FINANCIAL SERVICES SECTOR

CHAPTER TEN

SUMMARY

- India's financial services sector typifies the progress and opportunity of its economy. The sector will grow rapidly out to 2035, driven by rising incomes, heightened government focus on financial inclusion and digital adoption – India's digital payments could pass $1 trillion by 2030.
- As the Indian market matures, Australian businesses could partner with Indian financial services companies in sectors that align with our competitive strengths in asset management, general insurance and fintech.
- Partnership opportunities will be niche, targeting the economically advanced parts of India and in segments not dominated by state-owned enterprises.
- While Australian expertise may not be transferable on a large scale to an Indian context given differences in target markets and goal orientation, India's financial services sector will become more globally connected.
- Success in India will require strong local knowledge and a willingness to operate on longer time horizons than Australian financial services firms are used to, and for India to have made progress in regulatory clarity and investor protections.
- Out to 2035, technological change will have a transformational effect on this sector. India is set to benefit and could leapfrog Australia while our industry struggles with legacy systems.
- While the financial services sector and investment decisions are commercially-led, government can play a role in bridging knowledge and expectations gaps.
- Sharing Australia's regulatory experience and work on setting standards with Indian policy makers could also facilitate commercial engagement.

1.0 THE MACRO STORY

KEY JUDGEMENT

India's financial services sector is poised to grow on the back of rising incomes, significant government attention and the increasing pace of digital adoption. The long term fundamentals of the sector are sound, but the Indian Government's openness to private players and foreign participation is likely to remain patchy. Australia's competitive strengths include an efficiently regulated domestic sector, high volume of funds under management and niche sector expertise, which align with India's ambitions for improving its financial services sector. However, differences in market drivers will limit the transferability of Australian expertise to an Indian context.

1.1 The scale and key structural drivers of the sector

INDIAN DEMAND

Rising incomes will drive demand for financial services across income brackets in India, including in insurance and retail banking services

- the number of HNWIs is forecast to triple to over 1.2 million by 2030 [96]
- by 2035, India's five largest cities will have economies of comparable size to middle income countries today
  - Mumbai alone is projected to have an economy in 2030 as big as Malaysia today.[69]

High competition and many local players limit opportunities in the Indian retail banking sector

- State-owned banks represent 70 per cent of India's retail banking sector yet are responsible for only 43 per cent of profits[25]
  - privatisation is unlikely, but the need to improve provision of credit could see the Indian Government approve the entry of more private banks
- fragmentation has forced a large number of smaller private banks to compete on price and thin profit margins
- regulations in place since 1972 require at least 40 per cent of bank lending to be directed to agriculture and 'economically weaker' sectors.

India's state-owned Life Insurance Corporation holds over 75 per cent of the life insurance market while 20 other firms compete for the remaining share[12]

- industry premiums, coverage and pay-out rules are highly regulated and subject to frequent change
- Indian companies have strong distribution networks and local expertise, and foreign players may struggle to identify suitable segments of the market to target.

There is greater capacity for private sector and foreign entrants in general insurance, which is expected to grow between 13–19 per cent annually out to 2025, especially since many Indian insurance firms lack expertise in product development.[97]

CASE STUDY: FUTURE FUND: SUCCESSFUL INVESTMENT IN THE FUTURE MEANS TAKING A LONG VIEW

With its high growth economic trajectory, structural reforms aimed at lifting productivity and recent loosening of foreign investment caps, India offers genuine investment opportunities for Australian institutional investors.

Australia's sovereign wealth fund, Future Fund, has found success by pursuing a long term investment horizon and moving away from using quarterly benchmarks to define performance.

Rather than focusing primarily on equities, Future Fund has selected investments in alternative asset classes such as infrastructure, property, private equity and hedge funds. This diversification gives an edge across geographies and emerging economies.

The Future Fund approach requires a sophisticated understanding of risk – and it pays rewards. Future Fund has delivered returns of 7.7 per cent over its first 10 years of operation – a performance that has captured international attention and strengthened its brand.

Future Fund acknowledges that investing in India comes with challenges, particularly the lack of recognition of sovereign immunity for tax purposes.

Further reforms to address sovereign risks that impact on the stability of cash flows will continue to grow India's attractiveness as an investment destination. In particular, Future Fund is watching for success in combating corruption, improving regulatory quality and the rule of law surrounding investor protection.

Demand will also rise for financial services at the lower end of the income spectrum

- the Government of India has made financial inclusion a top priority by launching and expanding multiple programs, creating and strengthening transparency and digital systems, and enforcing regulatory measures to increase competition
- government efforts to persuade cash-based vendors to embrace formal banking, including through device-based and digital payments, will also accelerate financial services demand from micro and SMEs
- Australian firms, however, do not have experience or expertise in serving this market.

INDIAN SUPPLY

Fast digital adoption from consumers and skilled IT clusters, such as those in Hyderabad and Bengaluru, will continue driving the expansion of India's fintech industry, which is expected to double between 2016 and 2020 to $3.2 billion[142]

- the rate of technological change makes it difficult to forecast long term projections of the size of the fintech market in India.

