

CHAPTER-5

ROLE OF RESERVE BANK OF INDIA IN FINANCIAL INCLUSION

“We have believed - and we do believe now - that freedom is indivisible, that peace is indivisible, that economic prosperity is indivisible”

- Late Smt. Indira Gandhi, Former Prime Minister of India

Financial inclusion is an important step towards inclusive growth. It helps in the overall economic development of the disadvantaged poor. Financial inclusion is also considered to be a business opportunity for the formal financial institutions. It would help them in penetrating into unbanked areas and thereby attaining profit. Besides the bankers, the developmental authorities also have a major role in developing the supportive infrastructure, both physical and social. The four pillars of inclusive growth are productivity, employment, financial inclusion and infrastructure development. Literacy, health and communication are some of the essential ingredients needed for inclusive growth.

Financial inclusion is a flagship programme of the Reserve Bank. Its objective is to bring people, hitherto excluded, under the ambit of formal financial institutions. To push towards universal financial inclusion, the Reserve Bank has taken several initiatives. These include advising banks on devising their Financial Inclusion Plan and constituting a Financial Inclusion Advisory Committee (FIAC). The Committee, under the Chairmanship of Dr. K.C. Chakrabarty, is helping banks to develop a viable and sustainable model of banking services that focuses on accessible and affordable financial services. To sensitize financially illiterate people, financial literacy programmes have been initiated by the Reserve Bank in collaboration with commercial banks. Opening multiple channels of credit delivery is expected to improve access to institutional credit for excluded people, which, in turn, may help bring them within the ambit of the growth process.

Parameters of Financial inclusion

Financial inclusion policy comprises the following:

1. No Frills Accounts
2. Simplification of KYC norms

3. Use of Intermediaries
4. Introduction of General Credit Cards
5. Use of Technology
6. Use of Regional Language
7. One-time Settlement
8. Financial Education

Initiatives of RBI for Financial Inclusion

To help the underprivileged participating in the economic development and country's inclusive growth, following initiatives were undertaken by the Reserve Bank of India over the last four decades:

Initiatives taken during 1960s and 1970s

- Focus on increasing credit to the neglected economy and weaker sections of society.
- Development of the rural banking ecosystem including RRBs, rural and semi-urban branches.
- Implementation of the social contract with banks.
- Lead Bank Scheme launched for rural lending.

Initiatives taken during 1980s and 1990s

- Branch licensing policy to focus on expansion of commercial bank branches in rural areas.
- Establishment of National Bank for Agriculture and Rural Development (NABARD) to provide refinance to banks providing credit to agriculture.
- SHG-Bank Linkage Program launched by NABARD.

Initiatives taken during 2000s

- The term 'Financial Inclusion' was introduced for the first time in RBI's Annual Policy Statement for 2005- 06 and a policy namely "Financial Inclusion Policy" was framed.
- 100 percent financial inclusion drive launched.
- Restrictions on ATMs deployment removed.

The above mentioned are the various measures undertaken for financial and economic benefit of the vast disadvantaged section. But still more than half of the population remains socially and financially excluded from the formal financial sector. Hence in the year 2005 a Policy namely 'Financial Inclusion Policy' was introduced by the Reserve Bank of India according to the instruction of Government of India.

Reserve Bank of India set up the Khan Commission in 2004 to look into financial inclusion and the recommendations of the Commission were incorporated into the mid-term review of the policy (2005-06) and urged banks to review their existing practices to align them with the objective of financial inclusion. RBI also exhorted the banks and stressed the need to make available a basic banking 'no frills' account either with 'NIL' or very minimum balances as well as charges that would make such accounts accessible vast sections of the population.

The Reserve Bank has taken various steps to intensify the credit delivery mechanism and financial inclusion by changing the guidelines for priority sector lending and trying to bring excluded people from both rural and urban areas under the coverage of institutional finance. It is impossible to think about inclusive growth without access to formal finance at an affordable cost. In order to provide credit to the productive sector, which has the potential for employment generation, the Reserve Bank has taken a host of measures including revising the priority sector lending guidelines, which have been in existence since the 1970s. Apart from providing credit under this scheme, the Reserve Bank has adopted a policy of providing credit through multiple channels, viz. involving self-help groups (SHGs) and microfinance institutions (MFIs), expanding the scope of the business correspondence (BC) model, simplifying procedures and processes for micro and small enterprises (MSEs) and adopting information and communication technology (ICT) solutions for greater outreach and lower transaction costs.

