

**REPORT OF THE WORKING GROUP TO FORMULATE A
SCHEME FOR ENSURING REASONABLENESS OF BANK
CHARGES**



RESERVE BANK OF INDIA

SEPTEMBER 2006



CONTENTS

Letter of transmittal

Acknowledgements

Chapter No.	Particulars	Page Number
	Executive Summary	6
1.	Introduction	24
2.	Enumeration of basic services and the pricing methodology adopted by banks	35
3.	Principles of reasonableness in fixing, changing and notifying service charges	46
4.	Inclusion of the principles in the Fair Practice Code and monitoring compliance to the Code, by BCSBI	62



LETTER OF TRANSMITTAL



Chairman

**Working Group to formulate a Scheme for ensuring
Reasonableness of Bank Charges**

**Reserve Bank of India
Central Office
Mumbai - 400 001**

September 8, 2006

**Smt. Usha Thorat
Deputy Governor
Reserve Bank of India
Mumbai**

Madam,

I have great pleasure in submitting the Report of the Working Group set up to formulate a Scheme for ensuring reasonableness of bank charges. The report includes, *inter-alia*, suggestions for provision of basic banking services to individuals at a reasonable price.

On behalf of the Working Group members and on my own behalf, I thank you for entrusting us with this task.

With regards,

Yours sincerely,

(N. Sadasivan)



**REPORT OF THE WORKING GROUP TO FORMULATE A SCHEME
FOR ENSURING REASONABLENESS OF BANK CHARGES**

Sr.No.	Name	Signature
1	Shri N. Sadasivan, Chairman	
2	Shri S. Divakara, Member	
3	Shri H.N. Sinor, Member	
4	Shri P. Saran, Member	
5	Shri Kaza Sudhakar, Member Secretary	



ACKNOWLEDGEMENTS

The Report of the Working Group for ensuring the reasonableness of bank charges is the result of the sincere efforts of many people and the Working Group conveys its thanks to all of them.

First and foremost, the Working Group wishes to place on record its gratitude to Dr. Y.V. Reddy, Governor, Reserve Bank of India, and Smt. Usha Thorat, Deputy Governor, Reserve Bank of India for entrusting it with the task of addressing the important issue relating to bank service charges.

The Working Group wishes to convey its thanks to the representatives of Consumer Organizations who interacted with it, providing important feedback on the service charges levied by banks. The list of such representatives includes (i) Prof. Manubhai Shah, Chairman Emeritus, Consumer Education and Research Centre, Ahmedabad, (ii) Shri A. Ravat, Hon. Secretary, All India Bank Depositors' Association, Mumbai, (iii) Shri N.L. Rajah, Civic Action Group, Chennai, (iv) Shri P.R. Nagle, Mumbai Grahak Panchayat, (v) Shri Jehangir Gai, Consumer Welfare Association, Mumbai and (vi) Ms. Nupur Anchlia, Consumer Unity and Trust Society, Mumbai.

The Working Group places on record its gratitude to the Ms. Sucheta Dalal and Dr. M.S. Kamath, Columnists and Consumer Activists, and Shri B.M. Bhide, a retired senior banker, for their valuable contribution in the formulation of the Report.

The Working Group acknowledges the assistance offered by the select banks that interacted with RBI and provided with the information on the methodology adopted by them for pricing their services.

The Working Group appreciates and acknowledges the efforts put in by Shri V. Govindaraja, Assistant General Manager, Customer Service Department, Reserve Bank of India in the preparation of the Report. The Working Group also wishes to thank many others in the Reserve Bank, banks and other consumer organizations who have contributed in one way or the other in bringing out this Report.



Executive Summary and Recommendations

Chapter I: Introduction:

Background

1.1. In 1999, the practice of IBA fixing the benchmark service charges on behalf of the member banks was discontinued and the decision to prescribe the service charges was left to the discretion of the Boards of individual banks. Banks were then advised that they should ensure that the charges were reasonable and not out of line with the average cost of providing the services and that the customers with low volume of activities were not penalized. It was expected that, in time, market pressure would force the banks to price their services competitively ensuring services at a fair price.

1.2. However, the Reserve Bank continued to receive representations from the public regarding unreasonable and non-transparent service charges. The plethora of complaints received indicated that the issue of fairness in fixing the service charges by the banks needed to be examined. Accordingly, in order to ensure fair practices in banking services, in terms of the Annual Policy Statement 2006-07, Reserve Bank constituted a Working Group comprising a nominee of the Indian Banks' Association (IBA) and a representative of customers to formulate a scheme for ensuring reasonableness of bank charges, and to incorporate the same in the Fair Practices Code, the compliance of which would be monitored by the Banking Codes and Standards Board of India (BCSBI).

1.3. The Terms of reference of the Working Group are as under:

- a) To enumerate the various basic banking/financial services rendered to individual customers for which the scheme should be applicable.
- b) To study the basis/methodology adopted by banks for fixing the quantum of charges/fees for such services and to arrive at principles for assessing the reasonability of such charges/fees.
- c) To evolve a scheme for ensuring that the basis and the procedure adopted for fixing/changing and notifying service charges are reasonable and fair to the customers.
- d) To suggest suitable additions to the Fair Practices Code in regard to the scheme to be evolved in terms of (c) above.
- e) To suggest measures for monitoring compliance to the relative provisos in the Fair Practices Code by the Banking Codes and Standards Board of India.



1.4. It was observed that, as the scheme is proposed to be incorporated into the Fair Practice Code, which is a voluntary code for the banks, the scheme would be in a form appropriate for voluntary adoption by banks without any regulatory compulsion. It was next observed that though most of the banks may indicate that information relating to cost of services was not readily available with them, for studying the fairness of banking charges the cost would require to be examined with whatever information becomes available from the banks.

1.5. The Working Group decided to bring the issues into sharp focus by restating the terms of reference as follows:

- a) To enumerate the various basic banking and financial services rendered to individual customers for which the principles of fairness should be applicable and to study the methodology in fixing the charges.
- b) To indicate the principles to be adopted for ensuring that the process of fixing, changing and notifying service charges are reasonable.
- c) To suggest suitable additions to the Fair Practices Code in regard to the principles to be evolved in terms of (b) above and to suggest measures for monitoring compliance to the relative provisos in the Fair Practices Code by the Banking Codes and Standards Board of India.

Methodology adopted by the Working Group

1.6. Deliberations were held with several organizations/individuals: select set of banks (a combination of banks from public and private sectors including foreign banks and cooperative sector); representatives of Consumer Organisations; and experts in the area (Ms. Sucheta Dalal and Dr. M.S. Kamath, columnists and consumer activists and Shri B.M. Bhide, a retired senior banker). Additional information was obtained from banks. Several views conveyed by the public to Reserve Bank and the views appearing in articles in newspapers, information from the studies made in India and international best practices were all considered.

Historic perspective of pricing of banks' services:

1.7. From 1994, Indian Banks' Association (IBA) started prescribing the benchmark rates for all the services rendered by banks which were used by banks to price the services. In 1999, as per the recommendations of the Regulations Review Authority (RRA) set up by the Reserve Bank, and since the practice of IBA fixing the benchmark service charges on behalf of member banks was no more consistent with competition, the same was discontinued.

1.8. It was observed that post liberalization, in the initial period the public sector banks continued to price their services as per the IBA benchmark rates with suitable adjustments while the private and foreign banks devised higher charges citing their regular per-employee cost and their costly



technology intensive operations. With the passing of time, the public sector banks had also commenced adopting technology in a big way and in stages, increased their charges.

Studies on the subject and best practices

1.9. The Committee on Procedure and Performance Audit on Public Services had covered several issues relevant to service charges. The Committee had made several recommendations regarding the need for transparency in service charges.

1.10. A study carried out by the central bank of Sweden indicated that it is difficult to establish any relationship between bank services and their charges. In Canada, there is a legislation guaranteeing consumers' access to banking services and access to low-cost accounts. There is a regulation in European Union to protect the consumer by prohibiting institutions from charging more for certain cross-border payments in euro than for corresponding payments in euro transacted within the Member State. Further, the regulation requires institutions to be transparent with their charges for such payments. In UK, the Office of Fair Trading (OFT) has examined the issue of acquirer charges levied for use of ATMs of other banks. Financial Services Authority (FSA), in one of its published articles, listed the following as the principles for considering 'fairness': (i) give the customers what they have paid for, (ii) do not take advantage of the customer, (iii) offer the customer the best product the supplier can, (iv) resolve mistakes as quickly as possible, and (v) show flexibility, empathy and consideration in dealing with customers.

1.11. The guidance available from the various sources was considered to crystallize the approach regarding the question - what constitutes reasonableness in levying charges. It was concluded that the reasonableness or fairness could be defined on the basis of the concepts spelt out by the FSA: banks' charges can be considered as reasonable if, in providing their services to the customers, the banks show consistently flexibility, empathy and consideration and do not take advantage of the customer.

Chapter II: Enumeration of basic services and the pricing methodology adopted by banks

Enumeration of basic services:

2.1. The Consumer Organisations stated the following:

- a. All the services (banking as well as financial) offered by banks have to be brought within the ambit of the Working Group;
- b. Services such as DEMAT facilities also have to be included in the study; and
- c. Banks do not provide certain facilities that can be treated as basic requirements to maintaining an account or provide the same after charging for them.



2.2. The banks suggested that basic banking services to be covered might be restricted to the following three: deposit accounts, remittances and collections, with a cap on the transaction value, and make it applicable to a select target.

2.3. Along with the suggestions above, the items in the list of bank services earlier identified by Reserve Bank for ongoing display in the bank branch premises, were considered.

2.4. The issue next discussed was selection of the parameters by which, out of the whole range of banking and financial services, specific items can be identified as basic services. The issue was examined with reference to (i) categorization of individuals, (ii) the nature of transactions and (iii) the value of transactions (including rupee and foreign exchange transactions).

2.5. As regards the categorization of individuals, it was observed that there were no issues as far as higher-end premium consumers. The affected population only came from the other two layers in the pyramid: common man at the bottom and the middle segment.

2.6. It was felt that any prescription for identification of customers as belonging to a specific category would lead to problems in practice. Therefore, it was concluded that the principles covering the basic charges may include the parameter of certain clearly identifiable category of individuals and it will be left to the discretion of the banks to include any other category.

2.7. After scanning the list of services available to individuals from various banks, in addition to deposits, remittances and collections, it was decided that none of the other services can be considered as basic services.

2.8. The Working Group recommended two broad parameters for identifying the basic banking services:

(A) Nature of transactions:

- a. Banking services that are ordinarily availed by individuals in the middle and lower segments, will be the first parameter. These will comprise services related to deposit/loan accounts, remittance services and collection services.
- b. When the above transactions occur in different delivery channels, for the purpose of pricing, they may be treated on separate footing.

(B) Value of transactions:

Low value of transactions with customers/public upto the ceiling as given below will be the second parameter:

- i. Remittances upto Rs. 10,000/- in each instance.
 - ii. Collections below Rs. 10,000/- in each instance.
- (Foreign exchange transactions valued upto US \$ 500/-).



2.9. Based on the two parameters, the Working Group recommends enumeration of the following as the basic banking services:

Sr.No.	Service
Relating to deposit accounts	
1	Cheque book facility
2	Issue of Pass Book (or Statement) / Issue of Balance Certificate
3	Issue of duplicate pass book or statement
4	ATM cards
5	Debit cards (electronic cheque)
6	Stop Payment
7	Balance enquiry
8	Account closure
9	Cheque Return - Inward (cheque received for payment)
10	Signature verification
Relating to Loan Accounts	
11	No dues certificate
Remittance Facilities (including through other banks) (Rupee or foreign exchange)	
12	Demand Draft – Issue
13	Demand Draft – Cancellation
14	Demand Draft –Revalidation
15	Demand Draft – Duplicate issuance
16	Payment Order – Issue
17	Payment Order- Cancellation
18	Payment Order – Revalidation
19	Payment Order-Duplicate issuance
20	Telegraphic Transfer – Issue
21	Telegraphic Transfer –Cancellation
22	Telegraphic Transfer- Duplicate issuance
23	Payment by Electronic Clearing Services (ECS)
24	Transfer by National Electronic Fund Transfer (NEFT) and Electronic Funds Transfer (EFT).
Collection facilities	
25	Collection of Local Cheques
26	Collection of Outstation Cheques
27	Cheque Return-Outward (cheque deposited for collection)

The above list is compiled only as a guide and the list may not be treated as exhaustive. Banks may, at their discretion, include within the category of basic services such additional services as they consider appropriate.



