SC Judgement on Aadhaar: Here's why it is a blow to microfinance industry

Published: November 5, 2018 2:08 AM

By Sandeep Parekh

The financial industry is waiting for RBI, UIDAI and National Payments Corporation of India to come out with clarifications on what processes need to be modified based on the Supreme Court's ruling on Aadhaar. They are likely to continue to wait. None of these entities will likely come out with a clear way forward in the short run. The review will probably need to be done at the highest levels of the government which will need to review all the issues of privacy, data protection and legitimate concerns flagged by the Supreme Court. There will need to be a comprehensive relook at the legislative and delegated laws.

This piece looks at the state of play of the financial markets and more specifically the microfinance industry after the ruling. In short, the Supreme Court ruling will have a hugely adverse impact on the entire financial industry, which, after decades of paper pushing, had managed to streamline its KYC process. As the first author realised on joining IIM-A as a full time faculty member in 2008, employment proof and a dozen ID proofs were not good enough to open a simple savings account in Ahmedabad. Just a kilometre from the campus, one Roopalben Panchal had previously created over 25,000 bogus bank and demat accounts.

Imagine the plight of tens of millions of migrant workers, who do not work near where they were born. They did not win the ovarian lottery of being born where work is plentiful, and were, as a consequence, excluded from the formal financial world. Till a decade back, half of Indian households did not have a simple banking account. This was an embarrassingly poor show by India after nearly two decades of super growth.

For all its warts, Aadhaar changed this scenario. People could easily open a bank account with an Aadhaar card or participate in the hitherto unknown utopia of borrowing a thousand rupees for an agricultural equipment, repayable to the microfinance entity over a year's time or access capital in ways they could only dream of previously. Today, the microfinance industry reaches an estimated 35 million households. These are some of the most disadvantaged people of the country, who would like to dig themselves out of the hole of poverty with a lot of hard work and the little capital being made available to them. Vaya Finserv, of which the second author is the CEO, is one of the most digitally enabled microfinance entities in India. Today, or more accurately, till last month, they could, after meeting her for the first time, take her Aadhaar card, authenticate her online by a biometric validation and credit the borrower's bank account with a priceless `10,000 she needed for loading her small tea shop with tea and biscuits. All of this in a matter of minutes, not days, weeks or months. The only data from Aadhaar received additionally was the borrower's name, address and age all of which anyway, as a lender, they would capture as part of the loan application.

After the Supreme Court ruling, the private sector cannot use the seamless Aadhaar authentication of an individual the way they have till now. Authentication records in any case cannot be stored for more than 6 months. However, the Supreme Court has ruled that the Aadhaar card can be linked to one's Income tax (PAN) card. It also allows the use of Aadhaar for providing direct subsidies to the poor, including gas subsidies, rations, MNREGA wages, etc. However, mandatory linking of Aadhaar with banks is no longer kosher. The Court has briefly stated that, "If such a person voluntary wants to offer Aadhaar card as a proof of his/her identity, there may not be a problem". Further, while discussing the misuse of Aadhaar by corporate and/or individual, the Court held that Aadhaar can only be used as a proof of identity when the purpose of using it is provided by law.

The 'little person' now has to prove his identity at a significant time and cost to both the parties involved. The alternatives of providing a passport, driving licence, PAN card, which any middle or higher income customer can easily provide, is not

easily available with the working rural populace, especially women, whom microfinance caters to. Sometimes, getting a simple photocopy of an ID proof involves a half-day trip to the nearby suburban centre. These photocopy proofs are not always fully reliable and are subject to misuse. In addition, the regulator has provided a maximum exposure available to a household, so that problems of over-indebtedness are not faced. After much efforts in last few years, reliable credit bureau information with Aadhaar linkage was developed by lenders and CICs for small ticket microfinance loans.
In the absence of Aadhaar, the system can be gamed with a person providing multiple IDs, each authentic, with a variation of names. This could, again, lead to unintentional over-lending to vulnerable customers possibly causing repayment stress and increased frauds due to the unsecured nature of these loans. Most microfinance organisations in order to reduce risk would likely stick to their existing customer base rather than go deeper and find new credit customers who may be needing it the most.The government and the regulators should come out with clear laws and procedures on how non-governmental entities can use the Aadhaar architecture to ensure bottom-of-pyramid customers are able to find a simple and fool-proof way of identifying themselves. Issues of privacy, data protection and state surveillance can be addressed. After all, there is no reason that people receiving subsidies should be enabled for financial inclusion, but the same class, who would like to work hard, should be excluded from the benefits which come out of financial inclusion.
On a lighter note, if the Supreme Court wanted to be a luddite in technological matters, it could have hand written the 1,500 page ruling on Aadhaar, which would have shrunk its size by 90%. We mortals would have been thankful.
The author is Partner at Finsec Law Advisors. Piece co-authored by Jagadish Ramadugu, MD & CEO of VayaFinservPvt. Ltd.