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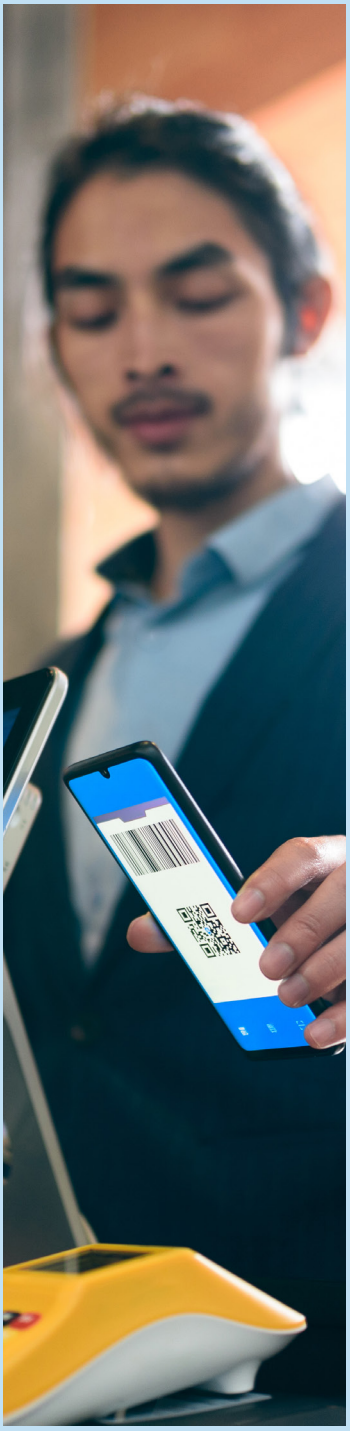

PAYMENTS DATA MONETIZATION AND LENDING ON THE FLY

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Introduction

The International Finance Corporation (IFC) states that 65 million business enterprises and informal small & medium businesses (SMBs) in developing countries have an unmet financial need. It is estimated that there is a gap of USD 5.2 trillion YOY which is equivalent to 1.4 times the current level of the global SMB lending.[1]

The fundamental concern for banks in this space is unavailability of the viable credit risk information to complete the underwriting process. This makes it expensive access either through formal or informal sources. On the other hand, in this process, ad-hoc capital management methods crept into this sector leading to extensive indiscipline, tax evasion. This is not an exception to the first world countries and form un-organized lending ecosystem in these markets. In such markets, most of the business transactions are preferred in anonymous and cash only mode.

Central banks and finance ministries of the countries are looking at this segment for significant credit expansion thus making this segment promising for formal contribution to GDP. [2]

The approach to this problem/opportunity space differs in first world and third world countries. While fintechs lead in the first world, it is more a country level and central bank driven innovation in the third world and India is in the forefront in this space (example is "the India stack") [4].

Triggers of Innovation in formalizing the SMB sector:

Innovation Trigger 1

Country level infrastructure for financial inclusion – Presence-less, paper-less, digital ID centered consenting infrastructure riding on the backbone of real time payments

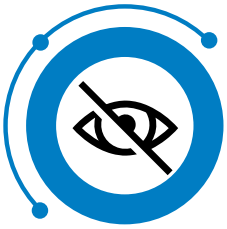
Fintech aggregators of the first world setting up platforms to bring in together data of value to quick KYC and underwriting through payments observability technology and payments data analysis

Leverage of Goods and Tax Networks payments data monetization for credit expansion

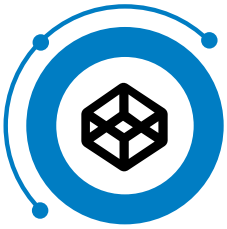
Innovation Trigger 2

On the other hand, payment systems innovation is putting stress on payment product fee revenues. This is because payments are becoming:

Immediate



Invisible

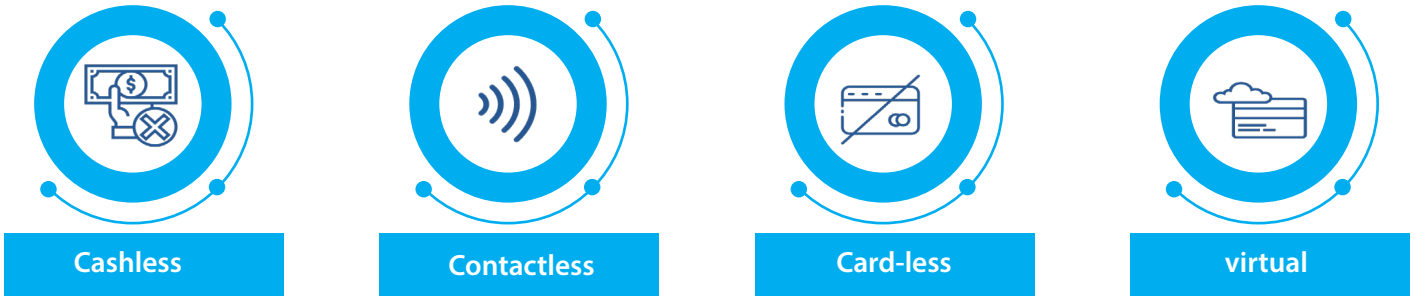


Inclusive

Free

Innovation Trigger 3

Pandemic driven changes on the other hand led to accelerated digital adoption.



All these scenarios have paved way for the banks to step up the opportunity to monetize payments data within the regulatory limits.

Some of the critical innovations and the synergies include:

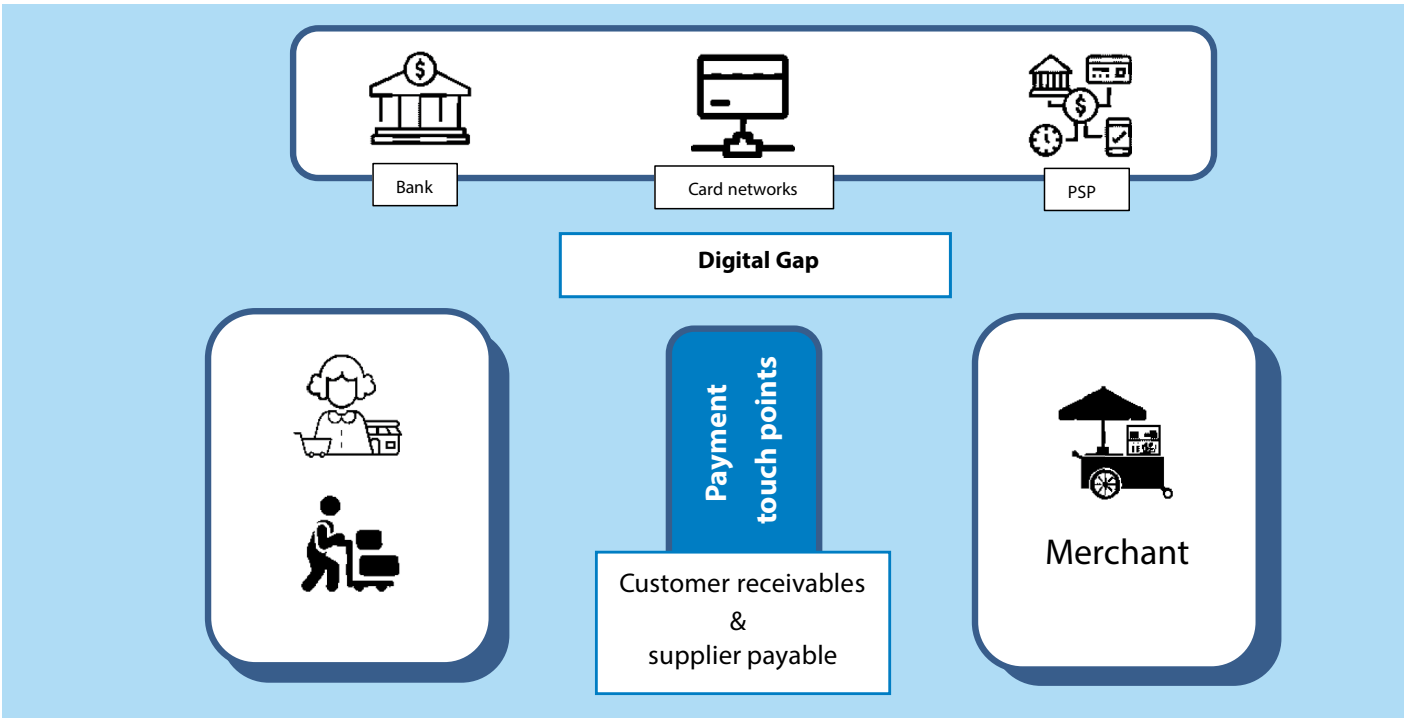
- **Payments Data as service**
- **Payments as a consumed service (White labelled service offerings)**