The pricing methodology adopted by banks

2.10. The Consumer Organisations maintain the view that pricing methodology adopted by the banks is quite opaque.

2.11. Banks submitted information on their pricing methodology in two distinct parts. Information from a first set of banks, from both public and private sector and which are not technology intensive, was that the charges are not fixed on the basis of cost of the services; charges are rather linked to the erstwhile benchmark rates advised by IBA, adjusted to inflation. For some service items, the charges are in line with the charges levied by the peer banks; this includes the charges in the nature of penalty. In certain cases, the charges are cross subsidized i.e. charges for certain segments of customers or types of services are lowered and charges for other customers/accounts/services are increased.

2.12. The second set of banks carry out technology intensive operations and the cost of their services is well recognized by them. As regards pricing the services, one of these banks has explained that the bank does not levy charges on each individual product or service. Products and services are bundled and offered to a customer as a composite offering. The bank recovers the cost of these operations through net interest income. The bank achieves break-even levels through higher average balances in customer accounts which yield healthy interest margins or by imposing charges for keeping inadequate balances. In the case of another bank, whenever it commences a relationship, the bank operates on the basis of relationship value (RV). The balance maintained in savings bank account counts for this RV, along with a range of income generating account balances and transaction values. In the case of a relationship conducted through savings accounts, the RV is fixed much lower than the required break even (BE) level, and for the non-maintenance of the RV, less than the required compensation is collected as a fee. In the banks in the second set, the charges vary also according to the channel of delivery.

2.13. In the case of the second set of banks, there is a large element of linkage between the cost and the service charges, which may hold good for other technologically oriented banks. The Working Group, however, finds that the reasonableness of service charges of banks as a whole cannot be tested on the basis of cost. This is because cost as a methodology is confined only to a small number of banks that do not represent significant share of the banking business.

2.14. It is observed that the methodology adopted by the banks in pricing the service charges is limited to the following: (i) maintaining a link to the IBA benchmark rates, adjusted for inflation, (ii) levying deterrent charges, (iii) matching with what the peer banks are charging (copy-cat approach), (iv) the level of competition (market pressure), (v) the delivery channel involved, and (vi) in some banks, based on the cost of the services. The technology intensive banks are pricing



by combination certain services given along with an account,, by imposing the minimum balance requirement. The income from the account balance covers the cost of account maintenance as well as a set of services which are not specifically charged. According to the banks, the balance fixed and the fees collected for non-maintenance are, at all times, kept well below the break even levels.

2.15. The Working Group acknowledges that its findings on the methodology are clearly incomplete. As only a small number of banks handling a small market share have the information regarding costs and use it, it is not clear to what extent the bank charges now in force are marked up over the cost. The Working Group discussed the issue and recommends to Reserve Bank that suitable steps be taken to determine and evaluate the costs of the banks, for providing the basic services.

Chapter III: Principles of reasonableness in fixing, changing and notifying service charges

Reasonableness in fixing charges

3.1. The Consumer Organisations argued that the liberalization of service charges, by leaving it to the discretion of individual banks to decide on a market determined competitive basis, has not worked in India. They argued that the bank customers are mostly 'captive', as they do not find it easy to change their banks even if they are not comfortable with the services offered by their banks. Consumer Organizations alleged that all bank charges are exorbitant and cited in particular the 'Average Quarterly Balance (AQB)' requirement and the penalties for non-maintenance of the same. Further, some of the charges levied by the banks could be deemed to be 'irrational'. Charges levied for the reason of no transaction in a quarter, collection of loan processing charge even in a case where the loan is not sanctioned and charges levied without any prior notice to the customer are examples of this. These organisations also suggested that Reserve Bank should prescribe benchmark service charge, with an operating band for each of the services. Prescription of a Maximum Service Charge (MSC) for all the bank services, on the lines of the Maximum Retail Price (MRP) in other industries, was also suggested.

3.2. On the other hand, the banks hold the view that the methodology they have adopted for fixing service charges is fair and there is no unreasonable levy on the customer. Their pricing methods such as linking to IBA benchmark, following the market forces, pricing of bundled products etc., are cited in support of their contention. The banks argued that if there is a compulsion to provide certain services at a cheaper price, this can also be achieved through a simple regulation. As an alternative, the proposed scheme on reasonableness of service charges could be made a part of the 'Financial Inclusion' instructions of Reserve Bank, by including fresh guidelines for fixing the service charges. Along with the banks, IBA has expressed similar views on the subject.



3.3. The complaints received at the Banking Ombudsman Offices and Reserve Bank were examined and it was observed that in a number of cases the charges have, in fact, been fixed without proper reason or the charges are not fair. Examples of such charges are: (i) Charge for absence of any transaction in an account in a quarter, (ii) Charges for erroneous transactions, (iii) Charges for unsolicited services, (iv) Charge for balance inquiry, (v) Charge for account closure, (vi) Charge for visit to the branch, (vii) Charges on pension accounts, and (viii) Charge for bookkeeping.

3.4. The rationale in the charges levied by some banks for receiving cash towards deposit into accounts and remittances was examined. The customer grievance in this regard is that handling of cash is an integral part of any bank transaction, especially in the Indian context; cash handling cannot, therefore, be treated as a distinct banking service and subjected to a charge. Though there is strength in this argument, it is observed that cash transactions are costlier to a bank as compared to the transactions booked through cheques or other instruments. A cash intensive transaction can, therefore, be considered as a service and a charge can be levied for this. However, in the case of basic services and deposits into savings accounts, since these transactions are not cash intensive, there is no question of any charge for handling cash for these.

3.5. For certain items of service the charges are levied as per the value of the transaction (ad-valorem) for the reason that with increase in value, the operational risk involved goes up. However, it was decided that in these cases, above a certain value the charges cannot rise proportionately and, therefore, ad valorem charges should be limited by a cap.

3.6. It is observed that the minimum balance requirement for an account, especially in technology intensive banks, is a pricing mechanism for a bundled product – account and services, aimed at recovering; (i) the base cost of acquiring an account and conducting core account maintenance tasks, and (ii) the cost of a set of services given to the customer without any charge. The banks that use the methodology assert that this pricing system is not unreasonable. The Working Group is, however, of the view that the methodology carries clearly some negative features. The methodology creates a barrier to a customer with a limited need: when a customer wants only a savings account and not any other service, he will have to pay a price for both the accounts and the services or move onto another bank which offers only the account.

3.7. It is recognized that the system of offering bundled products flows from the fact that the concerned banks conduct their operations from a high technology platform. Nevertheless, the methodology evidently carries an element of financial exclusion, though not by design. In so far as the basic services are concerned the banks' objective should be that these are made available to the users at reasonable prices/charges and towards this, the basic services should be delivered outside the scope of the bundled products. If this is done, the methodology will not be an issue for



basic services. The issue in this regard would then relate to the manner in which the banks conduct the banking business that they are authorized to undertake.

3.8. On the question - which process would ensure that the basic services to individuals are charged on reasonable terms, it is recognized that the innate nature of the basic services - low value and low volume, calls for a positive bias in the pricing: a bias involving only a concession and not a full waiver and with an element of cross subsidy where required. With this approach, it is recommended that banks should levy charges for basic services to individuals at the rates which are lower than the rates applied when the same services are given to non-individual entities.

3.9. Even amongst individuals, to some identifiable as a category, the basic services may be given with a larger concession. Individuals in rural areas, pensioners and senior citizens will belong to this group.

3.10. It was examined whether collection of loan processing charge even in a case where the loan is not sanctioned, can be termed as unreasonable or unfair. The banks have advanced the argument that the processing fee is for recouping the costs they incur for appraising the loan request and deciding whether or not to lend. The cost is incurred to the same extent irrespective of sanction or rejection. Therefore, recovery of fee in a rejection case is not unreasonable. The Working Group finds that while the loan applicant in a rejection sees the charge as unjust, the banks' explanation in this regard is acceptable. The Working Group suggests that the banks should disclose to loan applicants before hand that the processing fee is due even if the loan is rejected.

3.11. As regards the suggestion that benchmark service charges be prescribed for each of the services, it is observed that the benchmarking is not feasible as the banks render a wide range of services; the costs for the services may vary from bank to bank and the system of determination of cost for each service is not in place.

3.12. As regards fixing a Maximum Service Charge (MSC) under the MRP system, the system is mainly used for public utilities or essential commodities. The price administration adopted for these would not be applicable to bank services given the present stage of evolution of the economy, and liberalization of regulation. Further, there is no evidence to suggest that large-scale damage has been done due to the freedom given to the banks.

3.13. As regards the argument that the bank customers in India are mostly 'captive', it was decided that, while lack of choice is true in single bank locations, in all other locations the customers normally have the choice to pick a different bank if they want. It was also felt that, in any case, lack of mobility will not be an issue for the basic services, when the recommendations of the Working Group are implemented.



3.14. The suggestion that the intended purpose of the Working Group could be achieved through a simple regulation is not acceptable. This is because the reference to the Working Group had clearly enunciated that the measures for ensuring reasonableness of bank charges would be included in the Fair Practices Code of BCSBI.

3.15. The suggestion that the fair pricing scheme be spelt out as an extension of the Financial Inclusion scheme is also not acceptable for the following reasons: RBI instructions on the subject had only introduced the concept of financial inclusion and banks' voluntary adoption of the concept is expected. All aspects of the methodology for financial inclusion are left to the discretion of the banks. Since this has led to varied services being offered with the 'no frills' account, the 'no frills' approach will not lend to adoption of uniform principles covering service charges. Also the target group for the 'no frills' account is smaller than the target group which will avail the basic services.

Reasonableness in notifying the changes in service charges

3.16. The need for the customers to be fully aware of the service charges before they actually avail the services is widely accepted. According to the FSA, 'exhibiting clarity in all customer dealings' is one of the principles of fair practice. The Committee on Procedure and Performance Audit on Public Services had also given recommendations such as disclosing the service charges upfront, maintaining total transparency on the charges, informing any changes in the charges to depositors at least a month in advance, and informing the customers at the time of opening the accounts, the requirement of maintaining minimum balance and the connected charges. Also, various central banks, including Reserve Bank, have advised the banks as regards display of charges on their websites.

3.17. It is imperative that the customers are made aware of the service charges upfront and the changes in service charges are implemented only with the prior notice to and consent of the customers. For changes made in the charges, the notice to customers need not necessarily be to each individual customer, as it would be costly and impractical. Consent for the changes may be taken by giving the customers adequate time, after the notice, to opt out; consent in any other method will again be costly and impractical. The Working Group finds that for proper disclosure, the banks would do well to fully recognize the following needs of the customers and take steps to ensure that these are met:

(A) Disclosure of the service charges:

- ❖ The need to carry out a one-time publicity of the service charges so that all customers are made aware of the charges.
- ❖ The need for communicating the service charges to the new customers at the time of beginning of the relationship.



- ❖ The need for displaying the charges in the notice board at the branch and advertising in newspapers, so as to disseminate information to the customers/public, in addition to display on the website as per Reserve Bank instructions.
- ❖ The need for using appropriate method for communicating the service charges to customers of different profiles.

(B) Notifying the changes effected in the charges:

- ❑ The need for the banks to declare upfront at what frequency the charges would be changed and to adhere to this.
- ❑ The need for effecting any change in the charges only with prior notification to the customers of at least 30 days.
- ❑ The need for providing an option to the customer to accept the change and if not accepted, to exit from the relationship with the bank within the above 30 days without any cost.
- ❑ The need for advertising the changes in the newspapers.
- ❑ The need for including the information regarding the changes in any communication sent to the customer.
- ❑ The need for displaying prominently in the notice board as well as the website all the changes effected in the preceding 30 days.