Of the many schemes and programmes pushed forward by the Reserve Bank of India the following need special mention:

i) Opening of No-Frills accounts

In November 2005, a new concept of banking was introduced, known as 'no-frills' account with 'nil' or very low minimum balance to make such accounts accessible to vast sections of the population. In 2012, the nomenclature was

changed to Basic Savings Bank Deposit Accounts (BSBDAs) for all individuals with zero minimum balance and facility of ATM card/ Debit card. There is no charge on deposits and up to four withdrawals in a month are allowed. By doing this, every person has the right to open a bank account. Banks have been advised to provide small overdrafts in such accounts to meet emergency credit requirement in hassle free manner.

ii) Bouquet of Financial services

In order to ensure that all the financial needs of the customers are met, banks are advised to offer a minimum of four basic products, viz.;

- A savings cum overdraft account;
- A pure savings account, ideally a recurring or variable recurring deposit;
- A remittance product to facilitate EBT and other remittances; and
- Entrepreneurial credit products like a General Purpose Credit Card (GCC) or a Kisan Credit Card (KCC).

iii) Engaging Business Correspondents

In January 2006, the Reserve Bank permitted banks to engage Business Facilitators (BFs) and Business Correspondents (BCs) as intermediaries for providing financial and banking services. The BC Model allows banks to provide door step delivery of services especially to do ‘cash in - cash out’ transactions, thus addressing the ‘last mile’ problem. The list of eligible individuals/entities who can be engaged as BCs is being widened from time to time by adopting a test and learn approach to this process. In September 2010, RBI has allowed for profit organisations excluding NBFCs to operate as BCs. Banks can now leverage on the penetrative network of mobile companies. Mobile network companies have joined hands with banks to make available banking services to India’s unbanked population. The agents of mobile companies work as Customer Service Providers (CSPs) and provide BC services, thus expanding the outreach of banks.

iv) Use of Technology

Recognising that technology has the potential to address the issues of outreach and credit delivery in rural and remote areas, in a viable manner, commercial banks were advised to implement CBS so as to enable them to make effective use of ICT, to provide door step banking services through Business Correspondents Model wherein the accounts can be operated by even illiterate customers by using biometrics, thus, ensuring the security of transactions and enhancing confidence in the banking system. RRBs, due to their proximity to rural areas, have the inherent strength to scale financial inclusion, they have been roped in by bringing them on the CBS platform. A robust payment system is an essential adjunct of Financial Inclusion this is an extremely important area.

v) Relaxation of KYC Norms

The strict KYC norms inhibited linkage of common people with the Banking System. Know Your Customer (KYC) requirements for opening bank accounts were relaxed for small accounts in August 2005, thereby simplifying procedure. To facilitate easy opening of accounts especially for small customers, Know Your Customer (KYC) guidelines have been simplified to such an extent that small accounts can be opened without any documentation by just giving a self certification in the presence of bank officials. Further, in order to leverage on the initiative of UIDAI, we have allowed 'Aadhaar Card', the unique identification number being issued to all citizens of India, to be used as one of the eligible document for meeting the KYC requirement for opening a bank account. Recently in September 2013, we have allowed banks to provide e-KYC services based on Aadhaar, thus paving the way for account opening of all the people.

vi) Simplified Branch Authorization

To address the issue of uneven spread of bank branches, in December 2009, domestic scheduled commercial banks were permitted to freely open branches in Tier 3 to Tier 6 centres with population of less than 50,000 under general permission, subject to reporting. In the second quarter review of Monetary Policy, Branch Authorisation has been relaxed to the extent that banks

do not require prior permission to open branches even in tier I centres with population less than 1 lakh, which is subject to reporting.

vii) Opening of branches in unbanked rural centres

To further step up the opening of branches in rural areas, banks have been mandated to open at least 25 per cent of their new branches in unbanked rural centres. In the Annual Policy Statement for 2013-14, banks have been advised to consider frontloading (prioritizing) the opening of branches in unbanked rural centres over a three year cycle co-terminus with their FIPs. This is expected to facilitate the branch expansion in unbanked rural centres. Banks have been advised to open small intermediary brick and mortar structures between the base branch and the unbanked villages. The idea is to create an eco-system for ensuring efficient delivery of services, efficiency in cash management, redressal of customer grievances and closer supervision of BC operations.

