

*Financial Consumer (Depositor) Protection – Reflections on Some Lingering Questions**

R. Gandhi

At the outset, let me express my pleasure at being here today with you on the occasion of the M R Pai Memorial Lecture; it is my proud honour to have presented the Eleventh M R Pai Memorial award to Madam Smt. K J Udeshi, former Deputy Governor, Reserve Bank and former Chairperson, Banking Codes and Standards Board of India (BCSBI). It is normal for teachers to be presenting awards and prizes to their students and wards; but it is a strange thing for a student to present an award to his teacher. The M R Pai Foundation has just caused that. As young boys and girls, I am sure, many of you, like me, would have day dreamed to present awards and prizes to our teachers. Today, thanks to the M R Pai Foundation, my such daydream has become a reality. Smt Udeshi has been a mentor to me and many more in the Reserve Bank. With her charming disposition and dedication, her staunch adherence to principles and high values and varied knowledge and expertise, she had been a well-respected coach and mentor; and also a strict disciplinarian. Having been a sports person, she knew the value of playing by rules and importance of fair play. That definitely helped her in being a strict disciplinarian when she was in the Reserve Bank and also during her tenure as the first Chair-person of the BCSBI. I am very grateful to you, Madam, for giving me this privilege to honour you with the M R Pai Memorial Award.

2. As is well known, Shri M R Pai was a multi-faceted personality, but his greatest contribution lay in starting

the consumer movement in India. He was active in all areas, and confronted monopolistic giants like the telephone services, the Indian Airlines, and more particularly the banks, earning the title of Champion of the Consumer. Consumer protection and consumer activism has come a long way since those times. The best example of this is in what the Financial Sector Legislative Reforms Commission (FSLRC) has said in their Report in 2013.

'Consumer protection: A prime motivation of all financial regulation is to protect consumers. The relationship between financial firms and their customers is one where, many times, the outcomes may harm customers. These problems are not sporadic or accidental; but are often rooted in basic problems of information and incentives and will not be alleviated through financial literacy campaigns. The central purpose of financial regulation is to intervene in the relationship between financial firms and their customers, and address market failures. This requires a comprehensive consumer protection framework that covers both the problem of prevention (interventions that induce financial firms towards fair play) and cure (addressing consumer grievances)'.

3. I am sure this is music for the great soul of Shri Pai. I will be discussing the essential elements of, and the need for consumer protection, as well as initiatives taken both globally and in India with specific reference to the financial sector.

Consumer protection – Role of the Reserve Bank

4. Protection of the interests of the depositors has been one of the mandates of the Reserve Bank. The Banking Regulations Act 1949 is replete with the phrases like 'in the interests of depositors' wherever it entrusts powers to the Reserve Bank; be it granting of a banking license or cancellation thereof, giving directions on advances or on any banking matter, applying for suspension, winding up, or amalgamation of banks, approving appointment of CEOs or additional

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directors, removal of CEOs, all these are to be exercised keeping, among other things, the depositors interests in view. But the services provided by the banking sector today are much more than only deposit services. This rapid increase in the nature of financial services has highlighted the need for robust regulation as well as consumer education to protect and empower consumers. The need to extend provision of banking services to underserved sections of the population whose financial literacy is low, combined with the growing complexity of financial products and the use of technology can increase the risk of mis-selling. Financial consumer protection should be reinforced and integrated with other financial inclusion and financial education policies. If such protection is absent, the benefits to economic growth of expanded financial inclusion may be severely undermined. Financial consumer protection also contributes to strengthening financial stability. Taking these factors into account, the Reserve Bank has recently articulated its Core Purpose, Values and Vision as its commitment to the Nation to include regulating markets and institutions under its ambit to ensure financial system stability and consumer protection.

5. Apart from the Reserve Bank, the Government of India has also been concerned with financial consumer protection. The Financial Sector Legislative Reforms Commission (FSLRC), about which I had referred to earlier, was constituted by the Ministry of Finance in March 2011, and was asked to comprehensively review and redraw the legislations governing India's financial system. In its report submitted to the Ministry of Finance in March 2013, containing a draft Indian Financial Code to replace the bulk of the existing financial laws, consumer protection was also highlighted.