Process of collection of service charges:

3.18. In some cases, banks adopt deficient / capricious methods for recovering the service charges. There are instances where the balances in accounts are fully wiped out by successive recoveries of penalties for non-maintenance of minimum balance. In some cases, the shortfall in the account balance is caused by a transaction, including a debit for a charge that the bank itself has originated. Banks may ensure that each such transaction and the resultant balance are advised to the customer so that the customer may remedy the shortfall. Only thereafter banks may consider recovering the penalty for the shortfall. In the case of customers, who fail to respond, banks may take appropriate action with due notice to the customer. In general, banks should ensure that a fair procedure is followed for the recovery of service charges and for informing customers about recovery of the charges.

3.19. The Working Group suggests that for ensuring reasonableness in fixing and communicating the service charges, the following principles be adopted by banks:

- a) For basic services to individuals, the banks will levy charges at the rates that are lower than the rates applied when the same services are given to non-individual entities.
- b) For basic services rendered to special category of individuals, banks will levy charges on more liberal terms than the terms on which the charges are levied to other individuals.



- c) For the basic services rendered to individuals banks will levy charges only if the charges are just and supported by reason.
- d) For the basic services to individuals, the banks will levy service charges ad-valorem only to cover any incremental cost and subject to a cap.
- e) Banks will provide to the individual customers upfront and in a timely manner, complete information on the charges applicable to all basic services.
- f) Banks will provide advance information to the individual customers about the proposed changes in the service charges.
- g) Banks will collect for services given to individuals only such charges which have been notified to and agreed to by the customer.
- h) Banks will inform the customers in an appropriate manner recovery of service charges from the account or the transaction.
- i) Banks will without fail inform the customers in all cases when a transaction initiated by the bank itself results in or likely to lead to a shortfall in the minimum balance required to be maintained.

3.20. Certain observations on related issues:

- ❑ Deficient grievance redressal procedures at banks lead to complaints being escalated to the Banking Ombudsman/Reserve Bank.
- ❑ There is a need for giving full-fledged information on bank products and disclosure of their implications so that the customers can make an informed judgment about their choice of products.

Chapter IV: Inclusion of the Principles of reasonableness in the Fair Practice Code and monitoring compliance to the Code by BCSBI

4.1. Since July 2006, a set of fair practices, styled the 'Code of Bank's Commitments to Customers' stands as a code enunciated by the Banking Codes and Standards Board of India (BCSBI). The banks, which are the members of the BCSBI, are required to comply with the Code, with the compliance being monitored by the BCSBI. The Code sets minimum standards of banking practices for banks to follow when they are dealing with individual customers. Procedures adopted by the BCSBI for monitoring compliance with the Code are indicated as 'The Banking Code Rules'. Any failure to comply with commitments under the Code by a member bank shall constitute a breach, making the member liable to the Board's disciplinary action. The Board can conduct any investigation into an alleged breach and impose various sanctions.

4.2. The Code carries a series of commitments of the banks, spelt out under different sections. The Working Group recommends that the services listed in this report as basic services should find place in the Code. Following this, the principles covering reasonableness in fixing, changing and notifying service charges by banks may be included in the Code under the sections 'Products and Services' and 'Information'. The principles recommended by the Working Group are suitably



rephrased for the purpose of inclusion in the Code, in line with the commitments already stated in the Code.

4.3. In terms of the Rules, BCSBI is slated to ensure compliance of its member banks with all the commitments enshrined in the Code. BCSBI's monitoring system already in place includes collecting required information from the member banks including details of breaches of the Code and remedial actions taken thereon. According to the Working Group, monitoring on the lines described in the Rules will be adequate to verify ongoing compliance with the Code, including adherence to the principles for ensuring reasonableness.

4.4. As regards information concerning service charges that BCSBI may seek from the member banks, it is suggested that this may include the following items:

- (a) Details of complaints relating to:
 - (i) the rate and amount of service charges
 - (ii) the method of recovery of service charges
 - (iii) non-disclosure of service charges

The details may be taken from the complaints that have been received by the banks, as also those received by RBI and the Banking Ombudsman.

(b) Information/reason which supports the fixing of the service charges in a bank or changes made therein.

(c) The manner in which the service charges or changes therein have been notified to the customers/public.

The Working Group also suggests that BCSBI may track, from time to time, the changes in the levels of the service charges and on a comparative basis, to identify any abnormal increases. In addition to the information gathered from banks, BCSBI may look to feedback from Consumer Organisations and customer survey results to identify areas of significant non-compliances with the Code.



REPORT OF THE WORKING GROUP TO FORMULATE A SCHEME FOR ENSURING REASONABLENESS OF BANK CHARGES

CHAPTER I

Introduction

1.1. Background:

1.1.1. Levy of service charges by the banking industry is an area that is receiving considerable attention of customers and the regulator. From 1994 to 1999, Indian Banks' Association (IBA) communicated the benchmark service charges to the member banks, based on which each bank was deciding the charges. The practice of IBA fixing the benchmark service charges on behalf of the member banks was, however, discontinued subsequently and the decision to prescribe the service charges was left to the discretion of the Boards of individual banks (Annex 1). Banks were simultaneously advised that while fixing the service charges, they should ensure that charges were reasonable and not out of line with the average cost of providing these services and that the customers with low volume of activities were not penalized.

1.1.2. The above decision was arrived with the rationale that competition would force the banks to price their services competitively ensuring that the customer would obtain the services at a fair price; competition improves efficiencies and brings down tariffs. Further, though Reserve Bank had left the pricing of the services to the discretion of the banks, it was expected that in practice the prices would not get to be unreasonable.

1.1.3. However, Reserve Bank continued to receive representations from the public alleging unreasonable and non-transparent service charges being levied by banks, indicating that the existing institutional mechanism in this regard may not be adequate. Further, various complaints were received from the customers at Banking Ombudsman Offices, Reserve Bank as well by the banks themselves. A major portion of such complaints related to issues such as levying service charges for basic banking operations, penalties relating to non-maintenance of the minimum account balance and charging without prior intimation to the customer. The plethora of complaints received on the service charges, prima facie, indicated that the issue of fairness in fixing the service charges by the banks needed to be examined.

1.1.4. Accordingly, in order to ensure fair practices in banking services, Reserve Bank decided, in terms of Paragraph 162 of the Annual Policy Statement 2006-07, to constitute a Working Group comprising a nominee of the IBA and a representative of customers, to formulate a scheme for ensuring reasonableness of bank charges and to incorporate the same in the Fair Practices Code, the compliance of which would be monitored by the Banking Codes and Standards Board of India (BCSBI).



1.1.5. As decided, a Working Group was constituted under the chairmanship of Shri N. Sadasivan, Banking Ombudsman, Maharashtra and Goa, with the following members:

- a) Shri S. Divakara, All India Bank Depositors' Association.
- b) Shri H.N. Sinor, Chief Executive Officer, Indian Banks' Association.
- c) Shri P. Saran, Chief General Manager-in-charge, Department of Banking Operations and Development, RBI and
- d) Shri Kaza Sudhakar, Chief General Manager, Customer Service Department, RBI (Member-Secretary).

1.2. Terms of Reference

1.2.1. The Terms of reference of the Working Group are as under:

- a) To enumerate the various basic banking/financial services rendered to individual customers for which the scheme should be applicable.
- b) To study the basis/methodology adopted by banks for fixing the quantum of charges/fees for such services and to arrive at principles for assessing the reasonability of such charges/fees.
- c) To evolve a scheme for ensuring that the basis and the procedure adopted for fixing/changing and notifying service charges are reasonable and fair to the customers.
- d) To suggest suitable additions to the Fair Practices Code in regard to the scheme to be evolved in terms of (c) above.
- e) To suggest measures for monitoring compliance to the relative provisos in the Fair Practices Code by the Banking Codes and Standards Board of India.

1.2.2. The task of the Working Group basically involved formulation of a scheme that would ensure reasonableness in fixing and notifying of bank charges for certain banking/financial services rendered to individual customers. The Working Group decided that since Reserve Bank has indicated that the scheme would be incorporated into the Fair Practice Code, which is a voluntary code for the banks, the **scheme would be a form appropriate for voluntary adoption by banks without any regulatory compulsions**. The Working Group further decided that though most of the banks may indicate that information relating to cost was not readily available with them, for studying the fairness of banking charges the cost would require to be studied with whatever information becomes available from the banks.

1.2.3. In the above background and to bring in the issues in sharp focus, the Working Group decided to approach its task by restating the terms of reference as follows:

- a) To enumerate the various basic banking/financial services rendered to individual customers for which the principles of fairness should be applicable, and to study the methodology for pricing the services.



- b) To indicate the principles to be adopted for ensuring that the process of fixing, changing and notifying service charges is reasonable.
- c) To suggest suitable additions to the Fair Practices Code in regard to the principles to be evolved in terms of (b) above and to suggest measures for monitoring compliance by the Banking Codes and Standards Board of India.

1.3. Methodology adopted by the Working Group

1.3.1. The Working Group examined the issues arising from the terms of reference, by holding deliberations with banks, Consumer Organisations and experts in the area, and by obtaining information from banks. The Working Group convened two meetings with representatives of Consumer Organisations for obtaining their inputs on the service charges, with emphasis on the charges for basic banking services.

1.3.2. One meeting was convened with select banks (a combination of thirteen banks from public and private sectors including foreign banks, and cooperative sector) on the issues such as what the banks consider as basic banking services, the basis of fixing the charges for such services, and the manner by which it can be ensured that such charges are kept at a reasonable level; in particular the rationale for having certain types of charges, such as fee for no transactions in a quarter, fee for shortfall in minimum balance and charges for inward credits, etc. The banks were also informed that the intention of the Working Group was to come out with certain principles for ensuring reasonableness of service charges after fully taking into consideration their submissions in this regard.

1.3.3. The Working Group also met with experts in the area (Ms. Sucheta Dalal and Dr. M.S. Kamath, columnists and consumer activists, and Shri B.M. Bhide, a retired senior banker) to obtain their views on the issue. For the purpose of obtaining information from banks, a questionnaire (Annex 2) was sent to the identified banks. Further, the Working Group considered views expressed by public either by specific communication from them or through articles in newspapers.

1.3.4. The inputs received from the banks, Consumer Organizations and experts formed the core methodology of the Working Group. In all, the Working Group had seven meetings. Though the banks and Consumer Organizations forwarded various suggestions, only the suggestions that were found *relevant* have been included in the Report. Further, studies made in India on the issue and international best practices in respect of treating the customers of banks fairly - to the extent these are relevant to the Indian conditions, were also considered by the Working Group.

1.4. Historic perspective of pricing of banks' services:

1.4.1. From 1994, Indian Banks' Association (IBA) started prescribing the benchmark rates for all the services rendered by banks. The member banks were expected to price their services in line with the benchmark rate prescribed by IBA. IBA had covered all the services rendered by banks at



the relevant time: the services covered were few as compared to the range of present day services. Technology enabled services such as anywhere banking, ATM cards, Electronic Clearing Services, Real Time Gross Settlement are only present day activities.

1.4.2. The Regulations Review Authority (RRA) set up by the Reserve Bank reviewed in 1999, the system of IBA fixing charges for various bank transactions. RRA observed that the existing practice was consistent with the past regime of administered interest rates but was no more consistent with competition. It was, therefore, decided that the practice of IBA fixing the benchmark service charges on behalf of member banks should be discontinued and the decision to prescribe service charges should be left to the individual banks.

1.4.3. The Reserve Bank had accordingly advised the IBA to totally dispense with the practice of fixing benchmark service charges and gave complete freedom to banks in prescribing service charges. To avoid complaints in this regard, the concerned banks were advised to ensure that the charges fixed by them are reasonable and are not out of line with the average cost of providing these services. The banks were also advised to ensure that customers with low volume of activities were not penalised.