The development of India's technological and entrepreneurial ecosystem will make it easier to expand the financial services market into regional and rural areas

- while financial inclusion has been a focus of Indian policy makers for decades progress is now being seen

- new technologies are now making it viable
  - for example, the rollout of the Aadhaar card, a national biometric identification system now covering over one billion people, creates a comprehensive picture of prospective customers.

Indian fintech companies are driving change by specialising in targeted services along specific parts of the value chain which were previously the domain of brick and mortar companies

- for example, aggregators like BankBazaar.com offer a range of services such as loans, credit cards, deposits and insurance, and receive payments from banks for assisting in new business generation
- India offers the highest expected return on investment on fintech projects, at 29 per cent (not risk adjusted) versus a global average of 20 per cent.[143]

India's mutual funds segment is sizeable, equivalent to approximately one-tenth of the country's GDP[144]

- growth prospects are good, given India's high savings rate and its well-developed equity market.

The equity mutual funds market, with a boost from demonetisation, saw its assets under management cross $430 billion in 2017, double what it was three years earlier

- further development in the mutual funds sector will be hampered by modest demand beyond tier one cities, a lack of asset class diversity and narrow pension coverage.

India's pension system is at a nascent stage, dealing with challenges related to customer awareness, penetration and regulation

- pension funds under management stand at 1.1 per cent of GDP – compared to 1.5 per cent of GDP in China – and its subscriber base of 8.7 million is a small fraction of the working population[99]
- India's regulatory framework limits investment avenues for money raised through pensions
- however, this is changing with the Employees' Provident Fund Organisation granted approval to invest a part of its assets into exchange traded funds.

But the demand for pensions is expected to rise considerably out to 2035 on the back of an increase in the elderly population, a higher life expectancy and a decrease in the prevalence of the extended family structure

- this creates a pressing need to create a robust pension system in India, which would raise investment prospects, including for foreign companies.

AUSTRALIA'S COMPETITIVE ADVANTAGE

Australia has a competitive advantage across three areas of the financial services sector: capital, expertise and regulation.

Australia has a financial assets sector worth $8 trillion, four and a half times our GDP

- our funds management sector, with $2.7 trillion under management, is the sixth largest pool of funds under management globally and the largest in Asia
- the balance of Australia's sovereign wealth fund, the Future Fund, is approaching $140 billion and has delivered returns of 7.7 per cent per annum since inception.

Australia's highly evolved pension system ranks second in Asia-Pacific on penetration with 70 per cent of the population contributing to a pension scheme

- on measures of adequacy, sustainability and integrity, our pension system is regarded ahead of the United Kingdom, United States and Canada
- the lack of competition in the Australian market, in which less than 5 per cent of Australian members actively switch funds, may diminish the appetite for Australia's pension funds to compete overseas.

Australia's deep capital markets and sophisticated financial services system have been built on the back of a strong regulatory system

- Australia's regulatory framework has combined a necessary oversight role with the flexibility for industry to innovate and take advantage of new technology

- this could be used more effectively as an asset to engage the Indian financial sector.

We are renowned for our financial services acumen and product development

- the 2018 Global Financial Centres Index ranked Sydney and Melbourne at 9th and 12th respectively amongst the world's financial centres.[xxviii]

Australia is a global fintech hub, ranking fifth in the world in the 2017 Ernst & Young Fintech Adoption Index

- this makes Australia an attractive market for the launch and expansion of fintech products.

1.2 How the sector will likely evolve out to 2035

GROWTH IN FOREIGN INVESTMENT

Growth in India's financial services sector out to 2035 will be driven by expected increases in FDI and FPI, particularly into Indian infrastructure [*see Chapter 2: The Investment Story and Chapter 9: Infrastructure Sector*].

Despite India's high savings rate, the country will be an importer of capital to meet its growth ambitions

- while the relaxation of some FDI limits has spurred significant capital inflow in the last 12 to 24 months, the double digit return potential across large parts of India's financial services sector, including infrastructure, has yet to spark the magnitude of foreign investor activity India's Government had hoped.

Foreign investors may be waiting for evidence that Indian policy makers are serious about introducing new financing models to facilitate greater private sector participation

- efforts already underway by the Indian Government to attract foreign investment, such as the establishment of an equity fund in the form of the National Investment and Infrastructure Fund, could help reduce some of the risk profile for foreign investors, including from Australia
- however, India's financial markets have not matured to the point where they can realistically use bonds to fund infrastructure, and there is little indication that addressing this will be a priority for Indian governments in the medium term.

NEW TECHNOLOGIES AND RISING CONSUMER EXPECTATIONS WILL RE-SHAPE THE SECTOR GLOBALLY

The financial services industry is on the cusp of substantial change

- rapidly advancing technologies, rising consumer expectations and disruptive innovations will reshape the structure of the industry across the globe.

In India, the extent to which changes are evolutionary or revolutionary will depend on whether incumbents continue to develop technologies in-house, acquire or partner with new entrants to rollout technologies, or whether the new products bypass existing intermediaries and markets.

CHANGES TO INDIA'S FINANCIAL SYSTEM

The pace of change in India's financial system has the potential to be faster than in other countries due to the rapid take up of digital devices combined with India's track record of frugal innovation.