6. The work of the Commission in the field of consumer protection marks a watershed compared with traditional approaches in Indian financial law. It marks a break with the tradition of *caveat emptor*, the 'buyers beware' concept, and moves towards a position where a significant burden of consumer protection is placed

upon financial firms. The draft Code first establishes certain basic rights for all financial consumers. In addition, the Code defines what is a unsophisticated consumer, and an additional set of protections are defined for these consumers. The proposed basic protections are:

- a. Financial service providers must act with professional diligence;
- b. Protection against unfair contract terms;
- c. Protection against unfair conduct;
- d. Protection of personal information;
- e. Requirement of fair disclosure;
- f. Redress of complaints by financial service providers.

7. In addition, unsophisticated consumers will have three additional protections:

- a. The right to receive suitable advice;
- b. Protection from conflicts of interest of advisors;
- c. Access to the redress agency for redress of grievances.

8. The regulator will be given an enumerated set of powers through which it must implement these protections. Alongside these objectives and powers, the regulator will also be given a set of principles that guide the use of the powers.

9. The Reserve Bank has welcomed this suggested approach to consumer protection. The draft IFC is currently under examination.

Consumer protection – What does it imply and how will it help?

10. Financial consumer protection sets clear rules of conduct for financial firms regarding their retail customers. It aims to ensure that consumers: (1) receive information to allow them to make informed decisions,

(2) are not subject to unfair or deceptive practices, and (3) have access to recourse mechanisms to resolve disputes. Complementary financial literacy initiatives are aimed at giving consumers the knowledge and skills to understand the risks and rewards of using financial products and services—and their legal rights and obligations in using them. Clear rules of conduct for financial institutions, combined with programs of financial education for consumers, will increase consumer trust in financial markets and will support the development of these markets¹.

International initiatives regarding consumer protection – initiatives by International organisations

11. Globally, several initiatives have been taken for consumer protection by both the international standard setting bodies and the regulators. Regarding initiatives taken by standard setting bodies, the G20 requested the OECD/FSB and others to articulate principles on Financial Consumer Protection. These broadly state that financial consumer protection should be an integral part of the legal, regulatory and supervisory framework and there should be equitable and fair treatment of consumers with special attention dedicated to the needs of vulnerable groups. It should include access to adequate complaints handling and redress mechanisms that are accessible, affordable, independent, fair, accountable, timely and efficient. The G20/OECD Task Force on Financial Consumer Protection is currently focused on supporting the implementation of the High-level Principles. The OECD is working on how to enhance financial consumer protection, which includes determining what is required to help consumers gain the confidence, knowledge, information, security and choices they need to enable them to fully participate in financial markets. In 2011, the Financial Stability Board published its report on Consumer Finance Protection with particular focus on credit.

¹ Good Practices for financial consumers World Bank June 2012

12. Consumers International (CI) is a world federation of consumer groups. Recently, CI conducted a global survey of 80 member jurisdictions to assess the state of consumer protection across the world. Key findings include:

- Since 2012, Members felt the top three advances they had witnessed in consumer protection were from: new legislation, consumer representation and regulation and enforcement. Increasing consumers' awareness of their rights was also an important factor.
- Members felt that the three main factors that contribute to consumer detriment are: economic and development challenges, lack of regulation and enforcement; and poor quality products and services.