1.4.4. It was observed that in the initial period post liberalization, while fixing service charges, the public sector banks continued to price their services as per the IBA benchmark rates. In contrast, the private and foreign banks devised higher charges; their higher per employee cost and then costly technology intensive operations are cited in support of this. With the passing of time, the public sector banks had also commenced adopting technology and in stages increased their prices.

1.4.5. Presently, in their complaints to Reserve Bank, Banking Ombudsmen and other public authorities several bank customers have expressed their shock over the charges levied by the banks, particularly for certain basic banking services such as 'balance enquiry', 'cheque book' and 'ATM cards'. Further, complaints have been received by the above authorities on certain types of charges that are penal in nature, such as, no transactions per quarter, failure to keep average balances etc. The members of the Working Group studied several complaints of the types mentioned above.

1.5. Studies carried out in India on the subject

1.5.1. In India, the issue of service charges has not been studied till recently. In 2003, the Committee on Procedure and Performance Audit on Public Services (CPPAPS) (Tarapore Committee) had covered the issues relevant to service charges while dealing with 'Banking Operations: Deposit Accounts and Other Facilities Relating to Individuals (Non-Business)'. The important recommendations made include:



- a) *It is often argued that Savings Bank deposit accounts pose a heavy burden on banks and, therefore, the need for higher charges. In this context it is necessary to recall the evolution of the present position on Savings Bank deposit accounts. The Savings Bank Accounts were essentially intended for small depositors but over the years the facilities have been miscued. Way back in the 1960s, balances upto only Rs.50,000/- could be maintained in Savings Bank accounts and the number of withdrawals were restricted to 52 per year. In the process of competition, banks abandoned all these rules and allowed Savings Bank Accounts to be used like Current Accounts. The banks need to consider whether, in fairness to the **Common Person**, a graded system of service charges could be imposed. The Committee notes that Savings Bank deposits are a stable element and the weaker segments contribute to this stability and in fact their lack of financial acumen results in their inability to undertake in-out movements in the accounts and therefore they earn relatively lower rates of return. In contrast, the larger of the Savings Bank deposit holders shuffle funds around as if these are Current Accounts but masquerade as Savings Bank Accounts. The Committee recommended that banks should prescribe a reasonable number of withdrawals by cheque or cash in a year upto which there would be **no** service charges.*
- b) *While service charges are a matter for banks to decide, the Committee found it anathema that service charges are not revealed up front. Some of the banks are imposing unreasonable charges wherein customers are charged for seeking information on entries in their account. The Committee recommended that the RBI should emphasise that there must be total transparency on service charges and there should be no **stealth** charges. The Ad hoc Committees of the banks should examine the matter.*
- c) *The Committee observed that invariably banks are adding charges which are not made known to existing depositors. Any charges which apply to depositors should be transparently made known to all depositors and any charges should be made known to all depositors in advance with one month's notice.*
- d) *At the time of opening the accounts banks should inform their customers regarding the requirement of maintaining minimum balance and levying of charges etc., if the minimum balance is not maintained, in a transparent manner. Any subsequent changes in this regard should also be intimated to the account holders. The banks may decide the manner in which the information is made available to the customers. The Committee urges that the RBI should ensure adverse action where there are violations.*

As may be observed from above, the issues such as fair pricing of services and transparency of the charges have been addressed by the Tarapore Committee.



1.6. Related studies abroad

1.6.1. A study carried out by the Riksbank, the central bank of Sweden, on the 'Prices and costs in the Swedish payment system' indicates that it is difficult to establish a relationship between bank services and their charges. The study indicates that *the infrastructure, required for clearing and settlement, can generally be characterized by large fixed costs and low variable costs, with each further transaction made leading to relatively small additional costs. To make the prices reflect costs when fixed costs are high and variable costs are low, the answer is to use a combination of fixed fees and variable fees. The variable fee is a transaction fee that is paid for each transaction and the fixed fee is usually made in the form of an annual fee that the bank customer pays to obtain access to the service in question. Prices reflect the bank's actual costs if the variable fee is equal to the variable cost that arises through a further payment and the fixed fee covers the other operating costs. The banks often use this form of two-part pricing system, with their customers paying a fixed fee, a form of admission into an entire package of payment services. A paid-up annual fee for a debit card, charge card or credit card allows the holder to make payments with the card and to withdraw cash from ATMs. In the same way, a bank customer can make different kinds of credit transfers over the Internet once the annual fee has been paid. Once the admission fee has been paid, it is mainly the transaction fee that influences the bank customers' choice of instrument and channel and the Riksbank has therefore chosen to focus on these fees and corresponding variable costs. The question that the Riksbank tries to answer is to what extent transaction fees for each instrument and channel reflect variable costs. Although the focus is on variable costs and transaction fees, the Riksbank has also gathered data on fixed costs and fees. However, it is in the nature of fixed costs that they often are difficult to distribute between the different payment services.*

1.6.2. In Canada, there is a legislation guaranteeing consumers' access to banking services and access to a low-cost account. The legislation ensures that: all Canadian have access to a bank account; minimum standards be created for a minimum level of financial services; no fee and no minimum balance bank accounts be available; federal government cheques can be cashed at any bank branch.

1.6.3. There is a regulation in European Union to protect the consumer by prohibiting institutions from charging more for certain cross-border payments in euro than for corresponding payments in euro transacted within the Member State. Further, the regulation requires institutions to be transparent with their charges for such payments and to disseminate International Bank Account Numbers and Bank Identifier Codes in order to facilitate cross-border credit transfers.

1.6.4. In UK, the Office of Fair Trading (OFT) has examined the issue of acquirer charges levied by banks on customers using ATMs of other banks. OFT was responsible to a large extent in



ensuring that such charges are reasonable. Further, OFT has won judgments in its favour to protect the customers buying products by using credit cards within UK and even outside.

1.6.5. Financial Services Authority (FSA), in its published article '*Treating customers fairly: the consumers' view*' describes what can be called as 'fairness'. The FSA considers '**Give the customer what they have paid for**' as one of the aspects in fairness. It indicates that it focuses on the supplier's obligation to ensure that the customer's understanding of what they have purchased and the reality of the product they are being sold coincide. It also indicates that the supplier should **not take advantage of the customer** in the situations where there is an inequality between customer and provider as a result either of the providers having greater knowledge, understanding, or power, or the consumer being in a particularly needy position. Not taking advantage of the customer means avoiding 'pushy' sales tactics (e.g. attempting multiple cross-sales when a customer wishes to open a very specific product, which matches their expressed need fully); not selling them products which, through lack of understanding on the consumer's part, are either not what they need or are in some way inappropriate to their needs or expectations; not allowing the needs and priorities of the provider to unduly influence the sale of a product (for example selling a product the consumer does not really need because there are sales targets to be met etc).

1.6.6. FSA further states that the customer **be offered the best product the supplier can**. The 'best product' in this instance is the best product that the provider has available in its current range; the focus here is on not offering less competitive products to certain customers or in certain circumstances. This concept relates both to an initial sale (e.g. offering existing customers products which match those offered to new customers, in terms of rates and other features) and to the ongoing customer relationship. It is deemed equally, if not more, unfair to make new products available which could potentially benefit existing customers, without making every effort to draw them to their attention. According to FSA, **resolving mistakes as quickly as possible** is also an aspect of fairness. There is also a desire for a greater willingness for providers to acknowledge the mistakes that they make or the errors that occur and, where appropriate, to compensate the customer; there is a view that providers are quick to charge customers for their mistakes but less ready to pay out in recognition of their own errors.

1.6.7. FSA also indicates that there will be situations where customers have made honest mistakes either when purchasing a product or in dealing with their finances, fulfilling their obligations etc. When such situations occur, even though the provider would be entirely 'within its rights' to enforce the terms of a product, the respondent perception of 'fairness' is that a degree of discretion should be used and each situation judged separately, with the provider giving the customer the benefit of the doubt (or even, in some instances, erring on the side of generosity). The company should act in a way that recognizes it has the strong position in the relationship; the



'fair' thing to do is to be sympathetic. Accordingly, FSA indicates that **showing flexibility, empathy and consideration in dealing with customers** is also an act of fairness.

1.6.8. The Working Group considered the guidance available from the foregoing to crystallize its approach regarding the question - what constitutes reasonableness in levying charges. The Working Group concluded that the reasonableness or fairness could be defined on the basis of the concepts spelt out by the FSA: the charges can be considered as reasonable if, in providing their services to the customers, the banks do not take advantage of the customer/user and show consistently flexibility, empathy and consideration.



CHAPTER II

Enumeration of basic services and the pricing methodology adopted by banks

2.1. Enumeration of basic services:

Submissions by consumer organizations:

2.1.1. Various submissions were made by the Consumer Organizations to the Working Group on the issues relating to the terms of reference of the Working Group. The suggestions only as regards the enumeration of basic service charges are discussed here.

2.1.2. The Consumer Organisations indicated that, in their opinion, all the services (banking as well as financial) offered by banks have to be brought within the ambit of the Working Group given the large-scale unreasonableness in fixing of charges by banks. Further, they argued that financial services such as DEMAT facilities also have to be studied by the Working Group. One of the consumer organizations suggested that banks either do not provide certain facilities that can be treated as a basic requirement to maintaining an account, or provide the same after charging for them. The instances quoted by them include: 'issue of passbook instead of statement' and 'account balance query'. They accordingly argued that the banks must be in a position to offer bank accounts, including all the attendant requirements, with a nominal minimum balance requirement. Such an account could facilitate the customers in getting all basic banking services at a nominal cost.

Submissions by banks:

2.1.3. The banks took note that the terms of reference of the Working Group include only services rendered to individuals. The banks accordingly indicated that basic banking services might be restricted to the following three: deposit accounts, remittances and collections, with a cap on the transaction value, and make it applicable to a select target.

Disclosure of charges: RBI Instructions

2.1.4. On the question of banks' services, the Reserve Bank in its circular dated May 16, 2006 (Annex 3) had instructed the banks that the following services and charges and all free services be displayed in the bank branch premises:

Sr.No	Service/Charge
1	Minimum Balances to be maintained in the Savings Bank account
2	Charges leviable for non-maintenance of minimum balance in Savings Bank account
3	Charges for collection of outstation cheques
4	Charges for issue of Demand Draft



5	Charges for issue of cheque books, if any
6	Charges for account statement
7	Charges for account closure, if any
8	Charges for deposit/withdrawal at ATM locations, if any

The above list serves as a guide for the Working Group in deciding on the items of the basic banking services.

Findings and recommendations:

2.1.5. The Working Group discussed the parameters by which, out of the whole range of banking and financial services, specific items can be identified as basic services. The Working Group examined the issue with reference to (i) categorization of individuals - the users of the services, (ii) the nature of transactions and (iii) the value of transactions (both rupee and foreign exchange transactions).

2.1.6. As regards the categorization of individuals, the Working Group made the following observations:

- a) The Financial Services Authority in its article '*Treating customers fairly: the consumers' view*' indicated that there is perceived to be an inequality of power between a huge, rich, profit-focused (even 'greedy') industry which sets the agenda (all banks and their respective products being broadly the same) and a relatively powerless consumer with limited choice.
- b) There are no issues as far as higher-end premium consumers who will want value added/rich services and who will be able to meet the high level of balance requirement as well as charges for the same. The affected population belongs only to the other two layers in the pyramid: common man at the bottom and the middle segment that needed bank accounts with a nominal minimum balance requirement along with normal banking services at a nominal cost.
- c) Providing services to the middle segment did involve a commercial sense as the same could be equated to the **mass-market** type defined by the Financial Services Authority in its article '*Treating customers fairly: the consumers' view*'. FSA defines the segment as the one that is better informed about the financial services industry and have a reasonable understanding of products and services that they have experienced.
- d) Principles enunciated by the FSA can serve as a guide for recognizing the category of individuals to whom the principles of reasonableness can be made applicable. Accordingly, the Working Group opined that the objective of its constitution (i.e. ensuring the reasonableness of bank service charges) had to fulfill the basic banking requirements



of the middle segment and the lower segment indicated above. To illustrate, for levying service charges, a rural customer who belongs to the lower segment will require to be treated different from an urban customer in the high-end group, given the inherent handicap in the rural location. This approach would be true even if the cost of providing the service in the rural area is higher than the average elsewhere.