Technology leapfrogging in telecommunications, in which India will jump past the fibre cable stage to mobile network infrastructure, will be central to the future development of India's financial services sector

- mobile phone penetration in India is set to rise to 85–90 per cent by 2020 (from the current levels of 65–75 per cent in 2017), while the smartphone user base is expected to expand to about 500 million people in the same period.[98, 100]

[xxviii] It has been jointly published twice per year by Z/Yen Group in London and the China Development Institute in Shenzhen since 2015 and is widely quoted as a source for ranking financial centres. The ranking is an aggregate of indices from five key areas: 'business environment', 'financial sector development', 'infrastructure factors', 'human capital', 'reputation and general factors'.

Other digitisation projects, such as the United Payment Interface and associated mobile application Bharat Interface for Money – a safe, instant payment system – and DigiLocker, a cloud based platform for authentication and sharing of identity documents, will be linked to customers through Aadhaar

- the result could revolutionise document processing and enable end-to-end digital credit underwriting.

By 2025, digital finance is forecast to boost India's GDP by $950 billion and create 21 million new jobs.[101]

With an assist from the demonetisation campaign, the digital payments sector in India is expected to benefit the most from rising technological adoption in India

- digital payments could grow as much as tenfold to $500 billion by 2020 [102] and pass the $1 trillion mark by 2030 [103]
- digital banking adoption will also continue its rapid ascent
- nearly 80 per cent of all customer transactions in new private banks are conducted through digital channels
  - from 2013–16, the average volume of monthly transactions at ATMs increased 1.5 times, EFTPOS by 2.7 times, mobile banking by 9.6 times and e-wallets by 11 times.

Adoption of new technologies and processes, including blockchain ledgers, could reduce the cost of managing loans and make microfinancing commercially feasible

- the NITI Aayog-led IndiaChain plans to implement a fully-fledged blockchain infrastructure that uses 'electronic Know Your Customer' and Aadhaar to reduce fraud, speed up enforcement of contracts and increase transparency of transactions
- microfinancing for commercial purposes will require a change in India's banking culture, which has traditionally preferred to lend large amounts to limited clients rather than lending small amounts at scale
- while India's incumbent players may not be agile enough to adjust, they are unlikely to hinder new firms that may look to service this market.

The need for cyber security and personal data privacy will inform how financial institutions approach off-shoring, data storage and the use of big data [*see Chapter 13: Defence and Security*].

Fintech start-ups are already encroaching on established financial services markets

- unencumbered by legacy systems, they are developing customer friendly solutions from the ground up
- consumers are showing signs of preferring non-traditional financial service providers, largely due to more targeted product offerings and a greater focus on customer choice and experience, especially in areas of payments, loans and personal finance information tools
  - the most successful Indian fintech company to date has been Paytm, an electronic payment and e-commerce giant with over 200 million users.

Big data analytics will allow financial service providers to target and tailor products and services with greater precision

- firms can anticipate needs, price offerings and risk more effectively.

In financial services, brand loyalty and effectiveness of discounts will decline as value will increasingly be derived from the degree of personalisation and adaptability of the product

- platforms may emerge to give consumers the ability to build a portfolio of financial services from many providers that meets their specific needs
- in insurance, for example, business models could shift from being a reactive claim payer to preventative risk advisor.

CASE STUDY: INSURANCE AUSTRALIA GROUP: STRONG PROSPECTS IN THE INDIAN GENERAL INSURANCE MARKET

State Bank of India General Insurance Company (SBI General), is a joint venture between Insurance Australia Group (IAG) and the State Bank of India (SBI), India's largest and oldest bank with more than 24,000 branches across India.

SBI General was established in late 2009 and commenced operations in 2010, building a portfolio in the corporate, retail and SME markets across India. SBI owns 74 per cent of SBI General and IAG 26 per cent. IAG has an option to increase its shareholding to 49 per cent, following the March 2015 insurance law amendment to the foreign direct investment limit.

SBI General has continued to grow strongly and has achieved significant growth from nil revenue in 2010 to $750 million of Gross Written Premium in 2017, reaching 14th in the market with a 2.3 per cent market share.

However, such successes have not been without challenges. The development stage of the Indian economy and the insurance industry means regulatory frameworks continue to evolve rapidly which creates some uncertainty for investors/shareholders. There is also less concern and protocol in relation to making retrospective regulatory/legal changes. An example would be retrospective changes that impacted foreign shareholders' rights in JV Agreements, forcing them to be re-written with rights removed. Cultural differences, both generally and commercially, also create different processes and benchmarks for assessing what makes good or bad sense in relation to business decisions.

Nevertheless, enormous growth and significant portions of the market remain untapped. The non-life insurance industry grew by 18.9 per cent in the opening nine months of fiscal year ending 31 March 2018, led by the new government backed agricultural insurance schemes and increased penetration in motor insurance.

The healthy growth rate is expected to continue as economic growth boosts disposable income and the insurance market expands to reach more first-time buyers. A rapidly growing middle class is also driving increased insurance penetration and density, while a strong development/growth drive in commerce needs to be balanced with profit ambitions.