Financial Consumer Protection

13. Various national initiatives:

- a. In USA, the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (Dodd-Frank Act) established the Consumer Financial Protection Bureau (CFPB) to protect consumers by carrying out federal consumer financial laws. The CFPB is authorised to exercise its authority to ensure that: (1) Consumers are provided with timely and understandable information to make responsible decisions about transactions involving consumer financial products and services; (2) Consumers are protected from unfair, deceptive, or abusive acts and practices and from discrimination; (3) Outdated, unnecessary, or unduly burdensome regulations concerning consumer financial products and services are regularly identified and addressed in order to reduce unwarranted regulatory burdens; (4) Federal consumer financial law is enforced consistently, without regard to (service providers') status as depository institutions,

- in order to promote fair competition; and (5) Markets for consumer financial products and services operate transparently and efficiently to facilitate access and innovation.
- b. In UK, the Financial Services Act of 2012 set up the Financial Conduct Authority (FCA) which is responsible for regulating the consumer credit industry from 1 April 2014, taking over the role from the Office of Fair Trading. The FCA supervises banks to ensure they treat customers fairly, and encourages innovation and healthy competition. The authority has significant powers, including the power to regulate conduct related to the marketing of financial products. It is able to specify minimum standards and to place requirements on products. In addition, the FCA is able to ban financial products for up to a year while considering an indefinite ban; it will have the power to instruct firms to immediately retract or modify promotions which it finds to be misleading, and to publish such decisions.
 - c. In the European Union, the European Banking Authority (EBA) promotes a transparent, simple and fair internal market for consumers in financial products and services. The EBA seeks to foster consumer protection in financial services across the EU by identifying and addressing detriments consumers may experience, or are at risk of experiencing, in their dealings with financial firms. The role and tasks of the EBA related to consumer protection and financial activities include: collecting, analysing and reporting on consumer trends in the EU; reviewing and co-ordinating financial literacy and education initiatives; developing training standards for the industry; contributing to the development of common disclosure rules; monitoring existing and new financial activities; issuing warnings if a financial activity poses a serious threat to the EBA's objectives as set out in its funding Regulation; and temporarily prohibiting or restraining certain financial activities, provided certain conditions are met. The market is governed by the various directives issued by the EU such as the Directives on Consumer Credit.
 - d. In Hong Kong, the industry-established Code of Banking Practice (CoBP) promotes good banking practices by setting out the minimum standards which financial institutions should follow in their dealings with customers. The Code is a non-statutory one issued by the financial industry associations for voluntary compliance by financial institutions. The Hong Kong Monetary Authority (HKMA) expects financial institutions in Hong Kong to comply with the CoBP and will monitor compliance as part of its regular supervision. There are also examples of international voluntary codes.
- Consumer Protection in India – Initiatives by the Reserve Bank**
14. Consumer protection has been an ongoing effort of the Reserve Bank. For greater effectiveness and a more focused approach, several committees were appointed on aspects of customer service in banks from time to time, including the Talwar Committee (1975), the Goiporia Committee (1990), the Tarapore Committee (2004), the Sadasivan Working Group (2006), and the Damodaran Committee on Customer Service (2010). The importance of consumer protection was also highlighted in the Committee on Financial Sector Reform chaired by Dr Raghuram G. Rajan. The RBI had set up the Banking Ombudsman Scheme to act as a visible and credible dispute resolution agency for common persons utilising banking services and to ensure redress of grievances of users of banking

services in an inexpensive, expeditious and fair manner that provides impetus to improve customer services in the banking sector on a continuous basis.