2.1.7. The need for a distinctly different and liberalized approach in pricing the services to the middle and lower segments, as indicated above, cannot be denied. At the same time, the Working Group finds that any prescription for identification of customers, more particularly the members of the public, as belonging to a specific category will lead to problems in the approach, in practice. Therefore, the Working Group concluded that the principles covering the basic charges may include the parameter of certain clearly identifiable category of individuals, and it will be left to the discretion of the banks to include any other category.

2.1.8. On the question - which of the financial services would stand as basic services, the member representing the Consumer Organizations stressed the need for the recognizing Demat accounts as a basic service. The view is that, in time, in the evolving financial scene Demat accounts will be a widely used service and will demand a liberalized pricing approach. A counter view that was discussed was that Demat accounts are offered only by a handful of banks with the back-up of technology; use of these is limited only to a small segment of middle income group and none from the lower segment. If Demat is grouped with other basic services, a lot more services availed by the users of Demat would also stand for similar classification. The Working Group discussed these views and concluded that Demat accounts will not find a place in the list of basic services.

2.1.9. The Working Group scanned the list of services available to individuals from banks in addition to banking services like deposits, remittances etc (apart from Demat, others like safe deposits, lockers). The Working Group is of the view that none of such services can be considered as basic services.

2.1.10. Accordingly, the Working Group recommended that the following be considered as the broad parameters for identifying the basic banking services, to which the principles of reasonableness should be applicable. The parameters are: (A) Nature of transactions and (B) Value of transactions.

(A) Nature of transactions:

- a) Banking services that are ordinarily availed by individuals in the middle and lower segments, will be the first parameter. These will comprise services related to deposit/loan accounts, remittance services and collection services.
- b) When the above transactions occur in different delivery channels, for the purpose of pricing, they may be treated on separate footing.



(B) Value of transactions:

Low value of transactions with customers/public, will be the second parameter. The ceiling that should apply for the above services are:

- i. Remittances upto Rs. 10,000/- in each instance.
- ii. Collections below Rs. 10,000/- in each instance.

(Foreign exchange transactions valued upto US \$ 500/-).

2.1.11. Keeping the foregoing as the basis, the Working Group recommends enumeration of the following as the basic banking services:

Sr.No.	Service
Relating to deposit accounts	
1	Cheque book facility
2	Issue of Pass Book (or Statement) / Issue of Balance Certificate
3	Issue of duplicate pass book or statement
4	ATM cards
5	Debit cards (electronic cheque)
6	Stop Payment
7	Balance enquiry
8	Account closure
9	Cheque Return Inward (cheque received for payment)
10	Signature verification
Relating to Loan Accounts	
11	No dues certificate
Remittance Facilities (including through other banks) (Rupee or foreign exchange)	
12	Demand Draft – Issue
13	Demand Draft – Cancellation
14	Demand Draft –Revalidation
15	Demand Draft – Duplicate issuance
16	Payment Order – Issue
17	Payment Order- Cancellation
18	Payment Order – Revalidation
19	Payment Order-Duplicate issuance
20	Telegraphic Transfer – Issue
21	Telegraphic Transfer –Cancellation
22	Telegraphic Transfer- Duplicate issuance
23	Payment by Electronic Clearing Services (ECS)
24	Transfer by National Electronic Fund Transfer (NEFT) and Electronic Funds Transfer (EFT).



Collection facilities	
25	Collection of Local Cheques
26	Collection of Outstation Cheques
27	Cheque Return-Outward (cheque deposited for collection)

The basic services listed above include the items of services required to be disclosed as per RBI instructions dated May 16, 2006 (paragraph 2.1.5). The item 'minimum balance for SB account' included by Reserve Bank does not, however, find place in the above list. This is because, normally minimum balance is a charge for maintenance of an account and not a service. (In some banks it includes a charge for a set of services that are offered along with the SB account as a bundle. Services in the bundle, which are basic in nature are included in the list given above.) A detailed discussion of minimum balance finds place elsewhere in the report.

2.1.12. The Working Group has compiled the above list as a guide and the list may not be treated as exhaustive. Banks may, at their discretion, include within the category of basic services such additional services as they consider appropriate.

2.2. The pricing methodology adopted by banks

Submissions by consumer organisations:

2.2.1. The Consumer Organisations argued that they were not aware of the costs incurred by the banks in providing the services. They indicated that the service charges vary widely among the banks and pointed out that while some banks do provide certain services at concessional rates to certain segments of the population, the same concession was not available in all banks. Overall, the Consumer Organisations concluded that the pricing methodology adopted by the banks was quite opaque.

Submissions by banks:

2.2.2. The Working Group received from 13 banks information regarding the charges levied by them for a select set of services and also noted the submissions the banks made in this regard, in the interaction the Group had with the banks. Since many banks were not clear about the costing of their services, and some admitted that no formal costing was done, the Working Group requested Reserve Bank to ascertain from a sample set of banks the correct position relating to costing of services. Reserve Bank completed this exercise and provided to the Working Group a briefing on the information gathered from 11 banks, a mix of public and private sector, and including foreign banks. The information given by the banks in regard to methodology is in two distinct parts. The first part of the information is given by a set of large banks, comprising both public and private sector, who do not operate fully with a technology platform ('the first set'). These banks have indicated that their service charges are not fixed on the basis of cost of the services: the cost of each service offered by them is not available since, in many cases, a study of costing of



individual services has not been undertaken. The banks have, however, stated that their service charges are mostly as per the erstwhile benchmark rates advised by IBA, adjusted to inflation. For some service items the charges are fixed in line with the charges levied by the peer banks, including the charges in the nature of penalty. For example: cheque bouncing charges.

2.2.3. These banks further indicated that there are instances wherein banks cross subsidize the charges: lower the charges for certain segments of customers or certain types of services by increasing the charges for other customers/accounts/services.

2.2.4. The second part of the information is given by a set of banks which carry out technology intensive operations ('the second set'). The broad indication from them is that the cost of their services is well recognized by them. They have provided information relating to certain select services (random selection) which permits evaluation of the charges with reference to the related costs. In addition, they have provided explanations regarding the basis on which the minimum balance requirement of a savings account is fixed and charge is levied for non-compliance with it. In this regard, one of the banks has stated that it does not levy charges on an individual product or service basis but by bundling products and services that are offered to a customer as a composite offering. For instance, savings account as a product is offered along with services such as access to the account through multiple channels, cheque books, debit cards, statement of accounts, and other services - bill payment, insurance payment, subscription to mutual funds etc. The bank recovers the cost of these operations (the savings account and the services) through net interest income, rather than by levying charges. The bank achieves break-even levels through higher average balances (float) in customer accounts that yield healthy interest margins or by imposing charges for keeping inadequate balances. One other bank in the second set has stated that whenever it commences a relationship, the bank operates on the basis of relationship value (RV). The balance maintained in savings bank account counts for this RV, along with a range of income generating account balances and transaction values. In the case of a relationship conducted through savings accounts, the RV is fixed much lower than the required break even (BE) level, and for the non-maintenance of the RV, a less than the required compensation is collected as a fee. Other banks in the second set have also explained the system of minimum balance requirement, in similar terms – cost of maintaining the account and providing free services is recovered through the minimum balance which is fixed at or below the break even level.

2.2.5. The banks also argued that the charges also vary according to the channel of delivery. For instance, the charge for obtaining a demand draft through a branch is more than obtaining the same through internet banking.

Findings and recommendations:



2.2.6. The Working Group is of the opinion that the information given by first set of banks in the sample is likely to be true for all similar banks. The information shows that they have fixed the service charges and have changed these from time to time, not strictly on the basis of the cost of such services. In spite of de-linking the IBA benchmark rate over seven years ago, many of these banks claimed that they still maintain the linkage, with upward adjustment for inflation. The Working Group finds that since the benchmark rates that IBA had last set were not reflective of the cost (there is no evidence to suggest otherwise), the charges presently levied cannot be considered as cost based. Though the costs of these banks are not uniform, the charges levied by them vary within a narrow range. The Working Group is of the view that these banks that have the advantage of branch network have brought in a significant increase in their service charges to be in line with the higher-end charges levied by some of the other banks.

2.2.7. The Working Group observes that the information from the second set of banks presents a different picture altogether. In the case of services from them which attract charges, certain items show that the charges are fixed in excess of the cost. It is explained that such charges are **levied as a deterrent (penalty approach)** and for discouraging the customers from utilizing the services. Charges levied for cheque returned and stop payment instructions are in this category. Information also shows that for some items **less than the cost is charged**.

2.2.8. These banks have declared many services as free of charge, and given along with the **account, as a product (bundled product)**. In reality these services are not free. The cost of these is recovered through the minimum balance which the customer is required to maintain (i.e. the net interest yielded by the balance). Where the balance is fixed at a high level, the charge recovered can be more than the cost of the 'free' services, all taken together. The banks, however, have asserted that minimum balance and the charge for non-maintenance are fixed, respectively, only at a fraction of the balance and charge required to break even.

2.2.9. In the case of the second set of banks, there is a large element of linkage between the cost and the service charges, which may hold good for other technologically oriented banks. The Working Group, however, finds that the reasonableness of service charges of banks as a whole cannot be tested on the basis of cost. This is because cost as a methodology is confined only to a small number of banks that do not represent significant share of the banking business.

2.2.10. The Working Group concludes that the methodology adopted by the bank in pricing the services is limited to the following:

- ❖ Maintaining a link to the **IBA benchmark rates**, adjusted for inflation.
- ❖ Use of **Penalty approach** when levying deterrent charges.
- ❖ Considering the **charges of peer banks** as a major factor in fixing the prices for services (a copy cat approach).
- ❖ Impact of **competition (market pressure)** offered by other banks.



- ❖ The prices of banks vary as per the **delivery channel**. Most of the private/foreign banks offer facilities at a cheaper rate for the customers who availed certain services through the internet rather than by visiting the branches.
- ❖ Technology based banks use, to a significant extent, the **cost of the services** for pricing. These banks are pricing certain services along with the fee for an account, both given together, by imposing the minimum balance requirement. The income from the account balance covers the cost of account maintenance as well as a set of services that are not specifically charged. The banks maintain that the balance and the fee for non-maintenance are at all times, kept well below the break even level.

2.2.11. The Working Group acknowledges that its findings on the methodology are clearly incomplete. Banks' service charges are in the nature of prices; the primary test of the reasonability of the prices (sale prices) is the cost to the service provider. The majority of the banks in the field have no information about the costs they incur on the basic services - on the whole range of their service products, for that matter. Only a small number of banks handling a small market share have the information and use it. The question - whether the bank charges now in force are marked up high over the cost - is relevant for basic services, even in a de-regulated environment. This remains unanswered.

In this context, the member representing the Consumer Organizations made a specific observation. The observation is to the effect that as per the extant RBI instructions (dated September 7, 1999 and May 16, 2006), the banks' service charges should not be out of line with the average costs of providing the services. The cost has to be verified and for this purpose, the costs of the banks for their services should be determined to facilitate complete evaluation of the cost and service charges. If this is not feasible within Reserve Bank, an outside institution may be commissioned to carry out the study.

The Working Group discussed the issue and recommends to Reserve Bank that suitable steps be taken to determine and evaluate the costs of the banks for providing the basic services.



CHAPTER III

Principles of reasonableness in fixing, changing and notifying service charges

3.1. Reasonableness in fixing charges

Issues submitted by Consumer Organisations

3.1.1. The consumer organizations have complained that though certain facilities are, in fact, in the nature of basic requirement to maintaining an account, banks do not provide them and if provided, levy charges for these. For instance, 'account balance query' is a basic facility which some of the banks either do not provide or provide only for a limited number of times beyond which a fee is collected. Such instances impose 'clear charges' on the consumer.