Some key statistics showing this synergy [3]

- **More than 55% of the investment happened in the payments space**
- **Fintech lending accounts for almost 20% of SMB loans given by key financial institutions**
- **Retail digital lending has clocked more than 40% CAGR over the last decade**
- **Fintechs have witnessed more than 50% small ticket loan volumes over the last few years**

Digital lending growth and fading traditional methods of finance

Traditional Lending methodology tend to use indicators such as checking credit score and payment history as part of their underwriting process. In the period of digital transformation this method is complex and time consuming. Fintechs are revolutionizing SMB lending landscape by making instant lending decision based on business's real time data delivered at the point of need. They are using alternative lending models to build custom loans where borrowers can directly pay off loans from their receivables.

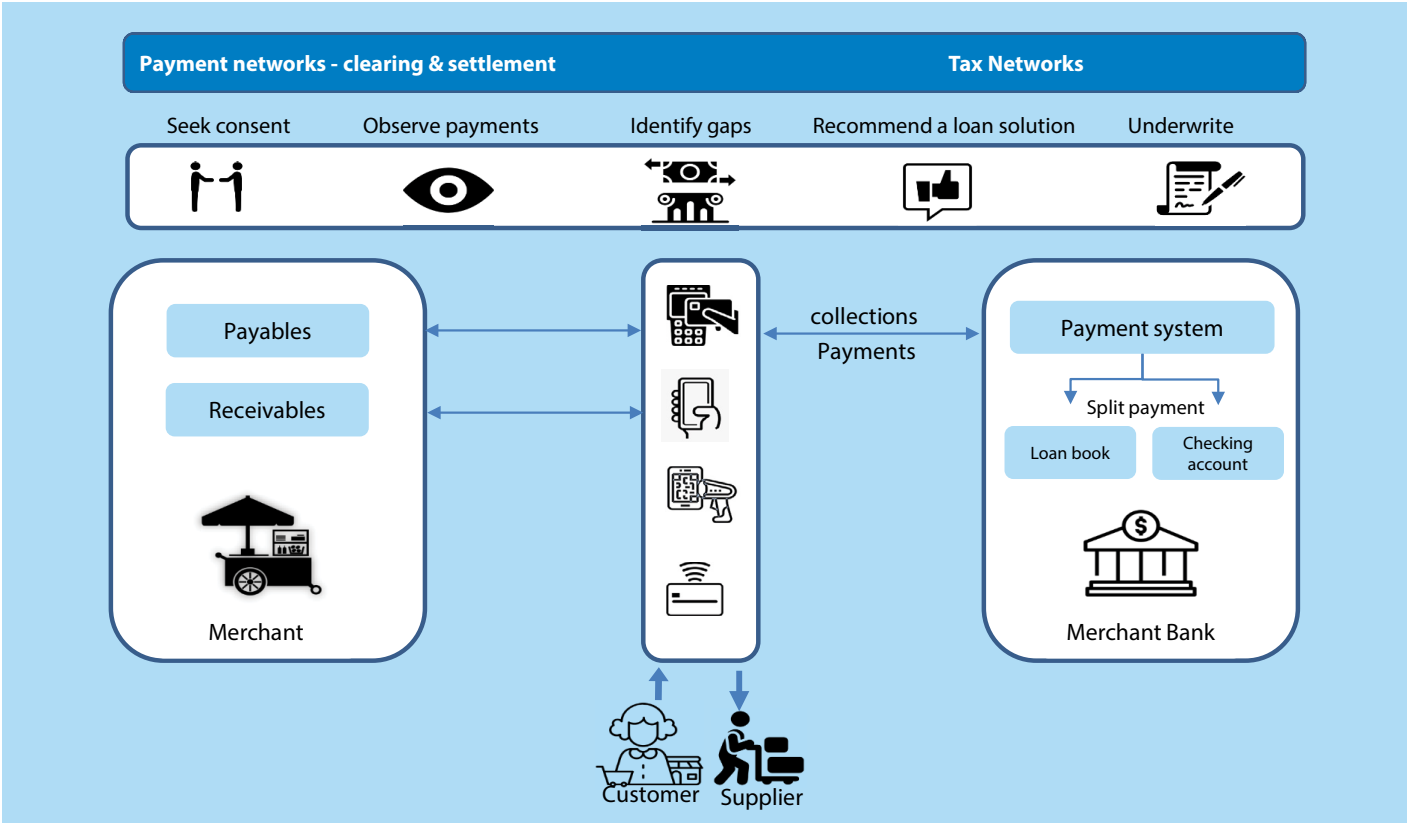


Emerging models for accelerated lending are being backed by holistic payment technology stack, creating opportunities to "lend on the fly"

Integrated data infrastructure model with boundaryless information flow between banks and its SMB customer is helping to capitalize on "observability of payments" – gap between payables and receivables to create working capital lending opportunities on the fly. Here lenders have access to merchant's real time transaction data which will help them understand the businesses' finances. This enables them to enhance risk modelling and strengthen credit assessments leading to faster decision making and maximized loan approvals.

Here are the key features of this payments data enabled lending ecosystem:

Consent payment data observability	Small Business merchant shares his consent with the account aggregators to track his financial transactions data. The account aggregator can request data from merchant's bank account through an open API
