Report of the Committee on Medium-term Path on Financial Inclusion

December 2015

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Letter of Transmittal

December 28, 2015

Dr. Raghuram G. Rajan
Governor
Reserve Bank of India
Central Office
Mumbai 400 001.

Dear Sir,

Report of the Committee on Medium-term Path on Financial Inclusion

We are pleased to submit the Report of the Committee on Medium-term Path on Financial Inclusion.

Yours sincerely,

(Deepak Mohanty)
Chairman

(Ashok Gulati) Member	(Asli Demirgüç -Kunt) Member	(A.P. Hota) Member
(Paresh Sukthankar) Member	(Kishor P. Kharat) Member	(Subrata Gupta) Member
(Pawan Bakhshi) Member	(Sudarshan Sen) Member	(Arun Pasricha) Member
(Nanda S. Dave) Member	(Y.K. Gupta) Member	(Saibal Ghosh) Member

(A. Udgata)
Member-Secretary

Preface

Finance is a powerful intervention for economic development. Access to finance, especially for the poor, is empowering because financial exclusion often leads to broader social exclusion. Yet, formal finance does not appear to have adequately permeated vast segments of our society, although progress is being made.

To advance the process, the Reserve Bank has granted 'in principle' approval to a multitude of players in the financial eco-system to establish Payments Banks and Small Finance Banks. The recently announced *Jan Dhan Yojana* by the government marks a landmark in the quest for universal financial access. The government is also focusing on paying benefits directly into these accounts. This will ensure that a big chunk of the accounts opened under various schemes, which are presently dormant, witness 'movement', thereby integrating access with use. These are very heartening developments.

Several Committees in the recent past have opined on our quest for a more inclusive financial regime. The thrust of their recommendations was towards having an enabling regulatory framework, improving delivery systems and exploiting its possible synergies. At the Reserve Bank Conference on Financial Inclusion in April 2015, the Hon'ble Prime Minister urged the Reserve Bank to take the lead in encouraging financial institutions to set concrete targets for financial inclusion to help transform the quality of life of the poor. Against this backdrop, this Committee on Medium-term Path on Financial Inclusion (CMPFI) was set up to devise a measurable and monitorable action plan for financial inclusion that encompasses both households and small businesses.

The Committee sets a much wider vision of financial inclusion as 'convenient' access to a set a basic formal financial products and services that should include savings, remittance, credit, government-supported insurance and pension products to small and marginal farmers and low-income households at reasonable cost with adequate protection progressively supplemented by social cash transfer besides increasing the access for micro and small enterprises to formal finance with greater reliance on technology to cut costs and improve service delivery, such that by 2021 over 90 per cent of the hitherto underserved sections of society become active stakeholders in economic progress empowered by formal finance. Thus, the financial inclusion initiative as envisaged by the Committee is much broader in scope, going beyond the traditional domain of the Reserve Bank. Meaningful financial inclusion is not feasible without government-to-person (G2P) social cash transfer. There is also an opportunity to usher in next-generation reforms by replacing agricultural input subsidy with income support, which increases the personal disposable surplus of the poor on a regular basis and could place the inclusion effort on a solid foundation.

With the *Jan Dhan, Aadhaar and Mobile (JAM)*) trinity taking hold, there is an ideal opportunity to seamlessly integrate access and use and, in the process, ensure that leakages in financial transfers are substantially lowered. Innovative delivery channels, such as mobile wallet and e-money coupled with regulatory changes to allow interoperability across banks and non-banks, seem to hold the key to a more efficient payment system and reduce the fascination for cash. Banks need to integrate the Business Correspondent (BC) model into their business strategy and with help from technology can develop a low-cost, reliable, 'last mile' delivery channel that could win the trust of the common person. Biometric identification coupled with the provision of credit information to credit bureaus can help build a more robust credit system that can then be used as the basis for obtaining loans at reasonable costs while avoiding the pitfalls of over-indebtedness. For micro and small enterprises, professionals who can evaluate the creditworthiness of these firms by acting as intermediaries with the bank can help alleviate the significant credit gap in this sector.

In agriculture, millions of small farmers live on the precipice, starved of credit. In the absence of bold structural reforms of land digitisation and tenancy certification to enable credit to the tiller, the problem is likely to persist. Agricultural distress can only be addressed satisfactorily by instituting universal crop insurance for small and marginal farmers at a heavily subsidised rate by the government, the money for which can be funded by doing away with the current interest subsidy scheme that has distorted the agricultural credit system and seems to have impeded long-term investment. The issue of gender exclusion can be addressed by a welfare scheme for the girl child linked to education. Similarly, exclusion based on beliefs can be explored by delivering simple interest free financial products through a separate window in conventional banks.

While financial products have their benefits, there is a clear danger of mis-selling, which could damage marginalised segments who have an uncertain cash flow. Efforts on financial education need to be strengthened, including product-driven financial literacy so that the poor are not short-changed. Grievance redressal for customer complaints in banks needs some imaginative thinking. The overall governance structure would have to be more business-like, focused on delivery.

The Committee believes that addressing significant pockets of exclusion, the adoption of technology and allowing multiple models and partnerships to emerge could effectively buttress the cause of financial inclusion.

In its work, the Committee benefited from several quarters. I thank Dr. C. Rangarajan, Dr. Bimal Jalan, Dr. Y.V. Reddy and Dr. D. Subbarao, all former Governors of the Reserve Bank, for their words of wisdom, as this is an issue that engaged the attention of the Reserve Bank for several decades and continues to do so.

I thank Ms. Anjuly Chib Duggal, Secretary and Shri Rajesh Aggarwal, Joint Secretary, Department of Financial Services, Government of India for sharing their insights on this issue.

We thank Shri H.R. Khan, Shri R. Gandhi and Shri S.S. Mundra, Deputy Governors and Shri U.S. Paliwal, Executive Director for sharing their thoughts.

Our gratitude to Dr. Raghuram G. Rajan, Governor for his vision and for giving us the responsibility.

Finally, I thank the members of the Committee—Prof. Ashok Gulati, Dr. Asli Demirgüç-Kunt, Mr. A. P. Hota, Mr. Paresh Sukthankar, Mr. Kishor P. Kharat, Mr. Subrata Gupta, Dr. Pawan Bakhshi, Mr. A. Udgata, Mr. Sudarshan Sen, Mr. Arun Pasricha, Mrs. Nanda S. Dave and Dr. Y.K. Gupta—for many evenings of stimulating discussion that make the report what it is. My special thanks to Dr. Saibal Ghosh for putting up with our endless demands for technical finesse.

"…and miles to go before I sleep", said Robert Frost, the celebrated American poet. The task of financial inclusion is onerous, but is, by no means, insurmountable. It is hoped that the Report will provide inputs and ideas for policymakers to drive forward the financial inclusion agenda, and make us a more efficiently financially included society.

Deepak Mohanty

RESERVE BANK OF INDIA
CENTRAL OFFICE
MUMBAI

MEMORANDUM

Constitution of Committee on Medium-term Path on Financial Inclusion

Wider use of financial services is the key to economic progress and overall well being. In this context, Hon'ble Prime Minister in his address at the Reserve Bank of India (RBI) on the occasion of its 80th anniversary urged the Bank to take the lead in encouraging financial institutions and to set a medium-to-long term target for sustainable financial inclusion.