2.0 OPPORTUNITIES FOR PARTNERSHIP

KEY JUDGEMENT

Australian industry can benefit from India's financial inclusion drive and economic modernisation by investing in segments of the financial services sector that are open to foreign participation, such as general insurance, or providing services to enable investment in other sectors, such as infrastructure.

Australian expertise in financial services may not be transferable on a large scale to an Indian context because of a misalignment in target markets and goal orientation. Australian industry is primarily focused on making a profit and products are geared to a sophisticated investor base, whereas India's financial ecosystem has a marked social undertone.

Niche opportunities will emerge as India's capital markets mature, including in asset management and fintech collaboration.

There is also potential for Australian financial institutions to source fintech capabilities and skills from India.

2.1 Export opportunities

Australia's engagement with India's financial services sector has been cautious

- in 2016–17, Australia exported $54 million in financial and insurance services to India and imported $31 million.

The biggest opportunities in financial services will be in joint ventures and investment rather than exports.

2.2 Collaboration

FINTECH SERVICES

Australia and India have complementary strengths in fintech

- Australia has emerged as a global fintech hub given our flexible regulatory regime, a technology-embracing banking culture and a steady flow of global funding
- there is scope for Australian capital and experience to partner with Indian talent to create world-class digital solutions
- India has a skilled entrepreneurial pipeline, low-cost infrastructure and a large but underpenetrated market
  - India can also benefit from using new technology to leapfrog the legacy systems that may hold back Australian firms.

However, differences in goal alignment may limit how this works in practice

- India's fintech ecosystem places a greater priority on social development – helping to bank the unbanked or delivering low-cost products and services to the most price-sensitive customers
- gaining an understanding of this market will be challenging for Australian fintechs, who operate with a more mature market in mind and on a for-profit first basis, with products geared to a higher-income retail and corporate market.

There will be niche collaboration opportunities where target markets overlap, such as in personal financial information tools, commodities trading, remittances, contract management and export financing

- these opportunities will be patchy in the short term and may be hindered by the lack of regulatory clarity in the fintech industry
- as fintech standards and governance become clearer and more services enter the mainstream, the potential for collaboration will increase.

Many Australian banks are ramping up their in-house fintech capabilities in an effort to provide end to end solutions

- the scarcity of specialised technology skills in Australia could lead Australian banks to consider basing their fintech innovation hubs in India, where Australian banks think highly of the quality of India's engineering and IT talent
- this would also help balance the employment drawdown in India caused by technology cannibalising employment in back office functions
- the scale and nature of this opportunity will depend in part on whether the fintech sector will turn into one that primarily competes with established players like banks or collaborates with them.

Australia is ahead of the curve on blockchain technology

- blockchain has the potential to remove layers of overhead costs dedicated to confirming authenticity or reconciling transactions between parties in the financial sector
- according to a 2016 study by IBM, roughly 65 per cent of banks globally are expecting to have blockchain solutions in production by 2020 [104]
- blockchain applications could extend beyond financial services to bring greater transparency and efficiency from energy markets to supply chain logistics.

India is attuned to the need to develop a better understanding of blockchain if the technology is to be used for economic modernisation

- while the Reserve Bank of India (RBI) is considering the regulatory aspects of the technology, Indian banks have undertaken pilot blockchain transactions with other banks
- Australia should use this window to initiate cooperation with India as the foundational rules are being set
  - this could build trust for Australia to expand bilateral cooperation and tighten interoperability as applications move beyond financial services to other sectors of the economy.

ASSET MANAGEMENT

The opportunity for Australian asset managers to partner with Indian mutual funds companies will be a medium term one

- it will depend on a steep change in financial literacy in India as well as an increase in pension fund and insurance subscription
- mutual funds are not currently the investment vehicle of choice for Indian households, making up only 3 per cent of total investment in financial assets by Indians.[105]

As the Indian market matures, Australian businesses could combine capital and expertise in using technology to develop consumer-centric products and expand distribution networks

- even as the Indian investor market becomes more sophisticated, the typical asset allocation will look vastly different to that of Australia
- investment houses with expertise in non-core assets and venture capital would be more suited to India.

As with any joint venture arrangement, particularly in India, partner selection and goal alignment is paramount

- foreign firms that have entered the asset management sector without a local partner have often exited the market
- challenges include a lack of brand awareness in smaller cities and an inability to expand distribution networks without significant upfront cost and time commitments.

Australia is world-leading in asset management, bolstered by a sophisticated investor base, strong financial institutions, innovative products and a mandatory superannuation scheme

- but Australian asset managers may see little value in expanding into challenging overseas markets like India as they benefit enormously from the flow of compulsory contributions in the domestic sector
- moreover, the relatively small size of Australia's asset management firms may make it more difficult to enter into a mutually beneficial joint partnership with a substantially larger Indian partner.

POLICY AND REGULATORY COOPERATION

We should improve institutional ties in financial services segments where both Australia is world-leading and India is reform-leaning

- government engagement could facilitate the entry of more Australian players in this space and improve growth prospects for Australian companies investing in India's financial services sector, and vice versa
- India will also have opportunities to absorb regulatory best practice through their exposure to the Basel process and Financial Stability Board.