Identification of gap between payables & receivables	Payments to suppliers, government entities in the form of taxes and other dues are measured against the receivables from the customers at the payment touch points
Risk scoring and implicit credit limit creation	Book debts, tax history, payments history business history coupled with KYC performed on the fly leveraging the payment transaction value chain
Loan recommendation	Create a pre-approved loan solution and recommend options
One-click loan request	Provide opportunity to make one click request on the payments touch point
Underwrite and Disburse	Credit the loan funds held in the checking account
Collect	Provide options to recover at the payment touch points



Direct loan repayment from receivables – An illustration

Merchants can configure their receivables in a way that a percentage of it can be automatically debited by the bank for loan repayment. This will reduce the loan outstanding and hence save a lot of interest cost.

In the below illustration, the merchant has opted for a loan facility on his card. The merchant has chosen to allot 40% of his card receivables for loan repayment and 60% will go to the business account on daily collection. The settlement will be split between loan account and checking account on daily basis facilitating reducing the loan liability and reduced cost of funds encouraging them to do more business and enter the formal economy space. Automatic loan payable apportionment helps reduce the loan outstanding thus saving on interest cost.

REPAY FROM RECEIVABLES ILLUSTRATION

Merchant Loan Account Limit → **$50000.00**

Date	Payment Method	Credit	Debit	Merchant Balance	Loan Outstanding
1 Jan	RTR	$10000		$10000	$50000
	QR	$15000		$25000	$50000
2 Jan	EFT		$20000	$5000	$50000
3 Jan	Card	$10000		$9000	$44000

Auto loan apportionment → 40% **Business Account** → 60% **Loan Account**

Loan gets repaid with enough cashflows for the merchant to stock future inventory. It also leads to lower APR's, shorter loan tenure, collateral free loan opportunities, minimized or eliminated late fee payment scenarios.

