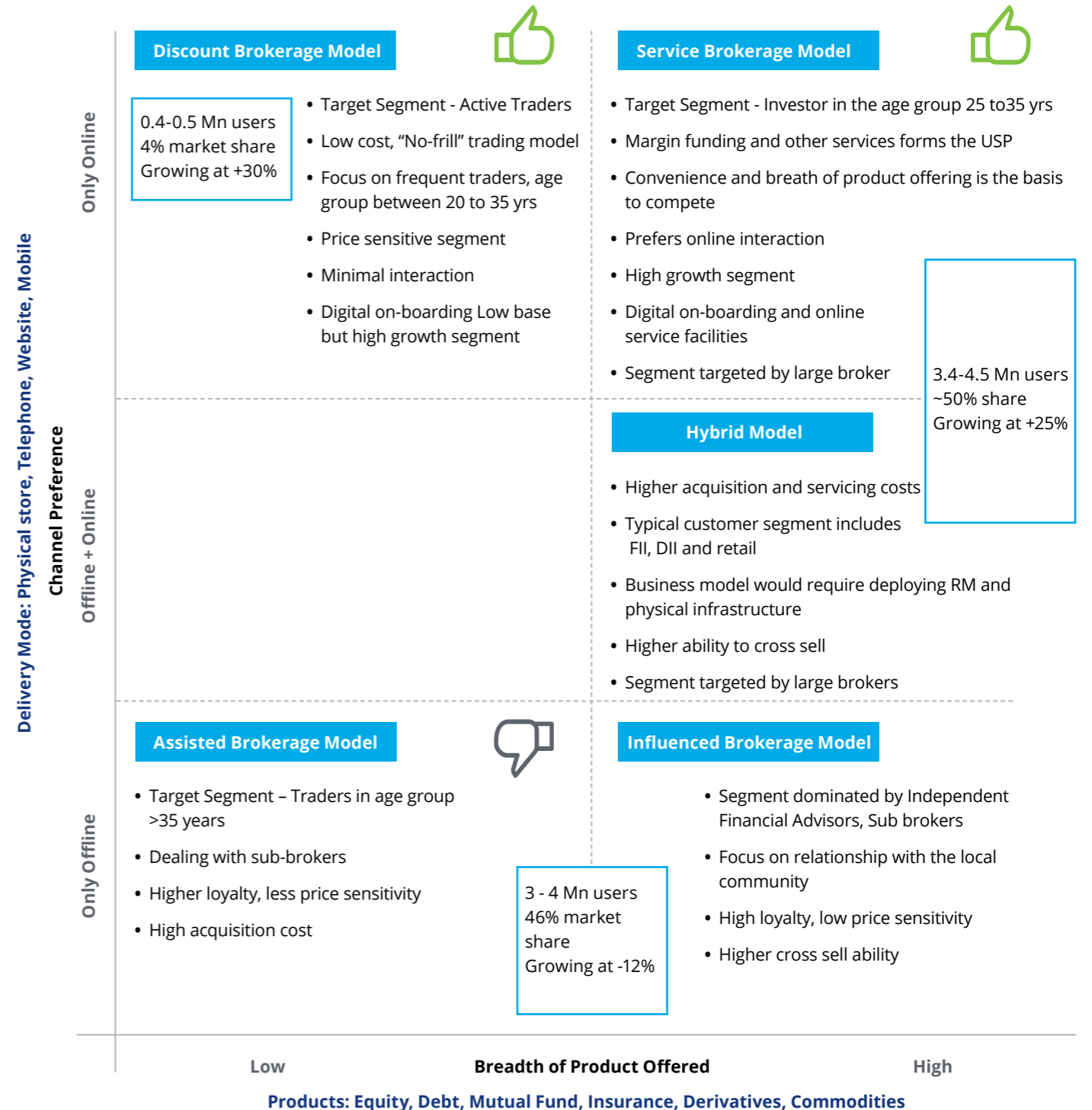


- IIFL, one of the first player to provide a trading portal – 5paisa.com – is among the top 10 broking houses in India
- **The revenue from capital market activities, equity broking and related activities provided only 11% of the group's revenue**
- The group has since diversified into multiple business lines – Wealth Management, Asset Management, Institutional Equities, Research and Advisory, Project Financing, Retail Finance (Home, Gold, CV) and Distribution business