2. Over the years the RBI has been framing policies for financial inclusion to ease access to banking services, particularly for the financially excluded segments of the economy. Recently, this process got added impetus with the launch of Pradhan Mantri Jan-Dhan Yojana (PMJDY) by the Government. Consequently, quantitative achievements in terms of opening of basic bank accounts have been substantial. While access is the starting point, it may not naturally translate into inclusion. There is, therefore, a need to have a supportive institutional framework and policies besides right incentives for access to result in greater inclusion. In this regard, the RBI is working to reinforce the institutional framework by the introduction of Small Finance Banks and Payment Banks with the primary objective of enhancing financial inclusion. Another consideration is that cost and quality of access requires leveraging technology for better service delivery. Moreover, for financial inclusion to be successful it needs to progress beyond bank accounts to include services such as other important social security transfers and insurance.

3. To take this initiative forward, it has been decided to constitute a Committee with the primary objective of working out a medium-term (five year) measurable action plan for financial inclusion. The terms of reference of the committee are as under:

(i) To review the existing policy of financial inclusion including supportive payment system and customer protection framework taking into account the recommendations made by various committees set up earlier.

(ii) To study cross country experiences in financial inclusion to identify key learnings, particularly in the area of technology-based delivery models, that could inform our policies and practices.

(iii) To articulate the underlying policy and institutional framework, also covering consumer protection and financial literacy, as well as delivery mechanism of financial inclusion encompassing both households and small businesses, with particular emphasis on rural inclusion including group-based credit delivery mechanisms.

(iv) To suggest a monitorable medium-term action plan for financial inclusion in terms of its various components like payments, deposit, credit, social security transfers, pension and insurance.

(v) To examine any other related issues.

4. The composition of the Committee is as follows:

Chairman:

(i) Mr. Deepak Mohanty, Executive Director, RBI

Members:

(ii) Prof. Ashok Gulati, Infosys Chair Professor for Agriculture, ICRIER

(iii) Dr. Asli Demirgüç-Kunt, Director of Research, The World Bank, Washington DC

(iv) Mr. A. P. Hota, MD & CEO, National Payments Corporation of India

(v) Mr. Paresh Sukthankar, Deputy Managing Director, HDFC Bank Ltd.

(vi) Mr. Kishor P. Kharat, Executive Director, Union Bank of India

(vii) Mr. Subrata Gupta, Chief General Manager, NABARD

(viii) Mr. Pawan Bakhshi, Head-Financial Services for the poor programme in India, Bill and Melinda Gates Foundation

(ix) Mr. Sudarshan Sen, Principal Chief General Manager, DBR, RBI

(x) Mr. Arun Pasricha, Chief General Manager, CEPD, RBI

(xi) Mrs. Nanda S. Dave, Chief General Manager, DPSS, RBI

(xii) Dr. Y.K. Gupta, Director, DSIM, RBI

(xiii) Dr. Saibal Ghosh, Deputy Adviser, Research, CAFRAL

Member-Secretary:

(xiv) Mr. A. Udgata, Principal Chief General Manager, FIDD, RBI

5. Financial Inclusion and Development Department (FIDD), RBI will provide secretarial assistance to the Committee which may be supported by a small inter-disciplinary team.

6. The Committee may consult various stakeholders/groups/institutions/experts as considered necessary.

7. The Committee is expected to submit its report in four months from the date of its first meeting.

Raghuram G. Rajan

(Raghuram G. Rajan)
Governor
July 14, 2015

Acknowledgements

The Report of the Committee on Medium-term Path on Financial Inclusion (CMPFI) was made possible with the support and contributions of many individuals and organisations. The Committee would like to gratefully acknowledge representatives of credit information companies, representatives of PPIs/Telcos, representatives of microfinance institutions, officials of state-level bankers' committees, offices of lead banks in various states, BC agents and bank officials for providing insights from the ground. The Committee appreciates the support provided by the regional offices of the Reserve Bank at Chennai, Hyderabad, Guwahati and Kolkata in organising stakeholder meetings and conducting quick studies.

The Committee places on record its appreciation of the valuable contributions from officials from the State Bank of India, Shri G.K. Kansal, Chief General Manager and Shri J. K. Thakkar, General Manager who were special invitees to the Committee meetings.

In order to provide technical support, an Internal Working Group was ably led by Shri T.V. Rao, General Manager, supported by Shri Sanjay Singh, Assistant Adviser, Shri B.S Sonawane, Assistant General Manager, Shri Radheshyam Verma, Research Officer, Shri Sachin Sharma, Manager, and Ms. C. SreeRangini, Manager. The Committee also places on record the valuable contributions from Shri Jose J. Kattoor and Shri R.K. Moolchandani, General Managers, Shri Prabhat Kumar, Deputy General Manager, Ms. Mary Kochuvaried, Assistant General Manager and Smt. Manisha Kale, Shri Swapnil Kumar Shanu, Shri S. Subramanian, Ms. Chaitanya Devi and Shri Gajendra Sahu, Managers.

The Committee would like to commend the enormous hard work put in by the Secretariat team from the Financial Inclusion and Development Department (FIDD) led by Shri Bipin S. Nair, Assistant General Manager supported by Smt. Mruga M. Paranjape, Shri Vergese Mathews, Managers, Shri Deepak H. Waghela, Assistant Manager, Shri Kumud Kumar and Shri Vikas Saini. The Committee also places on record the excellent assistance provided by Smt. S. Mane and Shri S.S. Jogale.

The Committee thanks Dr. A.S. Ramasastri, Dr. Gautam Chatterjee, Smt. Balbir Kaur, Smt. Lily Vadera and Smt. Jaya Mohanty for their suggestions. Finally, the Committee would like to thank other institutions and members of the public who gave their comments and suggestions.

List of Abbreviations

AIC	Agriculture Insurance Company
AIDIS	All-India Debt and Investment Survey
ANBC	Adjusted Net Banking Credit
AP	Andhra Pradesh
APB	Aadhaar Payment Bridge
ATM	Automated Teller Machine
AWS	Automated Weather Station
BC	Business Correspondent
BCA	Business Correspondent Agent
BCSBI	Banking Codes and Standards Board of India
BDC	Benazir Debit Card
BISP	Benazir Income Support Programme
BNM	Bank Negara Malaysia
BOS	Banking Ombudsman Scheme
BPL	Below Poverty Line
BRICS	Brazil, Russia, India, China and South Africa
BSBDA	Basic Savings Bank Deposit Account
BSE	Bombay Stock Exchange
CAGR	Compound Annual Growth Rate
CBS	Core Banking Solution
CBSE	Central Board for Secondary Education
CD Ratio	Credit-Deposit Ratio
CEP	Consumer Education and Protection
CEPD	Consumer Education and Protection Department
CERC	Central Electricity Regulatory Commission
CGAP	Consultative Group to Assist the Poor
CGA	Credit Guarantee Agency
CGCMB	Credit Guarantee Corporation Malaysia Berhad
CGC	Commercial Guarantee Company
CGS	Credit Guarantee Scheme
CGTMSE	Credit Guarantee Trust for Micro and Small Enterprises
CIC	Credit Information Company
CIN	Corporate Identity Number
CP	Consumer Protection
CRAR	Capital to Risk Weighted Assets Ratio
CSP	Customer Service Point
CSR	Corporate Social Responsibility
CSS	Centrally Sponsored Scheme
DAR	Debt-to-Asset Ratio
DBT	Direct Benefit Transfer
DCC	District Consultative Committee
DCCB	District Central Co-operative Bank
e-KYC	Electronic – Know Your Customer
EMDE	Emerging Market and Developing Economy
E-Money	Electronic Money
FCP	Financial Consumer Protection
FIDD	Financial Inclusion and Development Department
FII	Financial Inclusion Insights
FINDEX	Financial Inclusion Index
FIP	Financial Inclusion Plans
FLCC	Financial Literacy Counselling Centre
FLC	Financial Literacy Centre
FSA	Financial Services Authority
FSB	Financial Stability Board
FSDC	Financial Stability and Development Council
FSDC-SC	Financial Stability and Development Council – Sub Committee
FY	Financial Year
G20	Group of 20
G2P	Government-to-Person
GCA	Gross Cropped Area
GCC	General Credit Card
GDP	Gross Domestic Product
GIS	Geographical Information System
GOI	Government of India
GPS	Global Positioning System
GSM	Global System for Mobile
GVA	Gross Value Added
HQLA	High Quality Liquid Asset