The proposed lending model rests on 4 major capabilities coupled with powerful hybrid technology stack which would help Fintechs to cater to large number of SMB borrowers

These four major capabilities are:

1. Consent on Demand

An individual's or enterprise's data is spread across various banks, telecoms, Insurance, brokers with no framework in place for them to share with their benefactors. Account Aggregator (AA) is the construct/framework that addresses the above pain points and provides a digital platform for easy sharing and consumption of data from various entities with user consent

2. Financial transaction on demand and its observability

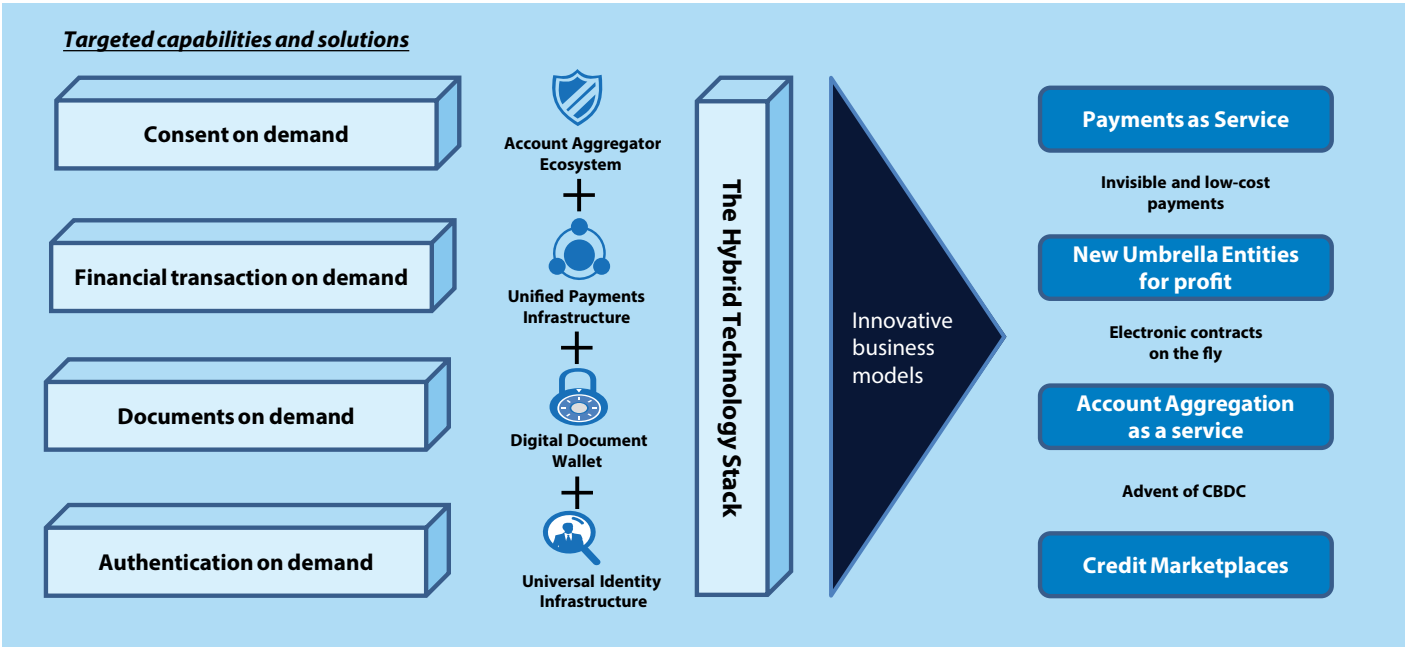
This data is then used by the fintech players to create an enhanced credit application which would be forwarded to digital lenders. The lenders are able to create a more informed, secure and customized loan offer for each individual SMB borrower.