The most prospective area for regulatory cooperation is in fintech

- India is in the early stages of developing its fintech regulatory architecture
- the Australian Securities and Investments Commission (ASIC) is well placed to work with India on fintech regulatory cooperation.

Both countries will also benefit from establishing robust international standards in the blockchain industry, which will provide market confidence and trust that proprietary information and money will remain safe

- it will help provide a common language for industry, policy makers, regulators and technology developers, and the basis for interoperability, as the use of blockchain expands.

CYBER SECURITY

Financial services organisations face some of the most challenging threats to their cybersecurity as the convenience of modern consumer banking – including ATMs, point-of-sale systems and mobile banking – has vastly increased the number of endpoints that need to be protected

- banks are also responsible for some of the most sensitive consumer and corporate data and risk serious reputational damage in case of a breach
- the banking sector is the largest user of cybersecurity products and services in Australia.

While cyber security is a nascent industry in Australia, Australia's well-functioning and effective cyber security entities can tap into the cyber security segment in India in software, services and training [see *Chapter 13: Defence and Security*].

2.3 Investment

INSTITUTIONAL INVESTMENT

There is significant attention but little knowledge in India of Australian super funds beyond headline figures of funds under management

- but Australian institutional investors are generally domestically focused, weighted towards equities and have an eye to short term results.

An average of 30 per cent of Australian super fund investments are in equities where returns are expected to decline

- these funds may eventually seek alternate investment options in higher growth markets such as India, which could emerge as a high-risk, high-return option.

Investors looking to boost returns could also consider the Future Fund's approach to India

- the Future Fund readily acknowledges the challenges of investing in India, including the legal system, ease of doing business and regulatory barriers
- but the Future Fund's footprint in India is increasing with investments across a number of asset classes
- it holds a long term outlook and is diversified across asset class and geographies, and recognises India's long term growth potential, strong economic structural reform agenda and ongoing political stability.

GENERAL INSURANCE

The projected increase in insurance take-up in India out to 2035 provides an opportunity in the medium term for Australian companies to tap into India's general insurance market

- within general insurance, health insurance is projected to experience the fastest growth
  - the health insurance premium share of total general insurance is expected to increase from 22 per cent in 2013 to up to 31 per cent by 2025.[97]

India is seeking foreign capital and expertise in digital distribution to support local firms to expand into regional and rural areas

- foreign firms that specialise in servicing a mature market have opted to acquire stakes in local companies, rather than establishing a joint venture or foreign subsidiary
- this provides access to an established brand and distribution network without the upfront costs and time involved to build a presence and on-the-ground relationships.

Opportunities for Australian companies in the insurance sector will be hindered by the ongoing market dominance of Indian state-owned enterprises

- Australian insurance firms looking to enter the Indian market may wish to consider joint ventures with Indian state-owned firms.

Joint venture arrangements in the insurance sector have worked for those prepared to invest time and align business cultures and personnel

- an increase in the FDI cap for insurance in 2015 from 26 per cent to 49 per cent has already seen foreign players invest – including Australian firms – in strong Indian general insurance companies
  - for example, Insurance Australia Group and India's SBI General Insurance
- other Australian firms may need to wait until FDI norms are relaxed further to find the right opportunity to meaningfully participate in this sector.

3.0 CONSTRAINTS AND CHALLENGES

KEY JUDGEMENT

India's financial services sector is heavily regulated and dominated by state-owned enterprises. Though foreign investment caps are likely to be relaxed out to 2035, structural inefficiencies and red tape will linger. The constraints to growth in this sector are not one sided. Australia's institutional investment industry is, by and large, preoccupied by short term wins and incentives that work against India's value proposition. Sustained improvements in India's ease of doing business, sovereign governance arrangements and in the India literacy of Australian companies and boards will help.

3.1 The policy and regulatory environment

India's financial services industry is heavily regulated by a range of authorities, many of which are averse to foreign debt and foreign players

- the RBI, SEBI, Insurance Regulatory and Development Authority of India, and Pension Fund Regulatory and Development Authority all have regulatory power in the sector
- extensive regulatory requirements for the formation of new companies in the banking, financial services and insurance sector have long posed a barrier to entry for prospective companies.

