Privacy and household finance

On the very same day that the Supreme Court pronounced its landmark judgement on the fundamental right to privacy, the Reserve Bank of India (RBI), with much less fanfare, released the report of its committee on household finance. While not exactly light reading, the report is remarkable for the depth of its comparative analysis and the modern technological solutions it recommends and even if the subject matter lacks some of the visceral appeal as the Supreme Court judgement, its contents are, nonetheless, enlightening.

Much of what has been pointed out in the report will come as no surprise to us. For instance, it highlights the fact that Indians invest a disproportionate amount of wealth in physical assets like gold and real estate, and not nearly enough in pension-oriented financial assets. And that we have higher-than-normal levels of unsecured debt—loans from friends and family for the most part but also from non-institutional sources like moneylenders.

What is less obvious is the strong negative correlation between low levels of participation in insurance and high levels of non-institutional debt—indicating that our failure to invest in insurance products forces us to take on high cost borrowings when calamity strikes. The report has also pointed out that, while the number of elderly people in the population will grow by 75% over the next decade and a half, only a very small fraction of that cohort will actually have saved in private pension plans indicating that they are all highly susceptible to adverse shocks later in life.

For these reasons and more, the report has recommended that Indian households should re-allocate their investments away from gold and towards the financial markets and shift borrowing from non-institutional debt into institutional finance. It suggests the introduction of measures that will provide households access to quality public health services and actuarially fair insurance products to help shield them from the impact of unpredictable medical emergencies.

All this is easier said than done. There is a general lack of trust in the formal financial markets, a factor that the report correlates highly with income levels—poorer households believe that investment in financial products is the prerogative of the wealthy. Additionally, due to the perception of high transaction cost and bureaucratic complexity, Indian households generally prefer to avoid interacting with the institutional financial system.

To address these concerns, the report has recommended the creation of customized products with low marginal servicing costs that are designed to scale across the entire range of complexities that describe Indian households. It suggests that these products should be priced fairly and dispensed along with financial advice that is provided with incentives that keep the best interests of the household at the fore.

This is where the report departs from those of previous committees. It goes into details on how we can achieve these results calling for the widespread use of modern technologies. It has actively recommended the use of fintech to build customizable, infinitely scalable solutions and has articulated a number of specific structural measures to achieve that. Central among these is the creation of a regulatory sandbox that will straddle the regulators of all four financial sectors—insurance, pensions, stock markets and banks—and will allow tech companies to test their products and regulators to assess their impact on the ecosystem in a controlled environment in which applicable regulations are temporarily relaxed.

But perhaps most relevant, particularly in the context of the Supreme Court judgement, is the emphasis the report lays on the need to enact a modern privacy law. Given its strong recommendation to use of fintech to rejuvenate the household finance sector, the report recognizes that a strong privacy law will be a necessary prerequisite. This is particularly true in the context of robo-advisory services or flow-based lending products that will, by necessity, access personal financial information in order to generate their results.

In the absence of a full-fledged privacy law, there is a clear and present danger that any fintech products that are deployed even in the controlled environs of a regulatory sandbox, could have serious repercussions on privacy. Without clearly thought through and technologically responsive guard rails that developers must apply to the products they develop, there is a risk that the unintended consequences of their products will do more harm than good. With this in mind, the report recommends the enactment of a rights-based privacy regime that imposes accountability obligations on developers and applies appropriate constraints on big data applications without imposing other burdensome compliance that will make their deployment unsustainable.

Now that the Supreme Court has instructed the Justice Srikrishna committee to come up with an appropriate law to safeguard privacy, it would be good if the committee gives due attention to this strong recommendation from RBI as to what that law should contain.

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