Source: Motilal Oswal Annual Report 2015-16, IIFL Annual Report 2015-16, Deloitte Analysis

Distribution in the broking industry has been dominated by offline brokers and sub brokers, discount brokers and financial planners across, both

online and offline channels. Basis the customer preferences of the product and the distribution channel, five broad distribution models have emerged.



Source: SEBI, NSE, BSE, Deloitte Analysis

- Future Outlook - With the upcoming technological innovations, evolving investor expectations, the broking industry is in the midst of a structural transformation. Key trends being observed in the broking industry include:
 - E-KYC and E-Sign - Digital customer on-boarding process with the use of electronic KYC and central KYC thus making almost real time account activation.
 - Digital platforms - Broking houses are extending trading facility through mobile apps, with significant trading volume shifting to the mobile channel.
 - Robo-advisory - Driven by technology evolution, market players have introduced Robo-advisory, offering automated advisory services based on a pre-defined set of rules and algorithms at significantly reduced costs.

- Use of Big Data analytics - Use of big data analytics (like sentiment analysis) to provide investment advice. For example, Reliance Securities uses analytics to provide automated insights, by running advanced algorithms on big data; Angel Broking - Analytics based advice on 30 days intraday and 20 years historical data, with 70+ studies.

Along with these trends, there is a huge shift of trading platform from being completely offline, to support both offline-online channels, and it is gradually moving towards being completely online. With this shift, discount brokers are gaining a significant share. These players are developing and marketing their ability to help customers meet their goals, with a suite of products and services, and also offering low brokerage charges. India has over 15 discount brokering companies. And now, with discount brokerage hitting the digital space, these brokers have access to a larger number of clients.



Glossary

AMC	Asset Management Company	IRDA	Insurance Regulatory and Development Authority
ASIC	Australian Securities and Investments Commission	KYC	Know Your Customer
ATM	Automated Teller Machine	LIA	Life Insurance Association
AUM	Assets Under Management	MAS	Monetary Authority of Singapore
B-15	Below 15 cities	MFU	MF Utility
BC	Business Correspondent	NBFC	Non-Banking Finance Company
BoP	Base of Pyramid	NPS	National Pension Scheme
CBRC	China Banking Regulatory Commission	NSEL	National Spot Exchange Limited
CCFS	Committee on Comprehensive Financial Services	NSE-MFSS	NSE Mutual Fund Service Scheme
CFPB	Consumer Financial Protection Bureau	PBOC	Peoples Bank of China
CSC	Customer Service Center	PMJDY	Pradhan Mantri Jan-Dhan Yojana
CSRC	China Securities Regulatory Commission	POS	Point of Service
DBT	Direct Benefit Transfer	PPP	Purchasing Power Parity
DFS	Digital Financial Services	PSL	Priority Sector Lending
DSA	Direct Selling Agents	RBI	Reserve Bank of India
ESMA	European Securities and Markets Authority	RPPD	The Responsibilities of Providers and Distributors for the Fair Treatment of Customers
ETF	Exchange-Traded Fund	RTA	Registrar and Transfer Agent
FCA	Financial Conduct Authority	SCORES	Sebi Complaints Redress System
FR	Financial Representative	SEBI	Securities and Exchange Board of India
FSCS	Financial Services Compensation Scheme	SMAC	Social, Mobile, Analytics and Cloud
FSMA	Financial Services and Market Authority	SME	Small and Medium Enterprises
GDP	Gross Domestic Product	ULIP	Unit Linked Insurance Plans
ICT	Information and Communication Technology	UPI	Unified Payments Interface
IFA	Individual Financial Advisors		



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