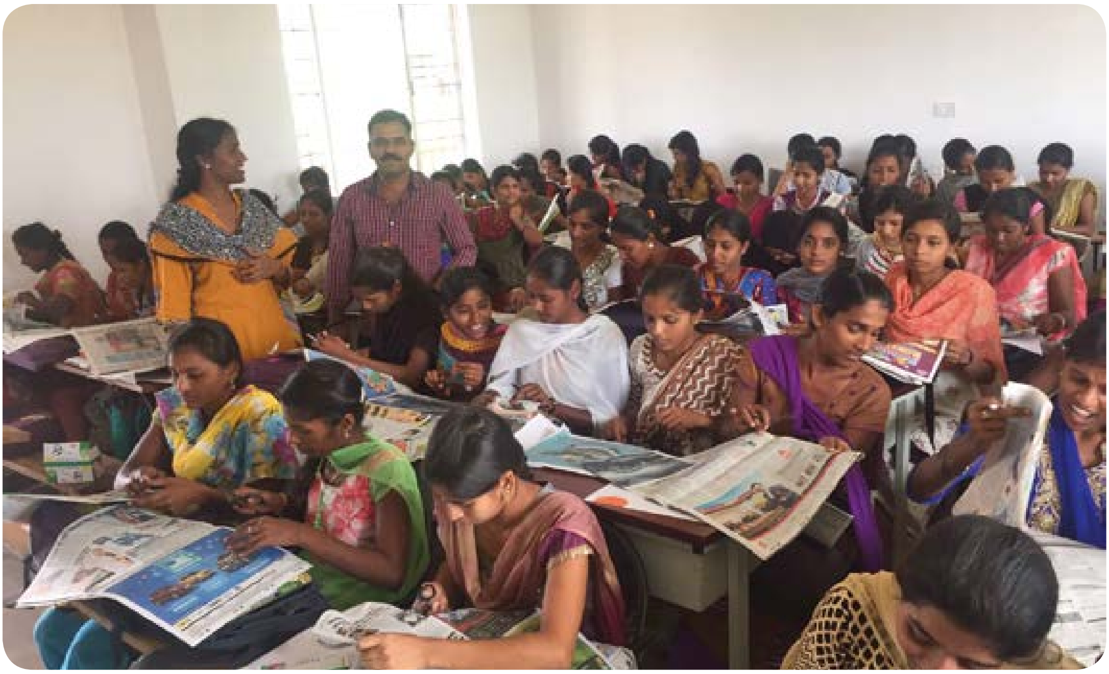
CASE STUDY: ANZ: RECOGNISING INDIA'S POTENTIAL

Recognising the long term potential and growth of India's economy, ANZ opened a branch in Mumbai in 2011 and subsequently established branches in Gurugram and Bengaluru. Through these branches ANZ provides corporate banking services to institutional customers, both local and from offshore, that allow them to conduct financial transactions across the region, and into Europe and the United States.

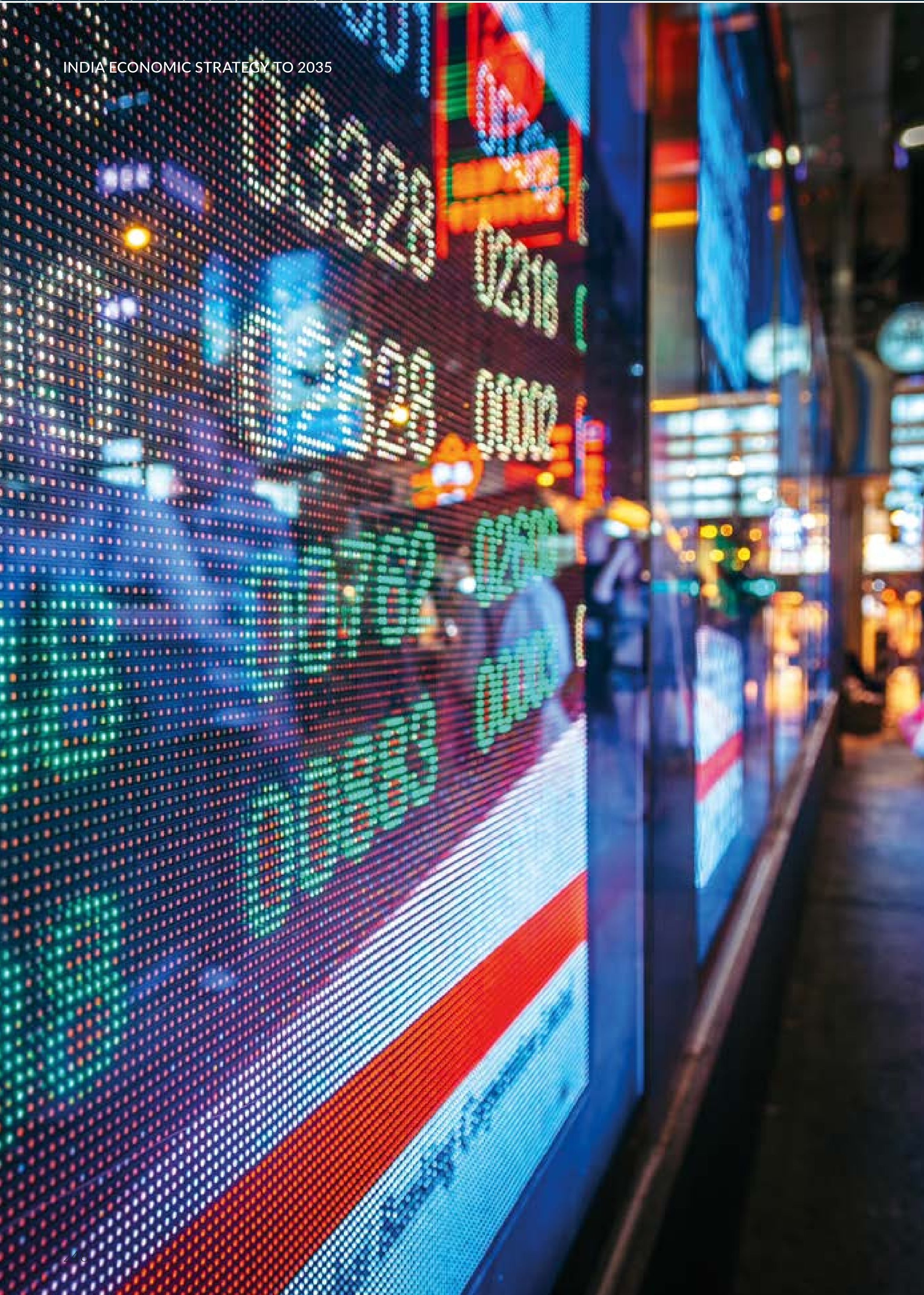
ANZ services include Indian Rupee and foreign currency working capital and term financing, transaction banking, foreign exchange and interest rate solutions, offshore debt capital markets and deposits.