In January 2006, the Reserve Bank permitted banks to utilise the services of intermediaries in providing banking services through the use of business facilitators and business correspondents. The BC model allows banks to do ‘cash in - cash out’ transactions at a location much closer to the rural population, thus addressing the last mile problem.

viii) Roadmap for providing Banking Services in unbanked villages with population more than 2000

With financial inclusion gaining increasing recognition as a business opportunity and with all banks geared to increase presence, a phase-wise approach was adopted to provide banking services in all unbanked villages in the country. On completion of the first phase where nearly 74000 villages with population more than 2000 were provided with a banking outlet, and in the second phase where the remaining unbanked villages, numbering close to 4,90,000, are identified in villages less than 2000 population and allocated to banks, for opening of banking outlets by March 2016.

ix) Direct Benefit Transfer

The introduction of direct benefit transfer validating identity through Aadhaar Card will facilitate delivery of social welfare benefits by direct credit to the bank accounts of beneficiaries. Government proposes to route all social security payments through the banking network using the Aadhaar based platform. In order to ensure smooth roll out of the Government's Direct Benefit Transfer (DBT) initiative, banks have been advised to open accounts of all eligible individuals in camp mode with the support of local Government authorities, seed the existing and new accounts with Aadhaar numbers and put in place an effective mechanism to monitor and review the progress in implementation of DBT.

x) Financial Literacy

Financial Literacy is an important adjunct for promoting financial inclusion, an integrated approach is adopted, wherein our efforts towards Financial Inclusion and Financial Literacy go hand in hand. Through Financial literacy and education, information on the general banking concepts is disseminated to diverse target groups, including school and college students, women, rural and urban poor, pensioners and senior citizens to enable them to make informed financial decisions. To ensure that the initiatives on the supply side are supported by initiatives on the demand side, nearly 800 financial literacy centres are set up by banks. In addition to this, the infrastructure created at the state level is leveraged, comprising of State Level Bankers Committee (SLBC) at the Apex which is ably supported by the Lead District Managers (LDMs) at the District level. A mass scale Financial Literacy Program is designed with an objective to integrate the financially excluded population with low level of income and low literacy level with the formal financial system. Financial Literacy Centres organize Outdoor Literacy camps which are spread over a period of three months and delivered in three phases wherein along with creating awareness, accounts are also opened in the Literacy camps. The program has been received well on the ground as an integrated approach of financial inclusion through creating awareness and providing access simultaneously.

xi) Financial Inclusion Plan of Banks

Banks are encouraged to adopt a structured and planned approach to financial inclusion with commitment at the highest levels, through preparation of Board approved Financial Inclusion Plans (FIPs). The first phase of FIPs was implemented over the period 2010-2013. The Reserve Bank has used the FIPs to gauge the performance of banks under their FI initiatives. Thus a structured and comprehensive monitoring mechanism is put in place for evaluating banks' performance vis-à-vis their targets. To ensure support of the Top Management of the Bank to the Financial Inclusion process and to ensure accountability of the senior functionaries of the bank, one on one annual review meetings, chaired by Deputy Governor, Dr. Chakrabarty are held with CMDs/CEOs of banks. A snapshot of the progress made by banks under the 3 year Financial Inclusion Plan (April 10 - March 13) for key parameters during the three year period indicates that banking outlets increased to nearly 2,68,000 banking as on March 13 as against 67,694 banking outlets in villages in March 2010. 7400 rural branches have been opened during this period of 3 years. Nearly 109 million Basic Savings Bank Deposit Accounts (BSBDAs) have been added taking the total no of BSBDAs to 182 million. Share of ICT based accounts have increased substantially - Percentage of ICT accounts to total BSBDAs has increased from 25 percent in March 10 to 45 percent in March 13. About 4904 lakh transactions have been carried out in ICT based accounts through BCs during the three year period.