IBA	Indian Banks' Association
ICC	Integrated Contact Centre
ICT	Information and Communication Technology
IDB	Islamic Development Bank
IFSB	Islamic Financial Services Board
IMF	International Monetary Fund
INR	Indian Rupee
IOI	Incidence of Indebtedness
JAM	Jan Dhan Aadhaar Mobile
JLG	Joint Liability Group
KCC	Kisan Credit Card
KFH	Kuwait Finance House
KODIT	Korea Credit Guarantee Fund
KRW	South Korean Won
LBS	Lead Bank Scheme
LCR	Liquidity Coverage Ratio
LPG	Liquid Petroleum Gas
MCGA	Municipal Credit Guarantee Agency
MENA	Middle East and North Africa
ME	Medium Enterprise
MFI	Micro-Finance Institution
MGF	Mutual Guarantee Funds
MIT	Massachusetts Institute of Technology
MLI	Member Lending Institute
MNREGA	Mahatma Gandhi National Rural Employment Guarantee Act
MSE	Micro and Small Enterprise
MSME	Micro, Small and Medium Enterprise
MUDRA	Micro Units Development and Refinance Agency Ltd
NABARD	National Bank for Agriculture and Rural Development
NBFC	Non-Banking Financial Company
NDP	Net Domestic Product
NEFT	National Electronic Funds Transfer
NGO	Non-Government Organisation
NIC	National Informatics Centre
NIPFP	National Institute of Public Finance and Policy
NPCI	National Payments Corporation of India

NPL	National Priorities List
NRLM	National Rural Livelihood Mission
NSA	Net Sown Area
NSDP	Net State Domestic Product
NSFE	National Strategy for Financial Education
NSSO	National Sample Survey Organisation
NUUP	National Unified USSD Platform
O&M	Operation and Maintenance
OBO	Office of Banking Ombudsman
OIC	Organisation for Islamic Cooperation
PACS	Primary Agriculture Credit Society
PA-HAL	Pratyaksha Hastaantarit Labh
PAN	Permanent Account Number
PCGA	Provincial Credit Re-Guarantee Agency
PCNSDP	Per Capita Net State Domestic Product
PLS	Profit and Loss Sharing
PMJDY	Pradhan Mantri Jan Dhan Yojana
PMRY	Pradhan Mantri Rojgar Yojana
PoS	Point-of-Sale
PPI	Prepaid Payment Instrument
PPP	Purchasing Power Parity
PSIA	Profit Sharing Investment Account
PSL	Priority Sector Lending
PTC	Pass-Through Certificate
RAROC	Risk Adjusted Return on Capital
RBI	Reserve Bank of India
SLR	Statutory Liquidity Ratio
SME	Small and Medium Enterprise
SPV	Special Purpose Vehicle
RIDF	Rural Infrastructure Development Fund
RoR	Record of Rights
RRB	Regional Rural Bank
RSETI	Rural Self Employment Training Institute
SBLP	SHG Bank Linkage Programme
SCB	Scheduled Commercial Bank
SERP	Society for Elimination of Rural Poverty

SGSRY	Swarna Jayanti Shahari Rozgar Yojana
SGSY	Swarnajayanti Gram Swarozgar Yojana
SHG	Self-Help Group
SIDBI	Small Industries Development Bank of India
SIM	Subscriber Identity Module
SLBC	State Level Bankers' Committee
StCBs	State Co-operative Banks
T&D	Transmission and Distribution
TGFIL	Technical Group on Financial Inclusion and Financial Literacy
TRAI	Telecom Regulatory Authority of India
TSP	Technology Service Provider
UCB	Urban Co-operative Bank
UKFSA	UK Financial Services Authority
USOF	Universal Service Obligation Fund
UT	Union Territory
ZIP	Zone Improvement Plan

Summary of Recommendations

Chapter	Recommendations
1	Given the enormity of the tasks and complexity of the issues, the Committee believes that dovetailing relevant financial policies with necessary structural reforms where the government has a central role can deliver real financial inclusion in a sustainable and stable manner **[Recommendation 1.1].**
	The Committee felt that although a quantum jump in banking access has taken place, a sig-nificant element of regional exclusion persists for various reasons that need to be addressed by stepping up the inclusion drive in the north-eastern, eastern and central states to achieve near-universal access. This may entail a change in the banks' traditional business model through greater reliance on mobile technology for 'last mile' service delivery, given the chal-lenges of topography and security issues in some areas. The Government has an important role to play in ensuring mobile connectivity. In some of the areas, mobile connectivity may not be commercially viable to start with, but the telecom service providers may be encour-aged to use their corporate social responsibility (CSR) funds for this purpose. The Commit-tee is of the view that the State-Level Bankers Committee (SLBC) is an appropriate forum to address such infrastructure issues in a collaborative manner. The use of Universal Service Obligation Fund (USOF), a non-lapsable fund designed to support a variety of innovation initiatives, can also be explored in this regard. **[Recommendation 1.2].**
	Considering the still significant exclusion of women, the Committee recommends that banks have to make special efforts to step up account opening for females. Given the government's emphasis on the welfare of the girl child, the Committee suggests that the government can consider a welfare scheme—Sukanya Shiksha —that can be jointly funded by the central and state governments. The scheme will link education with banking habits by crediting a nominal amount, in the name of each girl child belonging to the lower income group who enrols in middle school. This would make it incumbent on the school and the lead bank and its designated branch to open a bank account for social cash transfer. This scheme can also have the benefit of lowering school dropout rates and empower the girl child **[Recommendation 1.3].**
	Given the predominance of individual account holdings, the Committee recommends that a unique biometric identifier such as Aadhaar should be linked to each individual credit account and the information shared with credit information companies. This will not only be useful in identifying multiple accounts, but will also help in mitigating the overall indebtedness of individuals who are often lured into multiple borrowings without being aware of its consequences **[Recommendation 1.4].**
	The Committee recommends that a low-cost solution based on mobile technology can be a good candidate for improving financial inclusion by enhancing the effectiveness of 'last mile' service delivery **[Recommendation 1.5].**
	The Committee recommends that a key component of the financial inclusion policy should be to improve the credit system for the underprivileged, particularly millions of poor agricultural households, so as to ensure a perceptible shift of credit demand from the informal to the formal sector **[Recommendation 1.6].**

2. The Committee observes that despite improved financial access, usage remains low, underscoring the need to better leverage technology to facilitate usage **[Recommendation 2.1].**

On the basis of cross-country evidence and our own experience, the Committee is of the view that to translate financial access into enhanced convenience and usage, there is a need for better utilisation of the mobile banking facility and the maximum possible G2P payments, which would necessitate greater engagement by the government in the financial inclusion drive **[Recommendation 2.2].**

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3. The Committee recommends that in order to increase formal credit supply to all agrarian segments, the digitisation of land records should be taken up by the states on a priority basis **[Recommendation 3.1].**