3.1.2. The Consumer Organisations argued that the liberalization of service charges, by leaving it to the discretion of individual banks to decide on a market determined competitive basis, has not worked in India. They argued that the bank customers are mostly 'captive'; while a large number of bank customers in India in rural areas do not have any choice of banks as there is normally only a single bank branch serving there area, even the customers with choice in semi-urban, urban and metropolitan areas are hardly known to change their banks even if they are not comfortable with the services offered by the banks. This is so as a bank account is linked to several aspects such as 'bill-pay', receipt of ECS dividends, credits from other deposit accounts, and 'tax requirements'.

3.1.3. While alleging that the charges are exorbitant, the Consumer Organizations indicated that the major issue that has affected the vast spectrum of bank customers was that of the requirement of a minimum 'Average Quarterly Balance (AQB)' and the penalties for non-maintenance of the same. Customers of many banks, including public and cooperative sectors, had made several complaints in this regard. For instance, even a leading cooperative bank requires that Rs. 1000/- be maintained as AQB. Comparatively, in the past, before liberalization in 1999, the banks had the concept of maintaining a daily minimum balance of Rs. 100/- to Rs. 250/-, with very meagre/marginal penalties for non-maintenance of the same. The Consumer Organisations also pointed out that while some of the banks charge for the shortfall in the balance below the prescribed minimum, many banks charge a flat amount as a penalty, and even when the shortfall is marginal.

3.1.4. The Consumer Organizations indicated that some of the charges levied by the banks could be deemed to be 'irrational'. Such items include:

- a) Charges for facilities provided without any request from the customer,
- b) Charges fixed without any prior notice to the customer,



- c) Charges levied for the reason that no transactions took place in the account in a quarter, and
- d) Loan processing charges levied even when the loan application is rejected.

3.1.5. The Consumer Organisations also put forward a case for Reserve Bank prescribing a benchmark charge for each of the services. The suggestion is that a service charge band could be prescribed for each service within which the banks could operate. This suggestion flows from the following: in United States, the Insurance Commissioner of each State lays down the benchmark premium for each kind of insurance services, which becomes the basis of charges. With a view to promoting healthy competition and avoiding unfair competition, the commissioners provide a margin of 10-20% higher or lower than the benchmark premium.

3.1.6. A strong plea was made to adopt the approach prevailing in price control/ administration in areas like drugs and public utilities. The argument stands on the assertion that banking services address essential needs of public at large. The regulator should, therefore, ensure free access to these services at the most affordable rates. On this basis it was indicated that RBI could prescribe Maximum Service Charge (MSC) for all the bank services, on the lines of the Maximum Retail Price (MRP) applicable to drugs. The MSC could be arrived by working out the 'normative costs' for each of the services. Such a maximum charge would take care of the issue of excessive or unreasonable charges. Though such a practice is not prevalent in the banking sector in any country, India may take a lead and become a pioneer in this direction.

Submissions by banks:

3.1.7. On the question of reasonableness of service charges, the banks hold the view that the methodology they have adopted is fair and does not result in any unreasonable levy on the user. They have indicated the following in support of their contention:

- a) In general, all the banks expressed a view that there are instances wherein banks cross subsidize by lowering the charges for certain segments of customers/types of services, by increasing the charges for other customers/services. The banks have admitted that for certain services such as cheque bouncing, the price is very steep but this is because such services carry a negative aspect and hence a deterrent is built into the charges.
- b) The first set of banks referred to earlier, comprising both public and private sector banks, indicated that though they had not undertaken a study of costing of the individual services, for most of the services the prices are comparable with that of IBA benchmark rates prescribed in 1994, adjusted to inflation. They had also indicated that, to an extent, their pricing depended also upon the prices fixed by the peer banks.
- c) The second set of banks (technology intensive) indicated that though pricing of their services is dependent on the costs, their products like deposit accounts are generally provided along with certain services, as 'bundled products'. The charge for the bundled



product is reasonable. They also admitted that some of the prices are penalty type of prices. The banks also argued that some of their charges vary according to the channel of delivery and this is due to the varied costs in different channels.

3.1.8. The banks, as a group, argued that while reasonableness of bank charges is a desirable policy objective, a strict regime may not be appropriate in this regard. However, if it is thought that compulsion is necessary to provide certain services at a cheaper price, this can be achieved through simple regulation. The regulation for this may define the banking services and also fix the related low charges, though this may compel the banks to offer such cheaper services by adjusting the costs in other services that they provide. The Working Group understood from Reserve Bank that IBA has conveyed similar views on the subject.

3.1.9. The banks submitted that, as an alternative, any proposed scheme on reasonableness of service charges could be indicated as a part of the 'Financial Inclusion' instructions of Reserve Bank by amending the existing instructions to include guidelines for fixing the service charges. Reportedly, IBA holds a similar view.

Findings and recommendations:

3.1.10. The Working Group examined the complaints about banks' service charges received at the Banking Ombudsman Offices and Reserve Bank and observed that in a number of cases the charges have been fixed without proper reason or the charges are not fair. Certain instances of these as seen by the Working Group are given below:

- ❖ **Charge for absence of any transaction in a quarter:** This charge is patently unreasonable, since the bank is not incurring any additional cost if there is no transaction in a quarter.
- ❖ **Charges for erroneous transactions:** The Working Group has observed that the banks impose cheque-bouncing charges even if the inward cheques are wrongly returned or returned only for technical reasons. The Working Group opines that the banks have to penalize the customers only if the customer is at fault i.e. return is for non-maintenance of sufficient funds; cheque return for other reasons where customer is not responsible, should not attract any charge.
- ❖ **Charges for unsolicited services:** At times banks provide certain services without specific request from the customers (e.g. issue debit card) and charge for these. Such a charge levied before the customer accepts the service will be unreasonable. Charges for such unsolicited services may arise only with the consent of the customer. In this case the consent should be explicit; it would not be fair to treat the mere failure of the customer to reject the unsolicited service, as the customer's consent.



- ❖ **Charges for balance inquiry:** This charge is not justified since balance inquiry is one of the basic requirements of an individual account holder.
- ❖ **Charge for account closure:** This charge will not arise in certain circumstances. A customer may close an account for valid reasons such as unwillingness to bear increases in the service charges proposed, or relocation due to his transfer to another place.
- ❖ **Charge for visit to the branch:** The Working Group is of the view that levy of a fee for a visit to the branch is not justified. This holds good notwithstanding the suggestion about different delivery channels given in paragraph 2.1.11. This is because, this charge stands as a barrier to customers who find that without personal interactions at the bank, they are unable to avail the services they need.
- ❖ **Charges on pension accounts:** Conditions such as minimum balance requirements imposed on the pension accounts are not fair since the accounts are required to be maintained only for the purpose of drawing pension.
- ❖ **Charge for bookkeeping:** In certain loan transactions this charge is levied. This charge is not reasonable since bookkeeping is integral to banking transactions and not a service.

3.1.11. The Working Group reviewed the question of service charges levied by some banks for receiving cash towards deposit into accounts and remittances. The customers' contention in this regard is that handling of cash is an integral part of any bank transaction, especially in the Indian context where cash continues to dominate most of the retail transactions; cash handling cannot therefore be treated as a distinct banking service and subjected to a charge. The Working Group finds strength in this argument. The Working Group, however, observes that cash transactions are costlier to a bank as compared to the same transactions put through on the basis of cheques or other instruments. Therefore, a transaction involving handling of large amount in cash will impose additional costs on the bank. Such a cash intensive transaction will include a service and will be open to levy of a charge. Transactions of this nature will include remittance of a large value requested against cash payment; and large amount of cash deposits into accounts where the cost of handling cash is not covered by the bank's earnings from the balance held in the account. The Working Group concluded that as far as basic services and deposits into savings accounts are concerned, the question of any charge for handling cash for these will not arise, since these transactions are not cash intensive.

3.1.12. The Working Group examined certain items of service for which the charges are levied as per the value of the transaction (ad-valorem). The banks indicated that since the operational risk involved in providing the service goes up as the value of the transaction goes up, the charges are also levied accordingly. The Working Group partially agrees with the banks' contention, in so far as the incremental costs are involved. But, it opines that, above a certain value, the charges cannot



rise in proportion to the value of the transaction. Recognizing this, even now, the system of placing a cap for the charges levied ad-valorem is followed by some banks. Accordingly, ad-valorem charges would need to be subjected to a cap.

3.1.13. The Working Group discussed at length the procedure of certain banks to offer products and services as a bundle and fixing a minimum balance requirement for this, since this procedure impacts on the pricing of the services. The Working Group finds that information from technology intensive banks about the methodology followed for fixing the minimum balance requirement for SB accounts, has thrown up some questions. The minimum balance requirement is a pricing mechanism for recovering (i) the base cost of acquiring account and conducting core account maintenance tasks, and (ii) the cost of a set of services made available, without any charge, to the customer. The methodology involves the following:

- ❖ The customer buys from the bank a basic Savings Bank account along with some services at a single price viz. the minimum balance.
- ❖ The bank's offer is a bundle - an account and services, combined. The offer is not divisible and therefore, the customer pays the set price even when his need is only the account, and not the services.
- ❖ If the price is too high for getting only the account, as it would be given the bundling, the prospective customer will move away to another bank which offers the account without bundling, and at a lower price (minimum balance).
- ❖ The methodology creates a barrier to individuals with a limited need for financial service.

3.1.14. The banks which use the methodology assert that this product pricing system is not unreasonable. The system they follow flows from the fact that they conduct their operations from a high technology platform; this methodology is universally adopted. In fact, the system has merit in the sense that it educates the users to quickly adopt technology and receive larger value for the price they pay for the bank services.

3.1.15. The Working Group finds that the methodology evidently carries an element of financial exclusion: however, this is not by design. The Working Group holds a view that, in so far as the basic services are concerned, the banks' objective should be that these are made available to the users at reasonable prices/charges. Towards this, and to the extent required, the basic services should be delivered outside the scope of the bundled products. If this is done, the methodology will not be an issue from the point of basic services. The issue in this regard would then relate to the manner in which the banks conduct the banking business that they are authorized to undertake.



3.1.16. The Working Group discussed at length the central issue viz., which process would ensure that the basic services to individuals are charged on reasonable terms. The Working Group recognized that the innate nature of the basic services - low value and low volume calls for a positive bias in pricing, with an element of cross subsidy where required. The positive bias would involve only a concession and not a full waiver of the charges. On this basis, the Working Group's recommendation is that banks will levy charges for basic services to individuals at the rates which are lower than the rates applied when the same services are given to non-individual entities.

3.1.17. The Working Group finds that even amongst individuals, the basic services availed by some would bear further liberal approach. Individuals identifiable as a category will benefit from the approach. Individuals in rural areas would belong to this set. Pensioners and senior citizens will also belong to this group. It is appropriate that the banks adopt a system of larger concession in levying charges to these individuals.

3.1.18. Flowing from the foregoing observations, the Working Group suggests that in regard to fixing of service charges, a set of principles be adopted by banks. These are enumerated in paragraph 3.4.

3.1.19. In formulating the above recommendation, the Working Group had carefully considered several suggestions received from the Consumer Organizations. The Working Group did not accept some of the suggestions. The Working Group's views in regards to these suggestions are set out in following paragraphs.

- a) The Working Group examined the question whether collection of loan processing charge even in a case where the loan is not sanctioned, can be termed as unreasonable or unfair. The banks have advanced the argument that the processing fee is for recouping the costs they incur for appraising the loan request and deciding whether or not to lend. The cost is incurred to the same extent irrespective of sanction or rejection. Therefore, recovery of fee in a rejection case is not unreasonable. The Working Group finds that while the loan applicant in a rejection sees the charge as unjust, the banks' explanation in this regard is acceptable.

The Working Group suggests that the banks should disclose to loan applicants before hand that the processing fee is due even if the loan is rejected.

- b) As regards the suggestion from the Consumer Organisations that Reserve Bank should prescribe benchmark service charges for each of the services as is being done by the Insurance Commissioner of each State in United States, the Working Group feels that the benchmarking is not feasible. The banks render a wide range of services and the costs for the same may vary from bank to bank. Also, the system of determination of costs for each



service is not in place. In this background, the approach adopted for benchmarking insurance premia in US will not be applicable to the bank services.