With its local knowledge and global expertise, ANZ India aims to help clients achieve the results they want from the movement of their capital and goods across the region. It provides services to customers in the resources, energy, agriculture, financial institutions and technology sectors. As well as its branch based operations, ANZ has a shared services hub in Bengaluru supporting its businesses across Australia, New Zealand and Asia.

ANZ also provides financial and volunteering support to non-government organisations and charities in India. ANZ's flagship adult financial education program, MoneyMinded, is delivered in Mumbai and Bengaluru where it continues to help hundreds of participants improve their financial skills, knowledge and confidence.



WOMEN PARTICIPATING IN THE ANZ MONEYMINDED PROGRAM TO BUILD THEIR MONEY MANAGEMENT SKILLS, KNOWLEDGE AND CONFIDENCE' [ROBERT LOMDAHL, ANZ]



The complex regulatory environment particularly impinges on India's emerging fintech sector

- new regulatory hurdles, such as protocols around 'know your customer' and anti-money laundering, as well as digital identity authentication and data storage requirements, slow the adoption of new technologies.

Like their global peers, Indian regulators are still figuring out how to recalibrate to innovative disruptions

- the treatment of new business models enabled by fintech, including peer-to-peer transactions, crypto-currencies, crowd funding, systems integrity and data security are the biggest grey areas
- the lack of a regulatory framework makes significant investment in fintech a risk for Australian businesses.

The Future Fund, Australia's biggest institutional investor in India, has also suffered from a lack of regulatory clarity

- SEBI's 2012 'clubbing' rule, which brings the Future Fund and a range of state government funds under the same banner, effectively limits Future Fund holdings to 2.5 per cent of any listed entity, whereas a single foreign portfolio investor would be able to hold 10 per cent.[xxix]

India has made notable recent progress in reducing FDI caps in some sectors

- in 2015, the FDI limit on pensions and insurance increased from 26 per cent to 49 per cent
- in 2016, the limit in 'other financial services' category, which includes fintech and asset management, increased to 100 per cent
- India will need to go much further in opening up the financial services sector to foreign investment if it wants to increase capital inflows and accelerate adoption of world-leading technology and practices in these sectors.

Opportunities in the retail banking sector are curtailed by the dominance of public sector banks and the prevalence of many local private sector banks

- some foreign banks have succeeded in India but many have exited, including Australian banks
- those Australian banks with a presence in India primarily service corporates and HNWIs from Mumbai and New Delhi or outsource back office functions
  - India would need to secure investment from big name firms in Australia, New Zealand and other parts of the Indo-Pacific for significant opportunities to emerge for Australian firms in India's retail banking sector.

3.2 Skills, infrastructure and other constraints

The financial inclusion needs of India's rural poor are unlikely to be met by Australian firms

- this cohort will be serviced almost entirely by domestic financial institutions
- the reach of private and foreign banks into rural areas and financial inclusion is very low
- of the total distribution of credit from all private sector banks in India in 2017, only 2.39 per cent was distributed to rural areas; for foreign banks that figure was 0.35 per cent.

There are also constraints on the Australian side, such as benchmark-led management and shareholder expectations which can favour shorter term thinking in the institutional investment sector

- the culture of quarterly reporting constrains firms from investing in emerging markets such as India, where bouts of heightened volatility make members and boards nervous around performance.

[xxix] The Future Fund has argued that the 'clubbing' rule should not apply to it as the Australian funds in question clearly meet SEBI's definition of no common management and no common beneficial ownership between funds.

4.0 WHERE TO FOCUS

Unlike many other industries, the financial services market in India is a national market in which businesses do not have to rely upon the business conditions set by state governments. Nevertheless, India does have well-formed financial services and fintech clusters. These cities should be the entry point for Australian companies seeking to establish a presence in the market. In the medium term, Indian cities with the greatest unmet demand for capital and insurance are unlikely to offer the best prospects for the types of financial services in which Australia specialises. Australian efforts should also focus on the Central Government to bridge knowledge and expectation gaps and share regulatory expertise.

Much like other parts of the world, India's financial services sector has a high spatial concentration in one city – Mumbai

- the city is India's financial and corporate capital, housing the headquarters of regulators, including SEBI and the RBI
- by extension, the state of Maharashtra, of which Mumbai is the capital, is the most relevant for Australian financial services firms seeking to establish a presence in India.