Some recent initiatives by the Reserve Bank

15. Let me now detail some recent initiatives by the Reserve Bank regarding consumer protection:

- a) Most important perhaps was the release of a Charter of Customer Rights, which enshrined broad, overarching principles for protection of bank customers and enunciates the 'five' basic rights of bank customers. These are: (i) Right to Fair Treatment; (ii) Right to Transparency; Fair and Honest Dealing; (iii) Right to Suitability; (iv) Right to Privacy; and (v) Right to Grievance Redress and Compensation. The Reserve Bank also advised the Indian Banks' Association (IBA) and the Banking Codes and Standards Board of India (BCSBI) to formulate a 'Model Customer Rights Policy' encapsulating the principles enshrined in the Charter. Initially, all the scheduled commercial banks, regional rural banks and urban co-operative banks are expected to prepare their own Board approved policy incorporating the five basic rights of the Charter which, among other things, would contain a monitoring and oversight mechanism for ensuring adherence.
- b) The Reserve Bank of India undertook several measures on KYC, including releasing a note along with a poster and a booklet comprising a few common questions relating to Know Your Customer (KYC) norms for opening bank accounts. The objective of this is to bring awareness among the general public about the KYC simplification measures taken by the Reserve Bank in the recent times with a view to helping the common man in opening bank accounts.
- c) The measures taken for simplification of KYC include prescribing a single document for proof of identity and proof of address, removing the requirement for separate proof of address for current address, making KYC a bank process rather than a branch process, relaxing the Officially Valid Documents (OVDs) for low risk customers, increasing the time intervals for periodic updation of KYC for existing low/medium and high risk customers from 5/2/1 years to 10/8/2 years, respectively.
- d) Further, banks need not seek fresh proofs of identity and address at the time of periodic updation, from those customers who are categorised as 'low risk', in case of no change in status with respect to their identities and addresses. A self-certification by the customer to that effect should suffice in such cases. Banks may not insist on physical presence of such low risk customer at the time of periodic updation. Further, if an existing KYC compliant customer of a bank desires to open another account in the same bank, there should be no need for submission of fresh proof of identity and/or proof of address for the purpose. Further, Business Correspondents and Business Facilitators were allowed to act as Customer Service Point (CSP) for e-KYC purpose.
- e) To mitigate the difficulties faced by transgender persons in opening accounts, banks were directed to include 'third gender' in all forms/applications, *etc.* as a valid classification.
- f) Initiatives were taken to further enhance transparency in pricing of credit, based on the recommendations of Working Group on Pricing of Credit. Banks were advised to display on their website *inter alia*, the interest rate range of contracted loans for the past quarter

for different categories of advances granted to individual borrowers along with mean interest rates for such loans; the total fees and charges applicable on various types of loans to individual borrower which should also be disclosed at the time of processing of loan for transparency and comparability and to facilitate informed decision making by customers; Annual Percentage Rate (APR) or such similar other arrangement of representing the total cost of credit on a loan to an individual borrower so as to allow customers to compare the costs associated with borrowing across products and/or lenders. Apart from displaying such information, banks were also advised to provide a clear, concise, one page key fact statement/fact sheet, to all individual borrowers at every stage of the loan processing as well as in case of any change in any terms and conditions, which would also be included as a summary box to be displayed in the credit agreement.

- g) While undertaking insurance distribution business, either under the corporate agency or broking model under the relevant IRDA Regulations, banks were directed to put in place a system of assessment of the suitability of products for customers, and classify products into universally suitable products and complex products which necessarily require customer need assessment prior to sale. It should be ensured that there is a standardised system of assessing the needs of the customer and that initiation/transactional and approval processes are segregated. Banks should treat their customers fairly, honestly and transparently, with regard to suitability and appropriateness of the insurance product sold. There should be no violation either of Section 10(1) (ii) of the BR Act, 1949 or the

guidelines issued by IRDA in payment of commissions/brokerage/incentives. This may be factored in while formulating a suitable performance assessment and incentive structure for staff. Further, it must be ensured that no incentive (cash or non-cash) should be paid to the staff engaged in insurance broking/corporate agency services by the insurance company. The bank should not follow any restrictive practices of forcing a customer to either opt for products of a specific insurance company or link sale of such products to any banking product. It should be prominently stated in all publicity material distributed by the bank that the purchase by a bank's customer of any insurance products is purely voluntary, and is not linked to avilment of any other facility from the bank. Further, the details of fees/brokerage received in respect of insurance broking/agency business undertaken by them should be disclosed in the 'Notes to Accounts' to their Balance Sheet. A robust internal grievance redressal mechanism should be put in place along with a Board approved customer compensation policy for resolving issues related to services offered. It must also ensure that the insurance companies whose products are being sold have robust customer grievance redressal arrangements in place. Further, the bank must facilitate the redressal of grievances of the customer.