After completion of the first plan period, it is realized that there is a Access Usage conundrum a large banking network has been created along with the opening of large number of bank accounts. However, it is observed that simply creating the banking infrastructure and opening bank accounts will not fulfill our objectives of achieving total Financial Inclusion. To take the process forward, banks have been advised to draw up fresh three year Financial Inclusion Plans for the period 2013-16. To ensure involvement of all the stake holders in the FI efforts and to ensure uniformity in the reporting structure under the Financial Inclusion Plan, banks have to ensure that the FIPs prepared by them are disaggregated and percolated down upto the branch level. The focus under the

new plan is to ensure that the large banking network created is utilized for extending other products viz. credit products, which will help making the business more viable for banks. This would also ensure that the large number of accounts opened results in an equally large volume of transactions taking place and people reap the benefits of getting linked to the formal financial institutions.

xii) Robust Institutional Mechanism

Over the years one of the major achievements and strength has been the creation of a robust institutional mechanism which supports the roll out of banking services across the country. The Financial Stability and Development Council (FSDC), headed by the Finance Minister, has been set up. There is a Sub-Group of the FSDC headed by the Governor, RBI and within that a Technical Group, headed by Deputy Governor, Dr K.C.Chakrabarty, exclusively mandated to address issues related to financial inclusion and financial literacy. In order to measure the performance of banks and to continuously review the various models adopted under Financial Inclusion, Reserve Bank of India has constituted a Financial Inclusion Advisory Committee (FIAC), headed by a Deputy Governor, Dr K.C. Chakrabarty.

xiii) Road Ahead Extending the frontiers of the formal financial system

For attaining the inclusive growth there is requirement of broadening and deepening the reach of banking. A wider distribution and access of financial services help both consumers and producers increasing welfare and productivity. Such access is especially powerful for the poor as it provides them opportunities to build savings, make investments, avail credit and more important, insure themselves against income shocks and emergencies. As the real economy is dynamic, it is imperative that the banking system is flexible and competitive to cope with multiple objectives and demands made on it by various constituents of the economy.

RBI Strategies for Financial Inclusion

The strategies that need to be adopted for financial inclusion are as follows:

i) Policy measures

Financial regulators (RBI, SEBI and IRDA) and the Government of India have prescribed certain policies to improve the level of financial inclusion. A prudent policy must ensure the safety of depositors' funds, provide stability to the financial system and achieve universal access to financial services through synchronised efforts of the various stakeholders involved. Performance audit of banks should be conducted to measure the outreach of their target clientele and the financial inclusion targets achieved.

ii) Making financial services simple, hassle-free and affordable

Financing groups like self help groups or joint liability groups act as substitutes for collateral requirements, while providing social security and reducing transaction costs. Simplification of the lending procedures and lending at reasonable rates of interest can improve financial access further. The Government of India and the RBI have to ensure that the targets under the Differential Rate of Interest (DRI) scheme, which provides credit at 4 per cent interest to a targeted segment of the population, are achieved by the banks. Adoption of villages by banks and utilising the services of farmers' clubs, non-governmental organisations, post offices, business facilitators and business correspondents also help to increase financial inclusion.

ii) Creating a conducive climate for lending

Quality and reliable credit information has to be provided to potential borrowers through the establishment of Rural Credit Information Bureaus. A dedicated legal structure on the lines of the Debt Recovery Tribunal (DRT) should be set up for the recovery of rural loans and for a transparent method to write off the dues of deserving or genuinely distressed borrowers. Risk mitigation measures like the National Agriculture Risk Fund would provide relief to small and marginal farmers in times of calamities. The cooperative credit structure with its

grass-root presence and vast outreach should be wedded to the operational structure of commercial banks. Infrastructure projects pertaining to irrigation, connectivity and power should be taken up on a large scale to increase the credit-worthiness of individuals. Farmers clubs, training schools, agri-clinics and agri-business centres can effectively impart financial literacy to farmers.

iv) Use of innovative products

Innovative products are to be used to suit the rural for production of rice or wheat. As 90 per cent of the income of a below poverty-line (BPL) household in India is spent on food, PDS empowers the families to invest their income on other socially beneficial activities like education and health, enhancing income and savings of rural households and strengthening the rural economy.