

## Transforming India's Payments Industry

*The global financial crisis has changed the way Indian banks look at payments. Although, with the help of partner banks, much progress has been made, there is still work to be done in developing payments technology, strategy and scale.*

Aneish Kumar, Managing Director, Head of Treasury Services, Indian Subcontinent - BNY Mellon

The financial crisis has changed the payments landscape for Indian bankers and clients. They now face more risk exposure and often don't have the controls and processes in place to address cross-border regulatory requirements. Even though Indian banks operate in a fairly confined space and have not faced nearly as much turmoil as banks in other markets, the potential for global economic shocks to reach India is genuine. As a result, many Indian banks have sought partner banks that can provide them with accurate and current knowledge of compliance issues, risk mitigation solutions and fraud prevention, as well as allowing them to offer secure payments and timely information.

India's banking technology has lagged behind other parts of the world. Investment in technology to mitigate risk has been slow and relatively recent, occurring only in the past seven or eight years, so the Indian banking community does not have the technological capacity to mitigate all the risk the crisis has created. Continued IT investment is critical to the banks' keeping up to date with new regulations brought on by the credit crisis, but the crisis itself has to provide limited the fiscal resources to do so. A large proportion of banks in India have been able to call upon their correspondents support, but some have not.

### **Driving the Scale of the Payments Business**

The credit crisis has taught banks that overall, the payments system is profitable, stable and capital efficient. Any investment into a payments business offers 10 to 12 times return on investment. As a result, many of the larger Indian banks are trying to drive the scale of the payments business as a way to increase margins. Banks in India are also looking to optimise operational models and systems because, even with the necessary technology, without a service model, they cannot build a superior payment business. This has led to an increase in services: providing bulk payments, direct debits, direct credits, electronic fund transfers, and electronic clearing systems.

With the exception of the past year, the investment in cash management among Indian banks has been more intense than in any other part of the business. Banks have been under competitive pressure to find resources that can maintain the level of investment they have made. So, when the capital markets do not do well, it creates additional pressure to bring in capital from internal accruals.

Some banks have outsourced this function, but outsourcing also has problems, because banks can be penalised if an offshore function doesn't deliver. So most banks are investing

in technology to introduce best practices in cash management, replacing manual legacy systems.

To this end, banks are examining cash flow forecasting. They want to simplify processes, but also want detailed management information systems. This has led Indian banks to try to consolidate cash solutions. Banks and corporates with businesses in different parts of the country need cash pooling – a single location for their outgoing payments or incoming credits. They need to concentrate cash at one single point and, ultimately, to move funds from multiple accounts into a central account, and from a central account, across the globe. Such pooling makes cash flow forecasting easier and more understandable. Idle cash is a cost, so banks want to pool and then disperse it.

## **Regulation**

Current regulations are designed to enhance payments management in the ongoing credit crisis. They are intended to introduce best practices in cash management by improving or replacing the inefficient manual legacy systems – right down to core banking systems, which need to maintain strong controls and remain unified during the current bout of mergers and acquisitions.

There has also been an emphasis on persuading banks with stronger capabilities and stronger global credibility to mitigate the risks attached to the receiving/remitting bank. The emphasis from the regulators' side is on know your customer (KYC) and anti-money laundering regulations. Regulators want every bank to institute a system wherein they can improve their straight-through processing rate. Regulators also want full disclosure on standards and payments performance, and they are trying to impose enterprise security for electronic payments – e.g., giving guidelines on security information, and protective frameworks for the prevention of loss and control of confidential information.

Compliance requirements caused by both 9/11 and the current credit crisis are preventing the creation of a new payments infrastructure. The US's KYC requirements, and the European Union's Third Money Laundering Directive, each designed to tighten up the payment instruction process and prevent money laundering, are well-intentioned, but are proving to be extremely burdensome in an emerging market like India. Indian banks need to allocate a huge amount of resources to check payments and some are uncertain whether they will see a benefit. Small banks need to invest heavily in technology to meet these requirements across multiple services, which can leave them in a difficult position: banks can outsource these functions, but the bank will still be responsible for any non-compliance.

## **Long-term Development of Treasury Services in India**

The treasury services business, particularly with regard to payments, has historically been relegated to the back office. Now it has moved to the boardroom, catching the attention of the chairman, chief executive and head of treasury. Current thinking is that a well-functioning operation for treasury services or payment systems plays a critical role in creating value for a bank and its clients, and that automating operations has a generally positive effect, both on the value and profitability of a financial institution. But the current situation is forcing banks to innovate in their payments processing, and this is challenging correspondent banks to understand these trends.

This is a new paradigm in payments – systems have changed from a channel for transferring money, into a means of transferring value, which is *creating* value. When money is pooled, one can see the amount of float available, where to invest it, and how to multiply the

revenue out of it. There is also a great opportunity to build greater efficiencies and enhance risk mitigation processes with better products. Growth opportunities come when we assess our own current payments business model, or clients' payments business models, and develop a transformation strategy based on these assessments. That's why the payments function is moving from the back office to the boardroom.

### **Moving Forward**

The key to developing a strategy for the future lies in fraud prevention, and in identity and access management. Regulators are particularly focused on transaction monitoring to prevent money laundering. It will be of paramount importance to provide a compliance framework to meet these requirements. It will be key to have a dynamic and real-time based infrastructure for risk controls, and a robust information technology to build agile operational models.

I believe India will soon have a unified payment system tied to a seamless global payments infrastructure. As the industry changes, the pricing model is not going to remain static. Revenue streams will change and inefficient legacy systems will be replaced by technology-orientated, seamless systems. There could be a price advantage or disadvantage with this – it could work either way. Cost will continue to be a challenge for banks in India, because they continue to pursue lower transaction costs. Indian banks have to overcome these hurdles, but this is possible. Overcoming pricing risk should lead to Indian banks becoming more highly trusted, compliant and commercial organisations. And, as a result, more profitable



Aneish Kumar has nearly 30 years of cross-functional expertise in banking and financial services. He has been with BNY Mellon since 1998. Prior to joining BNY Mellon, he worked for 13 years in a leading public sector bank in India. Kumar also has worked as a senior vice president, responsible for corporate finance and leasing for a leading financial services company. He has extensive experience in trade finance, correspondent banking, cash management, cross-border trade and remittances, industrial credit, loan syndications, leasing and hire purchase, product and business development. Kumar has been a speaker at various finance and business forums as well as a guest lecturer for several training colleges and professional bodies. He has also written and published articles in several business and financial publications on a variety of topics, including trade finance, taxation, risk management, lease and hire purchase. Kumar holds an MBA in finance and international business.

BNY Mellon is a global financial services company focused on helping clients manage and service their financial assets, operating in 34 countries and serving more than 100 markets. The company is a leading provider of financial services for institutions, corporations and high-net-worth individuals, providing superior asset management and wealth management, asset servicing, issuer services, clearing services and treasury services through a worldwide client-focused team. It has \$22.1 trillion in assets under custody and administration, \$966 billion in assets under management, services \$11.9 trillion in outstanding debt and processes global payments averaging \$1.6 trillion per day.



BNY MELLON