- h) To encourage the usage of credit and debit cards, the Reserve Bank has issued various instructions on security of card transactions and risk mitigation measures, including directions on online alerts as well as on additional factor of authentication which have significantly increased customer confidence in using cards. Some initiatives taken recently

are as under:

- To avoid inconvenience, the requirement of Additional Factor of Authentication for small value card present transactions was relaxed for customers making small value payments on contactless cards upto a maximum value of ₹2,000/- per transaction subject to certain conditions.
 - Banks were also advised in the interest of customer awareness and protection to clearly explain to customers about the technology, its use, and risks while issuing such contact less cards; indicate the maximum liability devolving on the customer, if any, at the time of issuance of such cards along with the responsibility of the customer to report the loss of such cards to the bank; and to put in place robust mechanism for seamless reporting of lost/stolen cards, which can be accessed through multiple channels.
 - To further put in place risk mitigation measures for customers using various types of cards, banks are advised that with effect from February 1, 2016 all new cards issued – debit and credit, domestic and international – by banks shall be EMV chip and pin based cards.
- i) To alleviate the hardships faced by pensioners who are deprived of regular pension payments in case of misplacement of life certificates, all agency banks handling government pension payments were advised to issue a duly signed acknowledgement to pensioners on receipt of the life certificate submitted in physical form. Banks were also advised to promote the use of digital life certificates among pensioners, which would eliminate the need for physical presence at branches and issue of acknowledgement.
- j) To ensure transparency in the promotional material and to build an enduring relationship with the customers, correlate a product brand name to the name of the entity/company authorised under the PSS Act, all authorised entities issuing payment products were advised that all the information available to the public regarding the product as advertisements, on website, application form, *etc.* should prominently carry the name of the entity/company authorised by RBI under the PSS Act.
- k) Banks were advised to ensure that penal charges on non-maintenance of minimum balances in savings bank accounts are directly proportionate to the extent of shortfall observed, reasonable and not out of line with the average cost of providing the services that the balance in the savings account does not turn into negative balance solely on account of levy of charges for non-maintenance of minimum balance the bank should notify the customer clearly by SMS/email/letter *etc.* that in the event of the minimum balance not being restored in the account within a month from the date of notice, penal charges will be applicable. In case the minimum balance is not restored within a reasonable period, which shall not be less than one month from the date of notice of shortfall, penal charges may be recovered under intimation to the account holder.
- l) To further boost the quality of customer service and to ensure that there is undivided attention to resolution of customer complaints in banks, all public sector banks and select private sector and foreign banks were advised to appoint an internal ombudsman thereby providing a forum available to bank customers for grievance redressal before they approach the Banking Ombudsman.

- m) Apart from issuing instructions to banks, the Reserve Bank also issues cautionaries to members of the general public. We cautioned members of the public against an app (application) doing rounds on WhatsApp purportedly to facilitate checking of balance in customers' bank accounts.
- n) The Reserve Bank of India also cautioned the public against Multi-level Marketing (MLM) activities explaining the functioning of these entities, and advising that falling prey to such offers can result in direct financial losses, apart from the fact that these are cognizable offences under the Prize Chit and Money Circulation (Banning) Act 1978.

Some Lingering Questions

16. I understand that in many a depositor's mind, several questions linger and they eagerly await the regulator's response. As I understand, it is not the answer they seek but the rationale and explanation for our actions and the so called 'inactions'. It is our duty to explain. Let me discuss some of these contemporary issues and questions.