In order to ensure actual credit supply to the agricultural sector, the Committee recommends the introduction of Aadhaar-linked mechanism for Credit Eligibility Certificates. For example, in Andhra Pradesh, the revenue authorities issue Credit Eligibility Certificates to Tenant Farmers (under 'Andhra Pradesh Land Licensed Cultivators Act No 18 of 2011'). Such tenancy /lease certificates, while protecting the owner's rights, would enable land-less cultivators to obtain loans. The Reserve Bank may accordingly modify its regulatory guidelines to banks to directly lend to tenants / lessees against such credit eligibility certificates **[Recommendation 3.2].**

The Committee recommends phasing out the interest subvention scheme and ploughing the subsidy amount into a universal crop insurance scheme for small and marginal farmers (detailed in Chapter 8) **[Recommendation 3.3].**

The Committee recommends that the Kisan Credit Card (KCC) should continue to have a built in consumption credit component, recognising that while agricultural income could be lumpy, expenditure is an on-going process that results in negative cash flow for several months. A scheme of 'Gold KCC' with higher flexibility can be introduced for borrowers with prompt repayment records. Expenditure towards organic certification should be allowed under KCC. The government-sponsored personal insurance may be dovetailed with the KCC scheme. Going forward, a KCC can be explored which can provide a benefits tracking mechanism **[Recommendation 3.4].**

The Committee is of the view that with the digitisation of land records, which secures ownership, co-operative farming should be encouraged at the local level by panchayats. This would enhance the use of mechanisation and reduce input costs and prices. NGOs and Farmer Associations should educate farmers on the benefits of land consolidation. In each district, the efforts of the supply co-operatives, marketing co-operatives and credit co-operatives should be strengthened to encourage co-operative farming **[Recommendation 3.5].**

The Committee is of the view that the best way to take JLGs forward would be to have them join hands and form Producer Organisations. Capacity building of JLG members should be made essential and ways should be devised for market linkage of the produce/products **[Recommendation 3.6].**

The Committee recommends that a universal crop insurance scheme covering all crops should be introduced starting with small and marginal farmers with a monetary ceiling say of ₹200,000. The insurance should be mandatory for all agricultural loans. The insurance should be made affordable, with the farmer paying a nominal premium and the balance coming from government subsidy. The government can phase out the agricultural loan interest subvention scheme and plough back that allocation into the crop insurance subsidy. A graded crop insurance could be made available to medium and large cultivators with higher monetary ceiling and lower government subsidy **[Recommendation 3.7].**

The government may restructure the Agriculture Insurance Company (AIC) to take up the role of a dedicated 'Crop Insurance Corporation'. It should develop/run the programmes, promote competition including inviting bids from private insurance companies, usher in state-of-the art technology at all levels and arrange reinsurance of claims as well as the intensification of Automated Weather Stations (AWS) to ensure that at least one accredited AWS is set up every 10 kilometres. There would also be a need for installing additional rainfall data loggers **[Recommendation 3.8].**

The Committee feels that the use of technology would make the insurance scheme more efficient. Satellite imagery can be used for 'crop mapping' and to assess damage. GPS-enabled hand-held devices can be used for 'ground trothing'. In addition, drones and dove, micro satellites could also be deployed to assess crop damages. This will reduce the number of crop-cutting experiments required and will ensure faster claims settlement **[Recommendation 3.9].**

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4. The Committee recommends that any policy action for the MSME sector would need to consider several possibilities, be it new institutions or intermediaries who can help bridge the information gaps that plague these entities or even innovative ways of providing finance to this sector **[Recommendation 4.1].**

Keeping in view the extant over-extension of guarantees by the CGTMSE as well as the international evidence, the Committee recommends that multiple guarantee agencies, both public and private, that can provide credit guarantees in niche areas may be encouraged. This will not only reduce the burden on the CGTMSE but also make the extant insurance scheme economically viable **[Recommendation 4.2].**

In order to deepen the credit guarantee market, the role of counter guarantee and re-insurance companies should be explored **[Recommendation 4.3].**

MSEs that can provide collateral should not be put under the guarantee scheme, thereby reducing the pressure on the CGTMSE **[Recommendation 4.4].**

Accordingly, the Committee recommends a system of unique identification for all MSME borrowers and the sharing of such information with credit bureaus. While such identification and tracking is not an issue with registered MSMEs where the CIN/UAN can be used alongside their PAN number, biometric Aadhaar identification should form the basis for proprietary and partnership concerns. Even in the case of registered MSMEs, it will be useful to collect and link the Aadhaar identification of directors so as to check possible fraudulent operation by the same set of persons **[Recommendation 4.5].**

The Committee recommends exploring a system of professional credit intermediaries/ advisors for MSMEs, which could help bridge the information gap and thereby help banks to make better credit decisions. The credit intermediaries/ advisors could function in a transparent manner for a fee and be regulated by the Reserve Bank **[Recommendation 4.6].**

Besides exploring innovative financing methods, the Committee recommends that a framework for movable collateral registry for MSEs may be examined to step up financing to this sector **[Recommendation 4.7].**

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5. The Committee recommends that commercial banks in India may be enabled to open specialised interest-free windows with simple products like demand deposits, agency and participation securities on their liability side and to offer products based on cost-plus financing and deferred payment, deferred delivery contracts on the asset side **[Recommendation 5.1].**
In the event that interest-free banking is allowed in India, the extant regulatory guidelines in respect of capital and liquidity as applicable in the case of commercial banks would have to be made applicable to those as well **[Recommendation 5.2].**

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6. Multiple models and partnerships covering different niches should be encouraged. This is particularly the case among national full-service banks, regional banks of various types, NBFCs and semi-formal financial institutions, as well as the newly-licensed payments banks and small finance banks **[Recommendation 6.1].**

The Committee recommends that BCs should increasingly be established at fixed location BC outlets: the BC outlet/Customer Service Point (CSP) could be opened in the Village Panchayat Office, kirana shop, personal residence or any other convenient location that could win the confidence of the customer **[Recommendation 6.2].**

Monitoring of BCs should be allotted to designated link branches in the area. This will help strengthen BC operations and bridge the trust deficit **Recommendation 6.3].**

The competence of BCs should not be taken for granted. Accordingly, the Committee recommends a graded system of certification of BCs, from basic to advanced training. BCs with a good track record and advanced training can be trusted with more complex financial tasks such as credit products that go beyond deposit and remittance. The BC model increasingly needs to move from cost to revenue generation to make it viable **[Recommendation 6.4].**

The Committee recommends that banks will have to consider introducing a cash management system that can help to scale up BC operations **[Recommendation 6.5].**

The Committee recommends that the Indian Banks' Association (IBA) may create a Registry of BC Agents wherein BCs will have to register before commencement of operations. The registration process should be simple online process with photo and Aadhaar identification. It could include other details such as name of the BC, type of BC, location GIS coordinates of fixed point BCs, nature of operations, area of operation and, at a subsequent stage, their performance record including delinquency. This database can be made dynamic with quarterly updates, including a list of black-listed BCs which no other bank should approach or work with. This would help banks and other agencies to track the movement of BCs and supervise their operations more efficiently **[Recommendation 6.6].**

The Committee recommends that the Reserve Bank should take the lead in creating a geographical information system (GIS) to map all banking access points which would help improve the efficiency of regulating, supervising and monitoring of banking operations. Over time, a harmonised database of financial inclusion footprints, in terms of outlets, service points, devices and agent networks, may be put in place using a GIS platform **[Recommendation 6.7].**