The clustering of IT firms in Hyderabad (Telangana) and start-up culture in Bengaluru (Karnataka) has led to the emergence of a strong fintech ecosystem in both cities

- Telangana is also home to T-Hub, India's largest start-up incubator.

Andhra Pradesh and Karnataka are key states for fintech partnerships given the development of a fintech hub in each state and the existence of a strong IT and fintech ecosystem respectively.

Recognising its wide-ranging potential to modernise the economy, New Delhi, Kerala and Rajasthan are committing to develop blockchain specialisation hubs.

RECOMMENDATIONS

59. Cooperate with India on fintech development

59.1 Expand ASIC's international network of fintech cooperation agreements to India

- ASIC has several cooperation agreements in place, including with China, Singapore, Hong Kong, Japan, Malaysia, United Arab Emirates, Canada, United Kingdom , Indonesia and Switzerland – India should be added to this list of countries
- these agreements provide frameworks for information sharing between regulators and allows ASIC to refer businesses to partner agencies overseas to receive the same level of support offered to local fintechs
  - this can include dedicated contacts in each regulator and support prior to and during the authorisation process.

59.2 Establish a referral system for accessing advice to navigate each country's financial regulatory system

- ASIC's Innovation Hub already performs this function and could help SEBI set up a similar platform.

59.3 Provide support for Australian fintech start-ups to establish themselves in India

- financial services and fintech should be a key sector for a landing pad in Bengaluru [*see Recommendation 70.2*]
- alternatively, given the funding constraints around the establishment of a physical landing pad space, the Australian Government should explore options for 'soft-landing support', including in Mumbai (India's fintech hub)
  - this would provide an opportunity for Australian fintech start-ups to travel to India (or vice versa) to access an incubator or accelerator
  - start-ups could use the exchange to explore investment/partnerships in fintech or work bilaterally on a project to create a market solution that supported India's financial services needs.

59.4 Use fintech to engage with India on development cooperation in third countries

- India is seeking to increase the profile of its development program and clean up procurement and delivery
  - Australia and India could develop a bilateral innovation challenge for Indian and Australian fintech start-ups to provide solutions to developmental issues in the Indo-Pacific.

59.5 Increase the number of Indian and Australian fintech firms under the New Colombo Plan Internship and Mentorship Network.

60. Cooperate on Blockchain standards development

60.1 Leverage Australia's position as chair of the International Organisation for Standardisation's (ISO) Technical Committee for Blockchain Standards to work more closely with India

- Australia, through Standards Australia, is leading the development of international blockchain standards under the auspices of the ISO
  - India is one of the 33 full members of this Committee
  - we should share experiences on the testing and regulation of blockchain technologies, increase regular intersessional work and conduct more frequent agency to agency contact and teleconferences.

60.2 Standards Australia could share lessons from the development of Australia's Blockchain Standards Roadmap with the Bureau of Indian Standards

- the two countries could work together to increase consistency in terminology and measures for managing privacy, security and identity issues for near term uses in digital currencies, trade finance and remittances.

60.3 Showcase Australia's pioneering use of blockchain distributed ledger technology as the ASX's primary clearing and settlement system

- although it is a private company, the ASX could share lessons on how to address risks and adhere to regulatory requirements with India's National Stock Exchange (NSE) and Bombay Stock Exchange (BSE)
  - SEBI's newly formed Committee on Financial and Regulatory Technologies is in the research phase of considering blockchain applicability to the stock market
  - this could also lead to connecting Australian fintechs servicing the ASX to the NSE and BSE, and their supporting start-up ecosystem.

61. Bridge knowledge and expectation gaps

61.1 The Future Fund should share its experiences in India with Australian investors

- the strong performance of the Future Fund has other fund managers looking to it for advice
  - this is an opportunity to leverage the 'soft power' of the Future Fund to share its experience of the challenges and rewards of the investment environment in India.

61.2 Share perspectives on the opportunities and challenges prompted by fintech, including regulatory reform

- regular policy dialogues between Treasury, Ministry of Finance and NITI Aayog present one opportunity for this to be done at an officials' level.

61.3 Advocate for India to join the Asia Region Funds Passport (ARFP)

- the ARFP is an initiative of APEC
  - currently only APEC members have joined – Australia, Japan, Thailand, New Zealand and the Republic of Korea
  - membership of the ARFP from outside of APEC is possible under the rules of the ARFP
- once implemented, the ARFP will allow fund managers to sell investment funds between participating jurisdictions through a streamlined regulatory framework
  - consumers will benefit from a wider range of investment products and managers will benefit from market access into jurisdictions they could not previously operate in without a full local presence and licence
  - fund managers in participating jurisdictions will be able to access the ARFP once they satisfy a number of threshold criteria, which will ensure only experienced managers with appropriate capital backing can enter.

62. Support development of India's pension system

The Australian Government should work with the Indian Government to develop India's retirement savings industry by sharing best practices and lessons from Australia

- the Pension Fund Regulatory and Development Authority of India and the Australian Prudential Regulatory Authority could explore opportunities to share experience, including on how to drive demand and raise public awareness, how to create a robust regulatory system, and appropriate roles for private players
  - broader policy issues relating to retirement savings could also be explored between Treasury and the Indian Ministry of Finance.