- c) It was indicated by the Consumer Organizations that Reserve Bank could prescribe for each of the bank services, a Maximum Service Charge (MSC), on the lines of the Maximum Retail Price (MRP) available in other industries, by working out the 'normative costs' for each of the services. The Working Group does not find this suggestion acceptable. The Working Group observes that the MRP system is mainly used for public utilities or essential commodities. The system of price control adopted for these would not be applicable to bank services given the present stage of evolution of the economy and liberalization of regulation. Further, in the absence of clear information on cost incurred for giving the services, there is no evidence to suggest that the charges levied now include large-scale mark up and misuse of the freedom given to the banks.
- d) The Consumer Organizations argued that the bank customers in India are mostly 'captive' as the customers do not find it easy to change their banks even if they are not comfortable with the services offered by their banks. This prevents customers from moving over to other banks which offer cheaper services. The Working Group is of the opinion that, while lack of choice is true in single bank locations, in all other locations the customers normally have the choice to pick a different bank if they want. In any case, lack of mobility will not be an issue for the basic services, when the recommendations of the Working Group are implemented.

3.1.20. The Working Group also did not accept some of the suggestions received from the banks. The Working Group's views in regards to these suggestions are set out below:

- a) The Working Group considered the banks' suggestion that the intended purpose viz., reasonable charge, could be achieved through a simple regulation from Reserve Bank. The Working Group is not in agreement with this approach. The announcement in the Annual Policy Statement which has led to the reference to the Working Group had clearly enunciated that the measures for ensuring reasonableness of bank charges would be included in and implemented through the Fair Practices Code. The approach is one of voluntary action by the banks, and not issue of and compliance with any new regulation.
- b) The Working Group is not in agreement with another suggestion that the fair pricing scheme could be spelt out as an extension of the Financial Inclusion scheme that Reserve Bank has put in place. The Working Group is of the view that this approach will not be feasible. This is because Reserve Bank instructions in question have only introduced the concept of financial inclusion; voluntary adoption of the concept by the banks is expected. The instructions are not structured in the form of a regulation since all parameters for the financial inclusion are left to the discretion of the banks. Therefore, the contours of the 'no



frills' accounts vary from bank to bank, with varied list of services being offered with the 'no frills' account, and this would not lend itself to the adoption of the uniform principles covering the service charges of all banks. Further, in opening 'no frill' accounts, the approach was to help achieving greater financial inclusion by attracting the underprivileged section of the society to open bank accounts. This target group is different i.e. narrow as compared to the group which could avail the basic services. Therefore, mere extension of the financial inclusion approach will not serve the intended purpose.

3.2. Reasonableness in notifying the changes in service charges

3.2.1. It is important that customers (including public) are aware of the service charges, before they avail the services from the banks. The wide range of banking services and varied levels of charges for them make it all the more important for the banks to deliver sufficient information to their customers about the charges. In this connection, the issue of paramount importance is the method by which the banks communicate information about their services charges and, more importantly, the changes effected in the service charges. On these aspects, guidance is readily available to the Working Group from several sources. Information culled from these sources is set out in the following paragraphs.

3.2.2. The Financial Services Authority in its article '*Treating customers fairly: the consumers' view*' lists '**Exhibiting clarity in all customer dealings**' as one of the principles of fair practice. It indicates that customers want to be able to understand and rely on all that they are told by suppliers, whether in written or verbal communication. The supplier should therefore make its terms and conditions as clear and easy to understand as possible, spell out and explain any changes or new features.

3.2.3. The Committee on Procedure and Performance Audit on Public Services had covered the issues relating to service charges while dealing with 'Banking Operations: Deposit Accounts and Other Facilities Relating to Individuals (Non-Business)'. As may be seen in paragraph 1.5.1, the Committee had made recommendations such as revealing the service charges upfront, total transparency on service charges, making known the charges to depositors at least a month in advance, informing the customers the requirement of maintaining minimum balance and levying of charges at the time of opening the accounts and informing the customer in an earlier statement the debits which are made suo-moto by banks and not as a result of customer operations that may adversely impact the average minimum balance.

3.2.4. In a recent communication, the Central Bank of Philippines advised banks that they may collect service charges/maintenance fees on savings and demand deposit accounts, that fall below the required minimum monthly average daily balance (ADB). The imposition of such charges or fees and the ADB should be clearly stated among the terms and conditions of the deposit. The



instruction further advises that any change, in the service charges/maintenance fees/the required ADB, shall take effect only after **due notice to the depositor**. Notice given at least sixty days prior to implementation shall be considered sufficient notice. Failure of the depositor to manifest or register his objection to the new service charges and maintenance fees or any change in their terms and conditions in writing within thirty days from receipt of written notice of amendment shall be deemed to constitute acceptance of such changes. The banks will also post the information on their respective websites, automated teller machine (ATM) on-screen messages, and in conspicuous places within the bank premises and other places near the bank's own ATM at least sixty days prior to implementation.

3.2.5. Similarly, Hong Kong Monetary Authority has enjoined the responsibility on the financial institutions to readily make available to customers or prospective customers written terms and conditions of a banking service. The authority has also instructed the institutions to give 30 days' notice before any variation of the terms and conditions which affect fees and charges and the liabilities or obligations of customers take effect.

3.2.6. Various central banks have advised the banks as regards display of charges on their websites. Similarly, Reserve Bank, in a recent instruction (dated May 16, 2006), has advised the banks to display the service charges for all the normal banking transactions in their websites. Further, the banks have been advised to display a list of basic minimum services in their branch premises. Reserve Bank shall also place in its website weblinks to the websites of banks.

3.2.7. The Working Group took note of the good practices mentioned above. The Working Group finds that while the method of communication to the customers may vary, it is imperative that the customers are made aware of the service charges upfront and the changes in service charges are implemented only with the prior notice to and consent of the customers. For changes made in the charges, the notice to customers need not necessarily be to each individual customer, as it would be costly and impractical. Consent for the changes may be taken by giving the customers adequate time after the notice, to opt out; taking consent from the customers in any other method will again be costly and impractical. Considering all the above issues, the Working Group is of the view that the banks would do well to fully recognize the following needs and take steps to ensure that these are met:

(A) Disclosure of the service charges:

- ❖ The need to carry out a one-time publicity of the service charges so that all customers are made aware of the charges.
- ❖ The need for communicating the service charges to the new customers at the time of beginning of the relationship.



- ❖ The need for displaying the charges in the notice board at the branch and advertising in newspapers, so as to disseminate information to the customers/public, in addition to display on the website as per Reserve Bank instructions.
- ❖ The need for using appropriate method for communicating the service charges to customers of different profiles.

(B) Notifying the changes effected in the charges:

- ❑ The need for the banks to declare upfront at what frequency the charges would be changed and to adhere to this.
- ❑ The need for effecting any change in the charges only with prior notification to the customers of at least 30 days.
- ❑ The need for providing an option to the customer to accept the change and if not accepted to exit from the relationship with the bank within the above 30 days without any cost.
- ❑ The need for advertising the changes in the newspapers.
- ❑ The need for including the information regarding the changes in any communication sent to the customer.
- ❑ The need for displaying prominently in the notice board as well as the website all the changes that had been effected in the preceding 30 days.

3.3. Process of collection of service charges:

In some cases, banks adopt deficient / capricious methods for recovering the service charges. There are instances where the balances in accounts are fully wiped out by successive recoveries of penalties for non-maintenance of minimum balance. In some cases, the shortfall in the account balance is caused by a transaction, including a debit for a charge, that the bank itself has originated. The customers lose out in this process. To avoid this, banks may ensure that each such transaction and the resultant balance is advised to the customer so that the customer may remedy the shortfall. Only thereafter, banks may consider recovering the penalty for the shortfall. In the case of customers, who fail to respond, banks may take appropriate action with due notice to the customer. In general, banks should ensure that a fair procedure is followed for the recovery of service charges and for informing customers about recovery of the charges.

3.4. The Principles:

Flowing from the observations on the reasonableness in fixing service charges and the other aspects related thereto, the Working Group suggests that the following principles be adopted by banks:

- (a) For basic services to individuals, the banks will levy charges at the rates that are lower than the rates applied when the same services are given to non-individual entities.



(In this regard, the comments in paragraphs 3.1.13 to 3.1.16. will serve as guidance)

- (b) For basic services rendered to special category of individuals, banks will levy charges on more liberal terms than the terms on which the charges are levied to other individuals. (Paragraph 3.1.17.)
- (c) For the basic services rendered to individuals banks will levy charges only if the charges are just and are supported by reason. (Paragraph 3.1.10.)
- (d) For the basic services to individuals, the banks will levy service charges ad-valorem only to cover any incremental cost and subject to a cap. (Paragraph 3.1.12.)
- (e) Banks will provide to the individual customers upfront and in a timely manner, complete information on the charges applicable to all basic services.
- (f) Banks will provide advance information to the individual customers about the proposed changes in the service charges.
- (g) Banks will collect for services given to individuals only such charges which have been notified to and agreed to by the customer.
- (h) Banks will inform the customers in an appropriate manner recovery of service charges from the account or the transaction.
- (i) Banks will without fail inform the customers in all cases when a transaction initiated by the bank itself results in or likely to lead to a shortfall in the minimum balance required to be maintained.

(For items (e) to (i) above, paragraphs 3.2.7. and 3.3. will serve as guidance).

3.5. Other issues related to service charges:

Certain other related issues which were discussed by the Working Group are as follows:

(i) Deficiencies in the redressal of grievances about service charges

Deficient grievance redressal in the banks, including a process of prolonged correspondence, always lead to complaints being escalated to the Banking Ombudsman/Reserve Bank. The banks are, therefore, required to have a robust grievance redressal structure and processes, to ensure prompt in-house redressal of all customer complaints.

(ii) Financial Education:

The Working Group recommends that full-fledged information on bank products and their implications are to be disclosed to the customers so that the customers can make an informed judgment about their choice of products. This would automatically reduce the complaints about high charges from customers who may choose bundled products like an account along with expensive services, without any intention to avail them. Further, on a wider plane, banks should make efforts to educate the society on banking itself, the various banking services available, when they should be used and also the type of service and institution to be chosen. Financial education



of this nature would help society choose the bank and the service they need and thus, the gap between the expectation and delivery is minimized.



CHAPTER IV

Inclusion of the Principles in the Fair Practice Code and monitoring compliance to the Code, by BCSBI

4.1. This term of reference calls for addition of the principles of reasonableness to the Fair Practices Code of the banks. The Fair Practices Code has since been expanded and put in place in July 2006 as the 'Code of Bank's Commitments to Customers'. It stands as a code enunciated by the Banking Codes and Standards Board of India (BCSBI). The banks, which are the members of the BCSBI, are required to comply with the Code, with the compliance being monitored by the BCSBI.

4.2. The Code sets minimum standards of banking practices for banks to follow when they are dealing with individual customers. It provides protection to the banks' customers and explains how banks are expected to deal with the customers or their day-to-day operations. The Code applies to most of the products and services pertaining to current accounts, savings account, term deposits, recurring deposit, PPF accounts and all other deposit accounts. The Code requires that the banks commit to the customer to act fairly and reasonably in all its dealings with the customers. The Code covers various aspects such as: Products and Services, Protecting the Accounts, Interest Rates, Fees & Charges, Collection of Dues, Complaints, Grievances and Feedback.

4.3. Procedures adopted by the BCSBI for monitoring compliance with the Code are indicated as '**The Banking Code Rules**'. Failure to comply with or fulfil any commitment/s under the Code shall constitute a breach. A breach by a member bank shall render it liable to sanction. The Board can conduct or cause to conduct an investigation into an alleged breach. The Board imposes various sanctions including issuing of a warning or reprimand to the member and public censure of the member. Where a sanction is imposed on any member, it shall inform the Reserve Bank of India the details of the breach and the sanctions imposed.