The Committee is of the view that it is imperative for banks to conduct periodic reviews of its efforts under their financial inclusion plans (FIPs) at the Board level. This would facilitate banks to take timely corrective steps and prepare concrete strategic action plans **[Recommendation 6.8].**

The Committee recommends that NABARD may work out a programme along with other stakeholders to step up the SBLP, particularly in regions with less penetration. In this context, the District Consultative Committee (DCC) and SLBCs are the appropriate forum to sort out inter-institutional issues and set monitorable and implementable targets (see Chapter 10) **[Recommendation 6.9].**

The Committee is of the view that training of BC should also include their sensitisation towards SHGs **[Recommendation 6.10].**

Keeping in view the indebtedness and rising delinquency, the Committee is of the view that the credit history of all SHG members would need to be created, linking it to individual Aadhaar numbers. This will ensure credit discipline and will also provide comfort to banks **[Recommendation 6.11].**

The Committee sees the SHG-corporate linkage working as 'micro-factories' of corporates. An example is ITC's 'Mission Sunehra Kal'. Corporates can be encouraged to nurture SHGs as part of their Corporate Social Responsibility (CSR) initiatives **[Recommendation 6.12].**

The Committee recommends that bank credit to MFIs should be encouraged. The MFIs must provide credit information on their borrowers to credit bureaus through Aadhaar-linked unique identification of individual borrowers **[Recommendation 6.13].**

The Committee thinks it important to ensure adequate funding from channels that have stronger access (e.g., banks) to channels that are equipped and have the appetite to extend small-ticket loans, but may not have the same access to funding (e.g., NBFCs). The suitability of the products for the customer needs to be kept in view in this regard. Encouraging the development of the securitisation market for such small-ticket loans could be useful in this respect and help commercial banks acquire loans that qualify for priority sector lending **[Recommendation 6.14].**

The Committee is of the view that in order to preserve institutional neutrality, credit reporting requirements need to be harmonised across all credit providers. For instance, all lenders to the small borrower segment must be mandated to report to credit bureaus as has been the case with NBFC-MFIs. Therefore, the picture of indebtedness of the borrower must also include outstanding KCC, GCC and SHG loans. Once a realistic picture of the total indebtedness of the borrowers has been obtained, restrictions such as the maximum number of lenders per borrower can be removed, paving the way for competition to push down interest costs for the small borrower **[Recommendation 6.15].**

CICs also have a significant role to play in enabling credit flow to MSMEs, especially those without formal registration and standard accounting practices by helping them build a sound credit history (Chapter 5 provides details) **[Recommendation 6.16].**

In the absence of a framework for sharing of information among CICs, the same credit information is required to be provided to all CICs, which not only leads to avoidable duplication but also magnifies the reporting burden. The Committee recommends that a mechanism for mutual sharing of basic credit information for a fee among CICs should be mandated so that the lender could report to any of the CICs **[Recommendation 6.17].**

The advent of Payment Banks, an increasing number of cash-in and cash-out points through BCs, micro ATMs, mobile wallets and Rupay in the rural areas will enable customers to increase their access to the formal payment system. Over time, this would make it easier for banks to assess customers' repayment capability, as most of the cash flows will become digitally recorded. This, in turn, will lead to lenders being able to conceive and build automated credit decision models, which reduces the cost of credit underwriting. This would also enable banks to better monitor cash flows on an ongoing basis and to step up risk mitigating measures **[Recommendation 6.18].**

The Committee is of the view that the tax-exempt status for securitisation vehicles needs to be restored so that such entities do not have to pay distribution tax, given their critical role in efficient risk transmission. This will not lead to a loss of tax revenues since the income will still be fully traceable and taxable in the hands of the investors. Besides reviving and strengthening the securitisation market, these vehicles will allow a wide range of investors to participate in financing the pool of assets by means of Special Purpose Vehicles and rated Pass-through Certificates (PTCs). These would need to be structured such that the originator has continued incentives to monitor the project while having reduced their own exposure to the full extent of the project risk. This instrument can facilitate the growth of the retail credit market, particularly in areas such as home loans, farm loans and loans to landless labourers **[Recommendation 6.19].**

The current restriction requiring that the all-inclusive interest charged to the ultimate borrower by the originating entity must not exceed the base rate of the purchasing bank plus 8 per cent per annum must be removed, because this dissuades originators from expanding to low-access regions and sectors due to the high operating and borrowing costs **[Recommendation 6.20].**

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7 The Committee is of the view that given the low penetration of ATMs, installing more ATMs in rural and semi-urban centres will create more touch points for customers. The Financial Inclusion Fund (FIF) may be utilised to encourage rural ATM penetration **[Recommendation 7.1].**

The Committee recommends that interoperability of micro ATMs should be allowed to facilitate the usage of cards by customers in semi-urban and rural areas across any bank micro ATM and BC. For this, connectivity of micro ATMs to the National Financial Switch should be enabled. Adequate checks and balances should be put in place to ensure customer protection and system safeguards **[Recommendation 7.2].**

Considering the widespread availability of mobile phones across the country, the Committee recommends the use of application-based mobiles as PoS for creating necessary infrastructure to support the large number of new accounts and cards issued under the PMJDY. Initially, the FIF can be used to subsidise the associated costs. This will also help to address the issue of low availability of PoSs compared to the number of merchant outlets in the country. Banks should encourage merchants across geographies to adopt such application-based mobile as a PoS through some focused education and PoS deployment drives **[Recommendation 7.3].**

The Committee feels that banks need to introduce a simple registration process for customers to seed their mobile number for alerts as well as financial services. The Reserve Bank has already required banks to enable an interoperable ATM channel for mobile number registration **[Recommendation 7.4].**

The Committee recommends that the National Payments Corporation of India (NPCI) should ensure faster development of a multi-lingual mobile application for customers who use non-smart phones, especially for users of NUUP; this will address the issue of linguistic diversity and thereby promote its popularisation and quick adoption **[Recommendation 7.5].**

The Committee is of the opinion that the government may undertake initiatives to resolve the issues of number of steps per session in a transaction on NUUP, session drops and session charges; the Reserve Bank and NPCI may co-ordinate with the Telecom Regulatory Authority of India (TRAI) on this matter. Aadhaar and e-KYC should be the uniform KYC accepted by all regulators including TRAI **[Recommendation 7.6].**

For smart phone users, the Committee recommends that the NPCI work on developing a standardised interface application, which will ensure interoperability in mobile-banking transactions for customers. It should be implemented with proper due diligence and the required security checks **[Recommendation 7.7].**

The Committee recommends that pre-paid payment instrument (PPI) interoperability may be allowed for non-banks to facilitate ease of access to customers and promote wider spread of PPIs across the country. It should however require non-bank PPI operators to enhance their customer grievance redressal mechanism to deal with any issues thereof **[Recommendation 7.8].**

The Committee is of the view that for non-bank PPIs, a small-value cash-out may be permitted to incentivise usage with the necessary safeguards including adequate KYC and velocity checks **[Recommendation 7.9].**

Currently, many merchants discriminate against card payment by levying a surcharge on credit card transactions, which should not be allowed once the merchant has voluntarily agreed to participate in such modes of payments **[Recommendation 7.10].**

As there is a gap not only between product availability and awareness about such products but also about the precautions to be followed while using a digital or electronic payment product, the Committee recommends a wider financial literacy drive that exploits all possible communication channels to educate customers. The financial support for such campaigns can be drawn from the FIF **[Recommendation 7.11].**