Deposit Insurance

17. First issue that I want to discuss relates to deposit insurance. More specifically, the issue relating to increasing the limit on deposit insurance cover. Deposit Insurance protects depositors against the loss of their deposits in case a deposit institution is not able to meet its obligation to the insured depositors. In India, the commercial banks, Regional Rural Banks (RRBs), Local Area Banks (LABs) and co-operative banks are covered by deposit insurance. There has been a persistent demand from stakeholders and public representatives in the recent past for a hike in deposit insurance cover from the current level of ₹1 lakh. The Deposit Insurance Systems around the world have evolved over time by reforms adopted by various jurisdictions based on experience, international developments, guidance from

supra national bodies like IMF, International Association of Deposit Insurers (IADI) and other environmental changes from time to time. One of the basic principles of deposit insurance is that the deposit insurance system should cover at least 80 per cent of the deposit accounts and 20 – 30 per cent of the total assessable deposits. In India, we have surpassed this norm in a substantial way; as on March 31, 2015, our DICGC's deposit insurance covers as high as 92.3 per cent of the deposit accounts and 31 per cent of the total assessable deposits.

18. Therefore, before deciding on this demand, we have to factor in two major issues *viz.*, the moral hazard issue and the risk based premium issue. Deposit insurance inherently creates a moral hazard *i.e.* the parties to the deposit insurance *viz.*, a bank and its insured depositors get an incentive to take more risk because the costs of risk, in whole or in part, are borne by others, generally a deposit insurance agency, in our case the Deposit Insurance and Credit Guarantee Corporation (DICGC). Most deposit insurance systems initially adopt an *ex-ante* flat-rate premium system because they are relatively simple to design, implement and administer. However, these systems were open to criticism in that they do not reflect the level of risk that banks pose to the deposit insurance system. Flat-rate premium systems have also been viewed as being unfair as 'low-risk' banks are required to pay the same premium as 'higher-risk' banks. With no inbuilt incentive for 'higher risk' banks to improve their risk profile, a flat rate system would accentuate the moral hazard problem. Therefore the primary objective of most differential premium systems has been to provide incentives for banks to avoid excessive risk taking, minimise moral hazard and introduce more fairness into the premium assessment process. Introducing fairness into the system bolsters industry support for deposit insurance. A hike in cover without calibrating the premium rates to the risk profile of the insured banks only exacerbates the moral hazard. Recognising

this, a Committee on Differential Premium System for Banks in India (Chairman: Shri Jasbir Singh) has been constituted by DICGC and has submitted its Report yesterday. We hope that introduction of Risk Based Premium system will make ground for considering raising the insurance cover from the present ceiling of ₹1 lakh.

Structure of Differentiated Banks and Consumer Protection

19. You have noticed that we have recently granted 'in principle' licenses to 11 entities to form Payments Banks in the country; and several of you nurture a vague feeling about how these differentiated banks will subserve consumers interests. I want to explain to you how we have carefully structured the regulatory arrangements of these banks from the perspective of consumer protection.

20. As you will recall, consequent to the discussion paper called 'Banking Structure in India – The Way Forward', brought out by the Reserve Bank in August 2013, and the recommendations of the Committee headed by Shri Nachiket Mor, on Comprehensive Financial Services for Small Businesses and Low-Income Households to look into the issues relating to financial inclusion, in November 2014 we announced our intention to grant licenses to two types of differentiated banks *viz.*, the Payments Banks and the Small Finance Banks.

21. The objective of setting up of Payments Banks will be to further financial inclusion; the strategies will be by providing (i) small savings accounts and (ii) payments/remittance services to migrant labour workforce, low income households, small businesses, other unorganised sector entities and other users. The scope of the activities permitted for the Payment Banks included **a.** Acceptance of demand deposits. Payments Bank will initially be restricted to holding a maximum balance of ₹1 lakh per individual customer, **b.** Issuance of ATM/debit cards **c.** Payments and remittance services

through various channels and some ancillary activities.

22. The deposits collected by them can be only in current or savings account; they cannot accept fixed deposits. The payments banks are prohibited from lending activity. They can deploy the deposits largely in government securities only; a small portion, upto 25 per cent of their deposits, can be held in deposits with other banks.

