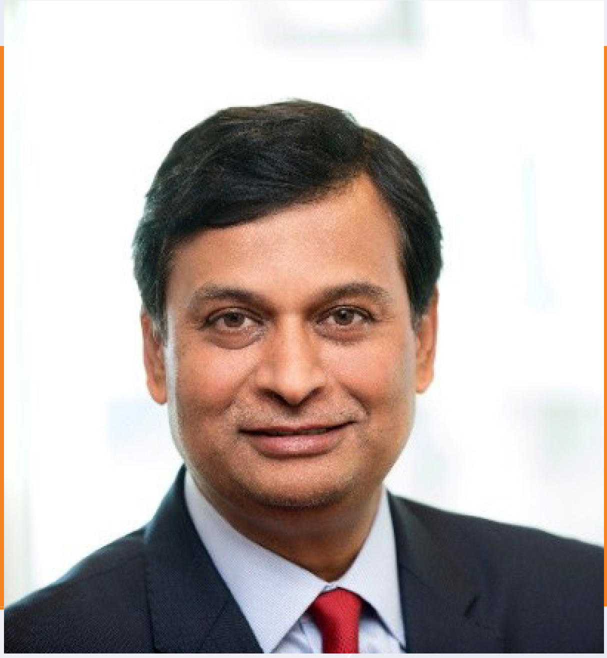
Leaders' Lens

In conversation with

Ajay Srinivasan



Former Chief Executive Officer
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As one of the tallest leaders in the space, what is your view on Shadow Banking from an Indian perspective, and how does it compare to other global markets like New York, London, Dubai and Singapore?

Ajay: Let me clarify what Shadow banking means to me, and then let me answer the question. In my understanding, shadow banking refers to a collection of bank-like activities (though mainly lending) operating outside the traditional banking regulatory framework. The essential concern that surfaced in the GFC was the interlinkages this system has with the financial system and, hence, the systemic risk that this may cause. Activities that get covered under this ambit include hedge funds, private credit vehicles, structured investment vehicles, pension funds, securitisation entities, fixed-income and money market funds, peer-to-peer lending and non-banking financial companies. As you can tell, these can be sizeable, and the Financial Stability Board in 2022 estimated the global shadow banking assets to be just less than half of global financial assets. So, we need to be clear that this sector is not small and does not operate in the shadows. In India, any lending activity, including through fintechs, is regulated by the RBI and fund-based or capital market-related activities are regulated by SEBI. RBI's graded layer-based approach to NBFCs will lead to greater regulatory supervision of the more systemically important NBFCs. There are also inter-regulatory forums that oversee conglomerates with operations across sectors to ensure no risk of contagion. Issues like maturity transformation have been addressed through regulations on asset-liability matching in both the lending business and the mutual fund space. As such, while non-bank financing through different vehicles will continue to grow in India, because of the regulatory framework in place, I don't foresee any increase in systemic risk.

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What, in your view, are some of the key factors that enabled the rapid rise and success of NBFCs in India?

Ajay: NBFCs (including HFCs) have grown rapidly in India and play a crucial role in the overall delivery of credit to the end borrower. Starting from mono-line entities like CV financiers or Gold based lenders, many NBFCs today operate across a wide range of segments. The key drivers of their growth, in my view, are:

a) The demand for credit that might not be fulfilled by the existing banking system.

b) Good customer understanding leading to customised products, flexible risk-based pricing, last mile delivery and the opening up of new segments.

c) Operational efficiency and optimised costs.

d) Focus on service.

e) Greater use of technology to drive business objectives.

How do you see the growth of fintechs, particularly in lending, and whether this can lead to growth in shadow banking?

Ajay: While the growth of fintechs in lending has been good, they are still a relatively small part of the overall system of assets. Anyone who is lending in India is regulated by the RBI, so while technically some of the smaller lenders might not have bank-like regulations, they are still regulated and don't pose any systemic risk. The liability side of fintech lenders is typically met by banks or NBFCs, and that could pose some constraints on their growth. On the asset side, as long as fintechs are solving problems for borrowers through better products, faster turnaround and better service - whether in the retail or the small business space- there will be continued opportunities to grow.

How are the BFSI CEOs responding to fintech challenges?

Ajay: I think the world of competition and win-lose mindsets is changing to collaboration and win-win mindsets. While bigger BFSI entities can benefit from the technology, agility and innovation of fintechs, which can lead to new customer segments, new products and often better margins, fintechs can benefit from the funding and scale benefits of the larger BFSIs. It is not surprising, therefore, to see a number of banks and NBFCs finding ways to work more closely with fintechs that can advance their strategic interests.

How impactful would fintechs be in enhancing financial inclusion?

Ajay: A lot has already happened in the country to improve financial inclusion, and fintechs will certainly augment this effort. By definition, fintechs will have to find new segments as they won't be able to compete with the banks or NBFCs in the more established segments. This search for new segments will only lead to more people entering the eligible borrower basket and improving inclusion.

What will the Financial Services sector look like in 2035?

Ajay: Projections and predictions a decade out, especially in a world changing as rapidly as ours, are fraught with risk. Therefore, let's start with things we can be more sure of.

India's population will continue to grow till about 2050 but may peak then. However, the demographics will slowly change over the next two decades, with the older cohorts increasing. India will meanwhile grow at about 6-7 percent per annum over the next decade, leading to per capita income rising by about 4% per annum in real terms.

Therefore, one can expect financial services to grow broadly at 12-15 percent over the next decade. While some big players will get bigger with acquisitions and organic growth, some disruptors, especially from the world of technology, will emerge as large players. Players who don't adapt will be at high risk.

With information, data and analytics being hygiene, information availability alone will not be as much of an advantage. Instead, customizing, personalizing, and innovation will drive product design and growth. With things like the account aggregator, credit bureaus, GST data on SMEs and much else available to lenders, for instance, lenders might have to design products and pricing to attract customers rather than customers looking for lenders. Bidding to win a customer could be the norm for some categories of customers.

With longevity, an increase in life expectancy, and more widely available information on the health parameters of an individual through connected wearables and a national health database, mortality risks in life insurance and the underwriting model will have to change. Similarly, in health insurance, working towards a customer's wellness and incentivizing protocols for lower claims will dominate the traditional management of the claims process. Several innovations in P&C products will have to come about as life as we know it changes.

Wealth management will be a much bigger business, given the rise of wealth in India and the demographic change to the older cohorts. Technology through AI and ML will drive investments and advice in a big way, and the human interface will have to add value in different ways. Alternates will become more mainstream as investors allocate money between the best stock pickers, ETFs and alternate assets like real estate, VC/PE, private credit, REITs/Invits, commodities, etc. Increased competition will constantly pressure margins and innovation, and technology and scale will be key to deriving a profit advantage.