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8. The Committee recommends that the deposit accounts of beneficiaries of government social payments, preferably all deposits accounts across banks, including the 'in-principle' licensed payments banks and small finance banks, be seeded with Aadhaar in

a time-bound manner so as to create the necessary eco-system for cash transfer. This could be complemented with the necessary changes in the business correspondent (BC) system (see Chapter 6 for details) and increased adoption of mobile wallets to bridge the 'last mile' of service delivery in a cost-efficient manner at the convenience of the common person. This would also result in significant cost reductions for the government besides promoting financial inclusion **[Recommendation 8.1].**
Given the increased role of the states in public welfare and the elimination of poverty and the higher transfer payments by the state governments following the 14th Finance Commission recommendations, the Committee recommends that the states need to adopt direct benefit transfer (DBT) more vigorously. In this context, the State-Level Bankers Committee (SLBC) can play an active role in addressing issues relating to convenient banking access, Aadhaar linking of beneficiary accounts and related infrastructure challenges **[Recommendation 8.2].**

The Committee recommends that the government may phase out the agricultural input subsidy and replace it with an income transfer scheme, which could potentially transform the agriculture sector besides promoting financial inclusion. This would first require digitisation of land records for clear titles and credit linkage to establish evidence of cultivation **[Recommendation 8.3].**

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9. The FLC network needs to be strengthened to deliver basic financial literacy at the ground level. Banks need to identify a few lead literacy officers who could train the people manning FLCs. The lead literacy officer in turn could be trained by the Reserve Bank in its College of Agricultural Banking (CAB) for which simple course material can be developed by CAB in collaboration with the concerned department in the Reserve Bank, i.e., the FIDD. Since simplicity in communicating complex financial issues is important, CAB can associate creative communication experts in the design of key messages, exploiting innovative technologies and relevant content based on customer segments **[Recommendation 9.1].**

A 'one size fits all' approach for financial education might be less than ideal as different target groups need different kinds of financial education. As a result, the content needs to be customised for different target groups. These will need to be followed up at periodic intervals to ascertain its impact **[Recommendation 9.2].**

There is a need for a structured programme for holding periodic financial literacy camps in pre-identified areas in every district, which should be regularly monitored by the DCCs. The lead bank for the district should play a leading role in identifying and allocating areas among the participating banks **[Recommendation 9.3].**

Local resources such as NGOs and theatre groups can be tapped to spread the message of literacy in an interesting manner to the local population for which funding can come from financial inclusion fund **[Recommendation 9.4].**

A technology-driven system through interactive screens/kiosks to encourage self-learning by people newly inducted into the financial system can be explored. The content can be updated from a central location, using the existing software. Possible locations for such kiosks, such as post offices, community health centres and panchayat offices, can be explored **[Recommendation 9.5].**

A financial literacy week can be observed every year in which participants demonstrate and exhibit the financial literacy tools and techniques that they use and share their success stories. This will bring out best practices in the system to achieve large-scale financial literacy. This will serve as a platform for co-ordination among different stakeholders of financial literacy **[Recommendation 9.6].**

Rural Self Employment Training Institutes (RSETIs), which have a dedicated infrastructure in each district of the country to impart training and skill upgrading of rural youth, can also be used for financial education of MSMEs **[Recommendation 9.7].**

The Committee recommends that the Reserve Bank commission periodic dipstick surveys across states to ascertain the extent of financial literacy and identify gaps in this regard. The results can provide policy-makers with a better understanding of the demand-side challenges **[Recommendation 9.8].**

The first pillar of complaint and grievance redressal is the branch, failing which it is the bank's internal ombudsman. Each branch should, therefore, be required to prominently display the name, phone number and email address of the designated officials for such complaints. The Reserve Bank should ensure compliance through random branch visits **[Recommendation 9.9].**

The Reserve Bank Banking Ombudsman at regional offices may make periodic field visits to directly receive customer complaints **[Recommendation 9.10].**

While continuing with the existing mechanism, all regulated entities would be required to put in place a technology-based platform for SMS acknowledgement and disposal of customer complaints, which can provide an audit trail of grievance redressal. All banks must have an online portal for customers to fill complaints **[Recommendation 9.11].**

Banks may be required to submit the consolidated status of number of complaints received and disposed off under broad heads to the CEPD, and the Reserve Bank, in turn, can release an annual bank-wise status in the public domain **[Recommendation 9.12].**

The Banking Codes and Standards Board of India (BCSBI) in collaboration with the Banking Ombudsman and the Indian Banks' Association (IBA) can explore the possibility of devising a scheme based on transparent criteria that incentivises banks to expeditiously address customer grievances **[Recommendation 9.13].**

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10. The Information Monitoring System needs to be strengthened. Currently, data flow takes a bottom-up approach wherein the branches of the banks in a district submit data to the lead bank and the lead bank consolidates the data manually and prepares the district-level database for review in meetings. Further, all lead banks submit data to the SLBC, which consolidates the state-level data for review in SLBC meetings. The Committee believes that it is equally important to explore a top-down approach for data flow, in a simple, uniform and meaningful format, with the help of the Core Banking Solution of the regional offices of the concerned bank. The monitoring process needs to be standardised in terms of reports, and also cover usage parameters. The data can flow from the central database of banks to various lower levels to ensure data consistency and integrity **[Recommendation 10.1].**

District credit plans need to be more realistic. The district-level credit plans should be prepared by lead banks, taking into account the potential linked plans prepared by NABARD every year which should take into account the availability of infrastructure, marketing facilities and policies/ programmes of the government, including the support by the concerned government departments of the local level in the spirit of the lead bank scheme **[Recommendation 10.2].**

At present, public sector banks have been given the lead bank responsibility with the exception of one private bank. The Committee feels that the responsibility of the SLBC / lead bank scheme should be given to different banks on a rotation basis for a fixed time-frame (of say 3 years) to facilitate fresh thinking and initiative as well as to instil a spirit of competition **[Recommendation 10.3].**

The Committee is of the view that banks with lead bank responsibilities can create a separate webpage with respect to their lead bank operations including the conduct of business in DCC meetings **[Recommendation 10.4].**

The current policy discussions across most SLBCs put substantial emphasis on the credit-deposit (CD) ratio. Rather, greater focus should be on development aspects for which the CD ratio could be a by-product. Such deliberations can include livelihood models, social cash transfer issues, gender inclusion, inclusion of different groups, Aadhaar seeding and universal account opening. There can also be other sets of issues that are region-specific and can focus on areas such as policy towards fraudulent deposit/ investment schemes, physical/network infrastructure and recovery management **[Recommendation 10.5].**

Given the focus on technology and the increasing number of customer complaints relating to debit/credit cards, the National Payments Corporation of India (NPCI) may be invited to SLBC meetings. They may particularly take up issues of Aadhaar-linkage in bank and payment accounts **[Recommendation 10.6].**

Financial Inclusion in India

Access counts, but usage matters

1

Chapter

Reforming to transform is a marathon, not a sprint.
Clearly, our financial inclusion reform has been transformational.

Extracts from the Hon'ble Prime Minister's Address at Delhi Economics Conclave, 6 November 2015

Financial inclusion, broadly understood as access to the formal financial sector for the marginalised and formal-finance deprived sections of society, has increasingly come to the forefront of public discourse in recent years. Policymakers all over the world are exploring ways and means to ensure greater inclusion of the financially excluded segments of society. There has been renewed global impetus to financial inclusion, particularly following the global financial crisis in 2008. It is believed that financial inclusion could be welfare-enhancing and, as a result, there is greater political support for the entire process.