Recommendations:

4.4. The Code carries a series of commitments of the banks, spelt out under different sections. The Working Group is of the opinion that the list of services recommended as basic services should find place in the Code. Following this, the principles covering reasonableness in fixing, changing and notifying service charges by banks, recommended in this Report, may be included in the Code under the sections 'Products and Services' and 'Information'. For the purpose of the Code, the related commitments may be expressed as follows:

- a. We will levy for basic services given to individuals, charges at the rates lower than the rates that we charge for non-individual entities.
- b. We will levy for basic services rendered to special category of individuals, charges on more liberal terms than what we charge to other individuals.



- c. We will levy charges for the basic services rendered to individuals only if the charge is just and is supported by reason.
- d. We will levy charges, for the basic services rendered to individuals, ad-valorem only to cover any incremental cost and subject to a cap.
- e. We will provide you upfront and in timely manner, complete information on the charges applicable to all basic services.
- f. We will provide advance information to you about any proposed change in the service charges.
- g. We will collect for services given to you only such charges you have agreed to.
- h. We will inform you in an appropriate manner when we recover service charges from the account or the transaction.
- i. We will inform you in all cases where a transaction initiated by the bank results in or likely to lead to a shortfall in the minimum balance required to be maintained.

(The above recommendations are in line with the principles enunciated in paragraph 3.4.)

4.5. The Working Group observes that in the Code, certain commitments are already included for providing to the customers information about the service charges, the terms and conditions, and changes in these. The commitments listed above in (e) to (i) stand to expand the commitments in the Code relating to transparency and fairness in providing information. The Working Group suggests that items in the list may suitably be included in the Code.

4.6. The Working Group observes that BCSBI is slated to ensure compliance of its member banks with all the commitments enshrined in the Code. BCSBI is structured on the lines of a self-regulating organization of its member banks; the banks subscribe to the Code as a voluntary self-regulating mechanism and submit to the supervision by the BCSBI of the compliance of the member banks with the commitments. As stated above, BCSBI has already spelt out in the Banking Code Rules the manner in which the monitoring of compliance will take place. It appears that the terms for this Working Group, including the term of reference regarding BCSBI's monitoring, were drawn up prior to BCSBI finalizing their Rules. The Working Group finds that the Rules subsequently drawn up provide for the following in regard to monitoring of the banks' compliance:

- ❖ BCSBI will collect required information from the member banks.
- ❖ A representative of BCSBI will, when required, visit the bank premises.
- ❖ BCSBI will get from the banks Annual Statement of Compliance in the form that it will specify.
- ❖ BCSBI will receive from the banks' Code Compliance Officer details of breaches of the Code and remedial actions taken.



4.7. The Working Group finds that the monitoring on the above lines will be adequate to verify ongoing compliance with the Code. As regards information concerning service charges that BCSBI will collect from the member banks, the Working Group suggests that this may include the following items:

- (a) Details of complaints relating to:
 - (i) the rate and amount of service charges
 - (ii) the method of recovery of service charges
 - (iii) non-disclosure of service charges

The details may be taken from the complaints that have been received by the banks, as also those received by RBI and the Banking Ombudsman.

- (b) Information/reason which supports the fixing of the service charge in a bank or changes made therein.
- (c) The manner in which the service charges or changes therein have been notified to the customers/public.

The Working Group also suggests that BCSBI may track, from time to time, the changes in the levels of the service charges and on a comparative basis, to identify any abnormal increases. In addition to the information gathered from banks, BCSBI may look to feedback from Consumer Organisations and customer survey results to identify areas of significant non-compliances with the Code.



ANNEX 1 (RBI Circular on levy of service charges by commercial banks)

Dir. BC. 86 /13.10.00/99-2000

September 7, 1999
Bhadra 16, 1921(Saka)

All Commercial Banks

Dear Sirs

Levy of Service Charges by Commercial Banks

Hitherto Indian Banks' Association had been communicating the benchmark service charges to the member banks based on which each bank was expected to decide the charges. The Association had conveyed its views on the service charges to member banks vide its circular No.OPR/C.22-12/2 dated August 18, 1997.

2. We have since reviewed the entire matter of fixing rates for various service charges by the banks and it has been observed that the existing practice was consistent with the past regime of administered interest rates but is no more consistent with the current accent on competition.

3. It has, therefore, been decided that the practice of IBA fixing the benchmark service charges on behalf of member banks should be done away with and the decision to prescribe service charges should be left to the individual banks. Banks are advised that while fixing service charges for various types of services like charges for cheque collection, etc., they should ensure that the charges are reasonable and are not out of line with the average cost of providing these services. Banks should also take care to ensure that customers with low volume of activities are not penalised.

4. Banks are advised to make arrangements for working out charges with prior approval of their Boards of Directors as recommended under paragraph 3 above and operationalise them in their branches as early as possible.

5. Please acknowledge receipt.

Yours faithfully

(A. L. Narasimhan)
Chief General Manager

ANNEX 2 (Questionnaire used by the Working Group to obtain information from the banks)

The Chairman and Managing Director/
The Chief Executive Officer
.....Bank

Dear Sir,



Annual Policy Statement-Working Group to formulate a scheme for ensuring reasonableness of bank charges

As you may be aware, in terms of para 162 of the Annual Policy Statement 2006-07, a Working Group has been constituted under the chairmanship of Shri N. Sadasivan, Banking Ombudsman, Mumbai to formulate a scheme for ensuring reasonableness of bank charges for services rendered to individual customers and to incorporate the same in the Fair Practices Code.

2. In its first meeting, held on May 23, 2006, the Working Group had decided that information may be obtained from banks to know the basis on which the charges are fixed. For the purpose, please find attached a questionnaire seeking information relating to certain basic banking services and methodology of fixing charges for the same. Kindly arrange to send the information at the earliest. You are also requested to depute a senior officer to participate in a meeting to be convened in this regard at a later date.

Yours faithfully,

(Kaza Sudhakar)
Chief General Manager
& Member Secretary

Encl: One.

ANNEX 2 (Continued)

**Working Group to formulate a scheme for ensuring reasonableness of bank charges-
Questionnaire to obtain information from banks**

The service charges levied on the following banking services may be advised to us along with the basis and methodology adopted for arriving at the charges concerned:

- (i) Savings Bank Account with cheque facility-charges for non-maintenance of minimum balance.
- (ii) Savings Bank Account with cheque facility- charges for issuing account statement.
- (iii) Remittance facilities through own bank-Issue of Demand Draft.
- (iv) Remittance facilities through own bank-Issue of Duplicate Demand Draft.
- (v) Cheque Collection- Outstation through own bank.
- (vi) Cheque Collection- Bouncing of cheques-local.
- (vii) Stop Payment charges.



- (viii) Retail Loan- Prepayment charges.
- (ix) Retail Loan- Charges for no due certificate.
- (x) Locker rent for different sizes of lockers
- (xi) Signature attestation
- (xii) RTGS, ECS and NEFT inward and outward charges
- (xiii) Credit card annual fees and interest for rollover of credit.



ANNEX 3 (RBI Circular on Display of Service Charges)

RBI/ 2005-06/386

RPCD.BOS./81 /13.33.01/2005-06

May 16, 2006

The Chairman/Chief Executive Officer/Managing Director,
All Commercial Banks
(Including RRBs).

Dear Sir/Madam,

Annual Policy Statement for the year 2006-07-Fair Practices Code- Display of Bank Charges

Please refer to the paragraph 162 of the Annual Policy Statement for the year 2006-07, a copy of which is enclosed.

2. As per extant instructions, the decision to prescribe service charges is left to the discretion of the Boards of individual banks. Banks would normally be expected, while fixing the service charges, to ensure that charges are reasonable, consistent with the cost of providing these services and that the customers with low value/volume of transactions are not penalized.

3. The Reserve Bank continues to receive representations from the public about the unreasonable and non-transparent service charges being levied by banks indicating that the existing institutional mechanism in this regard is not adequate. In order to ensure transparency in banking services, you are advised to display and update, on your website, the details of various service charges in the enclosed format in Annex I. The formats could be modified depending on products offered but all service charges as indicated in Annex I should be covered.

4. You are also advised to display the charges relating to certain services as at Annex II in your offices/branches. This may also be displayed in the local language.

5. You may kindly furnish to us by May 31, 2006, the details of service charges presently applicable, to enable us to place them on the RBI website.

Yours faithfully,

(G.Srinivasan)
Chief General Manager



(ANNEX 3 Continued)

Annual Policy Statement for the year 2006-07 (April 2006)
Fair Practices Code: Reasonableness of Bank Charges

162. The Reserve Bank continues to receive representations from the public about unreasonable and non-transparent service charges being levied by banks indicating that the existing institutional mechanism in this regard is not adequate. In order to ensure fair practices in banking services, it is proposed:

- To make it obligatory for banks to display and update, in their offices/branches as also on their websites, the details of various service charges in a format to be approved by the Reserve Bank. The Reserve Bank would also place such details on its website.



(ANNEX 3 Continued)

ANNEX- I to the circular

Service Charges -Minimum Information to be put on the Bank's website

Name of the bank
Savings Bank A/c - No frills A/c
Minimum Balance
Charges for non maintenance thereof
Saving Bank Accounts with Cheque facility
Minimum Balance
Charges for non maintenance thereof
Saving Bank Accounts without Cheque facility
Minimum Balance
Charges for non maintenance thereof
Other savings bank account facilities
Issue of Duplicate Statement
Issue of loose cheque leaves
Issue of duplicate pass book
Mode of calculation of minimum balance
Remittance Facilities through own bank
DD- Issue
DD-Cancellation
DD-Duplicate
DD-Revalidation
PO - Issue
PO-cancellation
PO-Duplicate
PO-Revalidation
TT - Issue
TT - Cancellation
TT-Duplicate
TT-Revalidation
EFT Charges- inward
EFT Charges- outward
RTGS-Outward
RTGS-Inward
Collection of Cheques
Remittance Facilities through other bank
DD- Issue



DD-Cancellation
DD-Duplicate
DD-Revalidation
PO - Issue
PO-cancellation
PO-Duplicate
PO-Revalidation
TT - Issue
TT - Cancellation
TT-Duplicate
TT-Revalidation
EFT Charges- inward
EFT Charges- outward
RTGS-Outward
RTGS-Inward
Collection of Cheques
Foreign Exchange Transactions
Remittance Outward
Remittance Inward
TCs - Selling
TCs - Encashing
TCs - Foreign Currency
Cheque Collection
Local
Outstation through own bank
Outstation through another bank
Bouncing of cheques- Local
Bouncing of cheques- outstation- through own bank
Bouncing of cheques- outstation- through another bank
Retail Loan
Loan Processing Charges
Prepayment Charges
No due Certificate
Solvency Certificate
Charges for late payment of EMI
Charges for changing from fixed to floating rates of interest
Charges for changing from float to fixed rates of interest
Cards



ATM
Membership fee
Annual Fee
Renewal Charges
Late Payment Charges
Interest Charges
Replacement charges
Transaction Charge for Partner banks
Transaction Charge for Non-Partner banks
Credit Card
Membership fee
Annual Fee
Renewal Charges
Late Payment Charges
Interest Charges
Replacement charges
Cash withdrawal
Debit Card
Membership fee
Annual Fee
Renewal Charges
Late Payment Charges
Replacement charges
Cash withdrawal
MISCELLANEOUS
Balance enquiry
Balance Certificate
Interest Certificate
Account closure
Use of Fax/Telephone/Modem
Photo attestation
Signature attestation
Stop Payment Charges
Inoperative account



(ANNEX 3 Continued)

ANNEX – II to the circular

Service Charges-Minimum information to be displayed in the premises of bank branches.

A. Services rendered free of charge:

B. Others

Minimum Balances to be maintained in the SB account
Charges leviable for non-maintenance of minimum balance in SB account
Charges for collection of outstation cheques
Charges for issue of Demand Draft
Charges for issue of cheque books, if any
Charges for account statement
Charges for account closure, if any
Charges for deposit/withdrawal at ATM locations, if any