3. Documents on demand

Once a borrower chooses a customized loan offer, further documentation for loan servicing and closure are assisted by a digital document wallet, thereby speeding up the loan cycle.

4. Authentication on Demand

The advanced digital universal identification infrastructure eliminates the need for manual and physical verification



Way forward…

Banks can capitalize on this ecosystem either consuming the service provided by the country level infrastructure or collaborating with fintechs providing this aggregation service. We observe that some of large banks are decoupling their payments business to create this kind of white labelled solutions. Owing to stiff competition from fintech and regulatory pressure to reduce the payment fee, alternative business models and solutions to monetize becomes neo-normal.

With the advent of CBDC, there would be disruption to the liabilities business of banks and could also impact the payments volumes. Leverage of payments data and associated programmability features that CBDC brings would be next challenge to commercial banks to prepare and adopt new operating models.

Experiments around W-CBDC solutions coming into cross border payments will also drive reduction in the fee income from corresponding banking business. Consolidation of NOSTRO/VOSTRO account relationships through outsourced partners in the form of B2B networks of account aggregators is also providing a win-win opportunity to manage the risks in cross border payments based on payments data. Objectively banks are aiming to transfer the risk in dealing with exotic currency relationships, while large multinationals banks and card networks taking that over establishing a symbiotic relationship. These entities could become designated FIs in the W-CBDC scenario for cross border aggregation (Ex: Project Inthanon & Lion Rock has proven the potential reducing correspondent banking fees significantly). In this scenario, Observability of the payment and payments data for intelligent routing to the least cost network whether it is B2B aggregator fintech or Nostro account aggregator multinational bank is the area of interest.

Are you prepared?

We had been helping, banks, card networks and Fintech to envision and co-create compelling business solutions with synergies to grow exponentially.

Meet the Subject Matter experts in this space

Sridhar Bhagawan B
Senior Principal, Business Consulting

Sridhar is a seasoned Banking industry generalist Consultant and Program Manager. He has expertise and extensive experience in program management IT Strategy, Enterprise Architecture, Solution Consulting. His 23 years' experience include branch banking, Management Consulting, Solution consulting and project portfolio management. He has worked on Payments & Core Banking transformations, Application replacements, Maintenance, Application Architecture blueprints, Business Process Re-engineering, operating model design and KM strategies including e Learning initiatives.

His consulting experience includes major banks in Africa, Australia, ASEAN, Canada, Middle East, India, and the US. He was a Commercial banker for 10 years and Consultant for the past 13 years. This includes a stint in a Core Banking product company (Finacle) in India.

Shivjeet S Deshmukh
Senior Consultant, Financial Services

Shivjeet has 10 years of industry experience. He has worked in a Large Public Sector Bank and a leading German Auto NBFC. He brings with him a diverse set of expertise in areas of Banking Products Management, Business Operations, Digital Credit Underwriting, Due Diligence, and effective Project Management. He has worked with leading European vendors and deployed robust loan origination & management system.

Kashif Razi
Consultant, Financial Services

Kashif has over 14 years' experience in IT Consulting and Delivery, working with some large Banking and Financial Services clients. His work spans across different roles and stages of an IT services program including business analysis, solution design and development, program management, stakeholder, and relationship management.

Over the years he has worked across various corporate banking functions and has significant experience in Transaction Banking, Wholesale Payments, AML/Sanction Filtering, Regulatory Compliance and Sovereign Lending operations.

Shruti G Mohata
Consultant, BFSI

Shruti has 4 years of work experience in financial services domain with Oracle Financial services. She has worked on Flexcube product in multiple modules including CASA, term deposits, loans, API and macros in retail banking projects. She has coordinated with the clients for preparation of functional specification documents, prepared use cases for testing the developments and performed exhaustive end to end testing. Also, she has implemented automation testing framework for multiple use cases.

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