In India, providing access to formal financial services and products has been a thrust of banking policy for several decades. The current thinking at the global level has also had its echo in India, with policymakers at various levels undertaking a wide range of measures to include the excluded or the under-served within the fold of formal finance. Accordingly, the Government and the Reserve Bank have undertaken a whole host of innovative and dedicated measures to drive forward the financial inclusion agenda.

Against this backdrop, the Committee felt that it would be useful to take stock of the current status of financial inclusion so as to better understand the kind of policy interventions that could accelerate the process. Accordingly, in what follows, the extant evidence is carefully analysed, focusing first on physical indicators such as branch network and accounts and, subsequently, on financial indicators such as credit and deposits. The international experience is dwelt upon, as appropriate and relevant. In order to keep the discussion contextual, the focus is on the more recent period, i.e., the period from 2006 onwards, because several previous Committees have already extensively documented India's financial inclusion experience within a broader historical context (see Annex for a summary).

The big push towards financial inclusion in India has emanated from the *Pradhan Mantri* JanDhan Yojana (PMJDY) in August 2014 and the Jan Dhan Aadhaar Mobile (JAM) trinity articulated in the Government's *Economic Survey* 2014-15 as well as the special thrust on financial inclusion by the Financial Stability and Development Council (FSDC) that includes a Technical Group for dedicated attention to this issue. Thus, the inclusion drive has gone beyond the confines of various financial regulators and assumed the character of a broader national development policy goal.

Recommendation 1.1
Given the enormity of the tasks and complexity of the issues, the Committee believes that dovetailing relevant financial policies with necessary structural reforms where the government has a central role can deliver real financial inclusion in a sustainable and stable manner.

Banking penetration of rural and semi-urban areas has increased significantly

At the turn of the century, the expansion of brick-and-mortar branches, despite several efforts, was limited. The low penetration of formal banking led the Reserve Bank to look at financial inclusion as a major policy drive. The slew of measures that followed were the introduction of Business Facilitators (BFs) and Business Correspondents (BCs) and deregulation of the opening of ATMs and branches, while ensuring sufficient coverage to hitherto unbanked areas. Concurrently, relaxations in the BC model were made to bridge the 'last mile' problem. This accelerated the pace of branch opening, with more branches being opened in rural and semi-urban areas. Notwithstanding this development, the number of branches per 100,000 of population in rural and semi-urban areas is still less than half of that in urban and metropolitan areas (Chart 1.1 and Table 1.1).

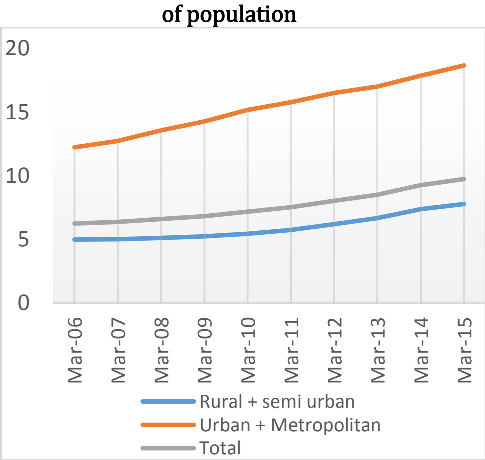
Table 1.1: Branch Expansion of SCBs

As on March	Number of Branches			Estimated population* (in million)			Branches/ 100,000 population		
	Rural + Semi-urban	Urban + Metro-politan	Total	Rural + Semi-urban	Urban + Met-ro-politan	Total	Rural + Semi-urban	Urban + Met-ro-politan	Total
2001	44,905	20,713	65,618	851	177	1,028	5.3	11.7	6.4
2006	45,673	23,904	69,577	920	195	1,115	5.0	12.3	6.2
2010	53,086	31,072	85,158	980	211	1,191	5.4	15.2	7.2
2014	76,753	40,958	1,17,711	1,044	228	1,272	7.3	17.9	9.2
2015	82,358	43,716	1,26,074	1,061	233	1,294	7.8	18.7	9.7
June 2015	82,794	43,910	1,26,704	1,065	235	1,300	7.8	18.7	9.7

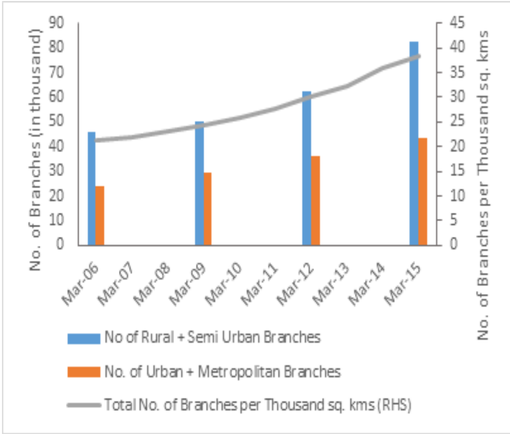
*Population estimates are based on CAGR between Census 2001 and Census 2011 data

Chart 1.1: Penetration of branch network of SCBs

Number of branches per 100,000 of population



Number of branches per 1000 sq. km.



Concurrent with higher branch expansion in semi-urban and rural areas, the compound annual growth rate (CAGR) for both the number of individual saving bank deposit accounts as well as deposit amounts outstanding therein was the highest for semi-urban regions followed by rural, urban and metropolitan regions (Table 1.2).

Table 1.2: Growth in Individuals' Savings Bank Deposits Accounts with SCBs

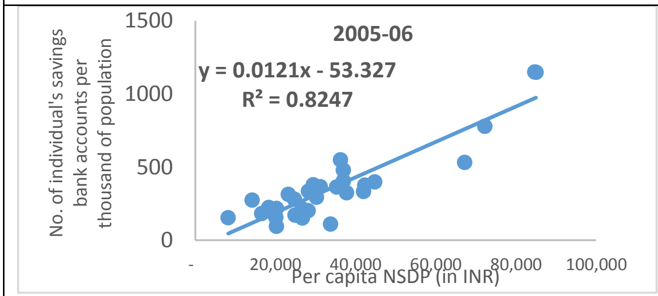
Population Group	Number of Individual Saving Bank Deposits Accounts (million)				Individual Saving Bank Deposits' Amount Outstanding (₹. billion)			
	2006	**2010**	**2015**	**CAGR (%)**	**2006**	**2010**	**2015**	**CAGR (%)**
Rural	104	167	384	15.6	962	1,703	3,601	15.8
Semi-urban	85	136	320	15.9	1,124	2,155	4,470	16.6
Urban	68	97	186	11.8	1,246	2,381	4,541	15.5
Metropolitan	71	100	180	10.9	1,838	3,731	6,476	15.0
All India	**329**	**500**	**1,070**	**14.0**	**5,170**	**9,970**	**19,088**	**15.6**

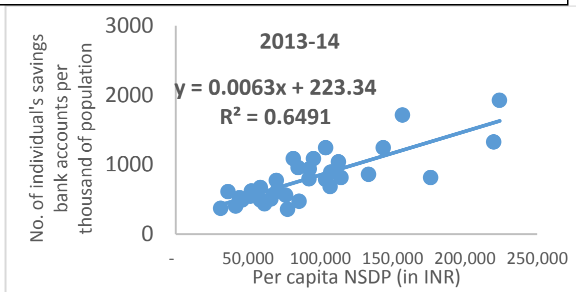
CAGR is for all scheduled commercial banks (SCBs) including regional rural banks (RRBs) during 2006-15.

