

MicroSave India Focus Note 69

UID and Financial Inclusion – Solution or Not?

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Introduction

The Unique Identification (UID)¹ is one of the most ambitious projects by government of India and seeks to give identification to every citizen of this country.

- The UIDAI (Unique Identification Authority of India) will aim to create a database of bio-metric and identity details of citizens and provide a unique number to all (but not smart cards/stored-value).
- The authentication of the person's identity that is in the UID database would occur when the need arises such as for government schemes, such as NREGA payments, etc. and also for private transactions through insurance companies and banks.

The UID will encompass the collection of details, including a person's biometric data e.g. iris, fingerprints, etc., coupled with his/her demographic information and location in India. The census, which has just started, will collect data for UID standards, which will be available through a secured service provider and a highly secure data vault with precautions against threats such as hacking and intrusions. The database will have information on more than one billion people's biometrics, which is ten times bigger than any biometric database available currently in the world.

The objective of this Note is to share some initial insights with financial service providers and other stakeholders. This should initiate internal discussions within these institutions as to how they can prepare themselves and leverage this new development and support/catalyse financial inclusion in India.

Potential Macro-Impacts on Financial Inclusion

The UID can really be a "game changer" especially in terms of financial inclusion. It can help foster true social security reform — to remove ghost clients and outright fraud by middle-men who prevent government benefits from reaching the poor. Many in the industry believe that the UID, catalysed by collaboration between telecom companies, banks and the government, can assist in the facilitation of improved financial inclusion services. Thus savings, etc. should become more convenient and less risky (without diluting security) at an affordable price for all involved. Other potential impacts are:

a) **Regulatory Reform:** The new UID system, if functioning well, could help the government to frame

a more practical policy on micro-savings/insurance for poor people by perhaps loosening some of the restrictive measures, such as transaction limits, that currently hinder financial inclusion. The UID, with its reliable and credible identification process, should help overcome major challenges involved in fulfilling even the most basic Know Your Customer (KYC) norms.

- b) **Improve Access:** The UID could challenge current location-bound systems and put the recipient at the centre, allowing choice, mobility and access. For example, since the UID can be authenticated from any location, a customer can access his/her account in his/her village or can do so in any other village or city through bank branches, Business Correspondents (BCs) or ATMs.
- c) **Remove Complexity and Paperwork:** Government-issued PAN and ration cards etc. are numerous and fragmented by purpose and region in India, which results in widespread bribery, denial of public services and loss of income, especially for poor citizens. UID could help in combining each of these identification forms into one, helping minimise/eliminate duplicate identities and do away with entire levels of bureaucracy and paperwork.

Potential Advantages for MFIs, Cooperatives & SHGs

Once implemented, the UIDs could also have a very positive impact on the microfinance, cooperative and SHG sectors, as financial delivery could become more affordable due to the reduced cost and increased credible identification processing. Some of the advantages that UID could bring to microfinance are:

Offer New Services

- a) **Savings and Insurance:** Allow MFIs to offer additional services beyond credit, as processing time and cost for the account opening/authentication process through banks could be reduced.
- b) **Remittances:** The remitter could send money to a specific person, minimising the risk of fraud and loss when using more informal channels.
- c) **ATMs:** Micro ATMs, using simple wireless technology coupled with UID authenticated transactions, could be deployed by banks either directly or through service providers (e.g. BCs) to provide transactions such as deposits, withdrawals,

¹ The project has since been renamed to be 'Aadhar' (meaning support, depend, the base or foundation) by the UIDAI, but this paper will use 'UID' throughout as this is what is known more commonly.

fund transfers, balance inquiries and mini-statements. Vendors, telecoms and banks have already been in discussion about the deployment of such machines.²

- d) **Be a One-stop Shop:** Beyond savings, insurance and remittances, other financial services could be offered, such as bill payments, NREGA and other social security payments, in a convenient location. This could also help to solve the challenge of sustainability for many stakeholders, including field agents and the larger institutions, by encouraging higher volumes.