23. The consumer protection aspects of the design are as follows: The public deposits in the Payments Banks will be covered by the deposit insurance of the DICGC. As the deposit ceiling is ₹1 lakh and the deposit insurance ceiling is also ₹1 lakh, it means that the depositors of the Payments Banks will be fully insured. Actually, there were arguments why Payments Banks should be covered under deposit insurance, when their assets will be fully in high quality liquid assets of government securities and high credit bank accounts. Still, we concluded that such an assurance as deposit insurance is needed for the depositors of payments banks, as the concept is new and depositors will need additional confidence.

24. As the payments bank may operate in remote areas mostly through BCs, ATMs and other networks, the payments bank will be required to have at least 25 per cent of physical access points including BCs in rural centres. Further, we require that a controlling office for a cluster of access points should also be established for control over various outlets and customer grievance redressal. We have insisted that the bank should have a high powered Customer Grievances Cell to handle customer complaints. The payments banks will also come under the purview of the RBI's Banking Ombudsman Scheme, 2006.

25. Now, let me explain the arduous process we adopted for granting 'in principle' licence. I want to emphasise here that granting banking licenses is not a tick box exercise; it needs to be based on the high regulatory comfort about the 'fit and proper' position

of those who will manage the bank. Further, banks are high leverage organisations; and whose moneys they leverage? They actually leverage public deposits. Should we not require highest degree of assurance about the entities with whom public moneys can be entrusted? Will this not actually mean, as we said in our Guidelines, licenses shall be issued on a very selective basis. The licensing authority has to apply its mind and exercise judgment. To do this, we had multiple layers of checks so that the exercise is not arbitrary. Actually, we had five layers of assessment – the first round was the preliminary scrutiny by staff based on eligibility criteria, the second round was a detailed analysis of applications by staff after information collection, including from agencies, the third round by an external committee comprising people with high integrity and expertise, the fourth round by the internal committee, and the fifth round by the Committee of the Central Board of the Reserve Bank. We are convinced that our decision to adopt the cautious approach in licensing of payments banks in the initial years is very prudent and sound.

26. Another care that we have taken is to keep intact the difference between authorising financial service providers versus licensing financial product purveyors. The Financial Service Providers do not deal in the consumers' money; they only render broking, agency and/or advisory services to the consumers. Whereas, the financial product purveyors like the banks, mutual funds and insurance companies, actually receive moneys from the consumers and manage those moneys. This handling of public moneys need a totally different regulatory approach, as compared to handling of servicing the consumers through agency or advisory function. That is why the prudential regulations on the former are much more stringent than the conduct regulations on the latter. It clearly follows that while the liberal authorisations may be possible in the case of service providers, cautious authorisations will be needed in the case of authorisations of banks.

27. We have also announced that we will license Small Finance Banks, another new set of differentiated banks. The objective of setting up of small finance banks, like the payments banks, is also to further financial inclusion; however, it is sought to be achieved through a different set of strategies *viz.*, (i) provision of savings vehicles primarily to unserved and underserved sections of the population, and (ii) supply of credit to small business units; small and marginal farmers; micro and small industries; and other unorganised sector entities, through high technology-low cost operations. The small finance bank, in furtherance of the objectives for which it will be set up, shall primarily undertake basic banking activities of acceptance of deposits and lending to unserved and underserved sections including small business units, small and marginal farmers, micro and small industries and unorganised sector entities. It can also undertake other non-risk sharing simple financial services activities, not requiring any commitment of own fund, such as distribution of mutual fund units, insurance products, pension products, *etc.*

28. The prudential guidelines for the Small Finance banks have been suitably tweaked. It will be required to extend 75 per cent of its Adjusted Net Bank Credit (ANBC) to the sectors eligible for classification as priority sector lending (PSL). The maximum loan size and investment limit exposure to a single and group obligor would be restricted to 10 per cent and 15 per cent of its capital funds, respectively. Further, in order to ensure that the bank extends loans primarily to small borrowers, at least 50 per cent of its loan portfolio should constitute loans and advances of upto ₹25 lakh.

29. Keeping customer protection requirement in view, we have prescribed that the Small Finance Banks should have high powered Customer Grievances Cell to handle customer complaints and the small finance banks will come under the purview of the RBI's Banking Ombudsman Scheme, 2006.