Reduce Risks

- e) **Reduce Multiple Borrowing/over-indebtedness:** UIDs could be used to track multiple borrowing through the new MFIN-supported credit bureau.³
- f) **Reduce Risk of Ghost Clients/fraud:** MicroSave has increasingly seen increasing numbers of fraud cases, creating ghost clients, etc. in SHG- and JLG-based systems. The UID could provide an extra layer of control to reduce the likelihood of such activities, as everyone involved would be traceable and any odd transaction behaviours could be flagged much earlier.
- g) **Reduce Cash in the System:** Cash transactions could be minimised as MFIs could directly credit (or debit) the loan amount to the UID-linked bank accounts of the clients. Fraud, theft, and even personal harm to staff, could be significantly reduced by removing as much cash as possible from the system.

Possible Risks⁴

General risks that arise from such a centralised solution includes possible errors in the collection and recording of information, difficulties in achieving the desired scale, technical hiccups, corruption of data from anonymous sources, and unauthorised access to or disclosure of personal information. Apart from the general risks, other specific risks when it comes to financial inclusion are:

- a) Since the UID numbers will be long, many people, might not remember their UID and need to write them down. Awareness training for beneficiaries and staff of the licensing agencies on how to use the UID and its benefits will be essential.

- b) Since the authentication from the UID database must be done online, connectivity could be an issue, especially with uploading and downloading large packets of data, such as biometrics.
- c) The UID system is relying heavily on biometric data; however for the solutions in place throughout India and the rest of the world, biometric systems are not even close to being perfect. There are many cases of false negatives (right people being wrongly denied).
- d) Some stakeholders (e.g. banks, insurance companies or field agents) may not fully buy into the UID system and require additional, back-up proof. It is very difficult to force large, bureaucratic organisations to change overnight, and for some, their livelihoods (legal or illegal) might be challenged.
- e) Just as technology has not been a panacea for improving financial inclusion, UID too can only be a facilitator of processes and transactions. Financial institutions, be they semi-formal like MFIs or formal like banks, must still have the desire, creativity and resources to improve financial inclusion.
- f) The UIDAI's goal is to have UIDs for 600 million Indians within the first five years, only half of India's population. Providers will need to devise interim solutions that are compatible with the UID project but also do not put efforts on indefinite hold.

What Lies Ahead

Over the last few years, India has seen critical reforms implemented to help create financial solutions for the poor. The UID number could help integrate these reforms and leverage the technology already in place into an effective low-cost solution, offering financial services to everyone at a short distance from their homes.⁵ The combination of UID, mobile and bank account numbers could truly enhance financial inclusion. "Both the UID platform and the BC model, apart from existing platforms such as ATM, internet and mobile banking, will build up the required critical mass for getting closer to achieve financial inclusion in India", says Mr. Nandan Nilekani, the UIDAI Chairman⁶. The next IFN 70 will discuss in more detail how the UID may affect mobile-banking in India.

² <http://economictimes.indiatimes.com/news/news-by-industry/banking/finance/banking/Banks-to-talk-ATM-expansion-with-telcos/articleshow/5397243.cms>

³ Recently, MFIN has recently announced it wants to become a formal partner for UID registration for this purpose. <http://economictimes.indiatimes.com/news/news-by-industry/banking/finance/finance/Microfin-cos-want-to-be-a-UIDAI-registrar/articleshow/6136740.cms>. But some industry observers note that MFIs essentially lend to households not individuals and thus the potential and usefulness of the UID for this purpose may be being over-estimated.

⁴ For a more detailed and holistic overview on the risks involved, please refer to Sections 6 and 9 of the UIDAI Strategy Overview, available at <http://uidai.gov.in>.

⁵ UIDAI has already been in discussions with the RBI, The Banker's Association (and SBI in particular), the Ministry of Rural Development (NREGA), insurance companies like LIC, and several donors and MFIs, such as SEWA. The RBI has asked all banks for a UID compliant financial inclusion plan to be rolled out in the next three years. Organisations are encouraged to initiate a dialogue with the UIDAI by contacting webadmin-uidai@nic.in.

⁶ Mint, March 17, 2010, *Unique ID Number will help bring in transparency: Nilekani*, www.livemint.com.