30. We have received 72 applications and are in the final stages of determining who all can be granted licenses. At the cost of repetition, I want to emphasise here also that granting banking licenses is not a tick box exercise; it needs to be based on the high regulatory comfort about the 'fit and proper' position of those who will manage the bank. The Small Finance Banks are also high leverage organisations, and we require highest degree of assurance about the entities with whom public moneys can be entrusted. Therefore, licences shall be issued on a very selective basis only; we will soon announce grant of licenses to the selected applicants.

Market Development and Customer Protection

31. As regulators we often face the dilemma of market development or market innovations versus customer protection. We are still a developing and emerging market; while in several respects we have reached international standards, there are still quite a sizable segments in the financial sector that needs development and innovations. Financial inclusion is a case in point. New ideas need to be encouraged; initial cost which will be typically high needs to be recovered; initial period risks and failures need adequate return and compensation. On the other hand, these compulsions will militate against consumer protection. As regulators, we recognise this dilemma. We did face this dilemma in recent years in the cases of micro finance institutions, the ATMs, credit and debit cards, the electronic fund transfer services like the RTGS and NEFT and even the cash services. We were convinced about the need for expansion of these services and conveniences; we understood the trade-offs between the charges for these services and the consumer interests. Our approach has been a gradual move from facilitating entrenchment of such developments and innovations by ensuring competition and choices for consumers to a fairer treatment of consumers and fair charges.

Life in Low Interest Rate Regime

32. Now, I would like to paint the scenario that will emerge in our country in the next few years and some preparations that all of us as savers should be undertaking. For a very long period, more specifically in our own living memory of the post-Independence era, India had been going through high inflationary period; of course, thankfully, we never had the hyper inflationary periods like in several African or South American countries; but certainly, our experience of inflation was in high single digits to teens and hence inflationary expectations were very well entrenched. Though we did experience low inflationary levels in some periods, we could not sustain it. For yet another time, we are now experiencing low levels of inflation and it is amply clear that this time around we will be able to sustain it for the years to come. Also, the monetary policy framework agreement that we have with the Government, prescribes that the objective of monetary policy will be to maintain the consumer inflation at four, plus or minus two per cent. This gives the necessary assurance and confidence to keep the inflationary expectations at bay. It is heartening to note that influential thinkers now worry about recession.

33. What does this low inflationary period entails for the savers? For one thing, they will realise that the real value of their savings is higher and remains preserved and protected. In periods of low inflation, the real value of money does not change much. However, they will find that the nominal interest rates that they receive will be low, as compared to the interest rates that they enjoyed during the high inflation period. After all, the simple formula for determining interest rate is:

$$\text{Nominal Interest rate} = \\ \text{Real Interest rate} + \text{Rate of Inflation.}$$

34. As the real interest rate in any economy will be more or less constant, the nominal interest rate is directly proportional to rate of inflation. Thus it will rise when rate of inflation increases and fall when the rate of inflation falls.

35. The uninformed may get worried; it may give rise to an illusion – more specifically in the minds of those who live on fixed interest income; as if their income levels have come down. It is not so; actually, their low nominal interest income will now command and fetch better goods and services, as the real value of their saving and incomes have been preserved.

36. As business and consumer confidence will be higher and better during low inflationary levels, savers will have higher appetite for risk taking. This will mean less reliance on pure fixed interest income; before investing, savers will weigh various financial products of capital market for appropriate risk-reward combination. Savers will increasingly need and seek

the services of financial advisers and analysts to help them decide investments. This is the life we must all be prepared for.

Conclusion

37. To conclude, let me once again recall what 'the uncommon common man', Shri M R Pai espoused. In his words 'most Indians are ignorant of their rights and are therefore taken for a ride'. As regulators, we are conscious of this position and that is why we constantly pay our closer attention on financial consumer protection, more specifically the protection of the vulnerable, defenseless retail consumers.

38. Thank you very much for your patient attention.