In normal conditions, the availability of banking services could be predicated on the level of economic activity. The Committee examined whether the recent supply-push towards financial inclusion has made a difference. Regression analysis suggests that while per capita income is the dominant factor in explaining the penetration of banking services, the slope of the regression line has flattened over time, suggesting policy-induced improvements in supply in recent times (Chart 1.2).

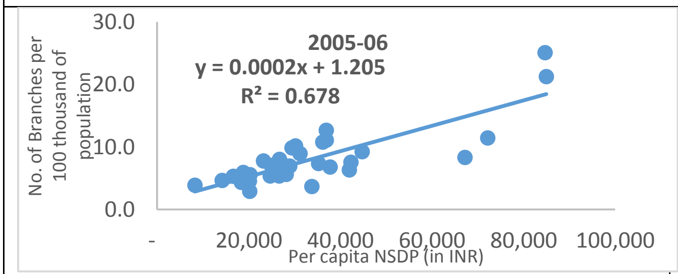
Chart 1.2: Banking penetration vis-à-vis per capita NSDP

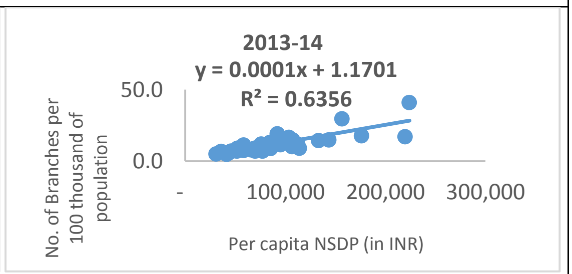
State-wise per capita NSDP vis-à-vis number of individual savings bank accounts to per 1000 of population



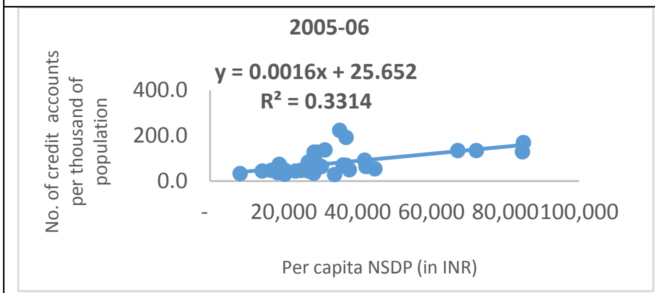


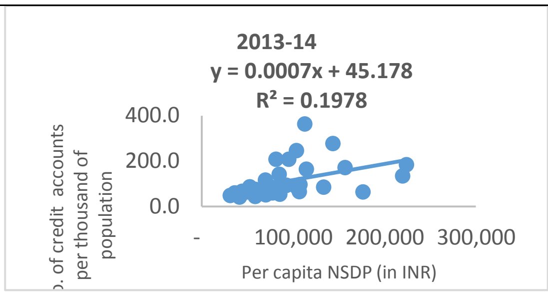
State-wise per capita NSDP vis-à-vis number of branches per 100,000 persons





State-wise per capita NSDP vis-à-vis number of credit accounts to per 1000 of population

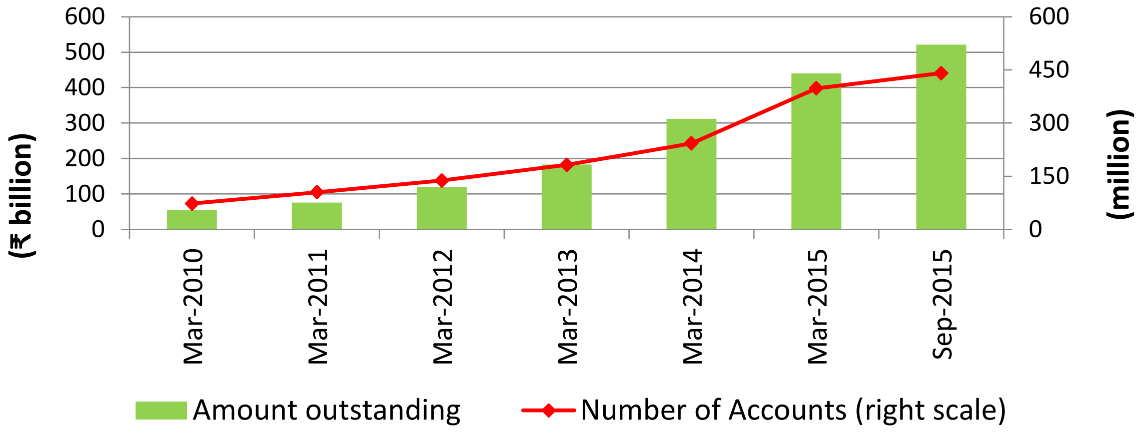




Test of statistical significance: From the above charts, it can be seen that the impact of per capita NSDP on the indicators of financial inclusion was weakening over time. The z-test shows that the impact of per capita NSDP on the number of individual savings bank accounts per thousand of population and the number of branches per 100,000 in 2013-14 was significantly different at the 99 per cent confidence level from 2005-06, whereas, the impact of per capita NSDP on the number of credit accounts per thousand of population in 2013-14 was significantly different at 90 per cent confidence level from 2005-06.

Apart from the regulatory thrust on branch expansion, in order to provide basic banking services to the marginalised sections of society, banks were advised to open 'no-frills' accounts, which were subsequently labelled as Basic Saving Bank Deposit Accounts (BSBDA). In the past five and a half years, these BSBD accounts have risen more than six-fold and nearly half of these accounts were opened through Business Correspondents (BCs) (Chart1.3).

Chart 1.3 : Progress in No Frills/ Basic Savings Bank Accounts

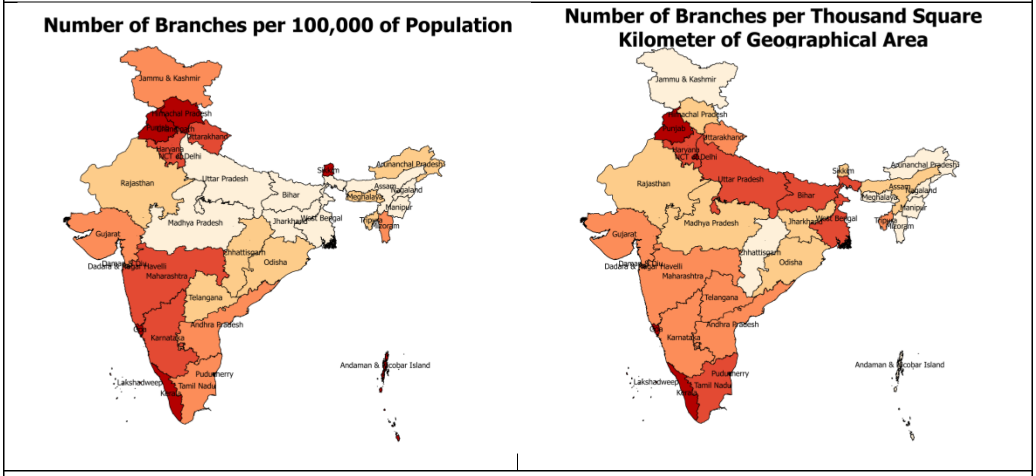


However, eastern, north-eastern and central regions lag behind in terms of banking penetration

The relative position of various states/union territories in terms of bank branch coverage, normalised by population (demographic bank penetration) and area (geographic branch penetration), respectively, are given in Chart 1.4[1]. While geographic penetration can be interpreted as a proxy for the average distance of a potential customer from the nearest physical bank outlet, higher demographic penetration would imply easier access.

[1] Beck.T., A. Demirguc-Kunt and M. S. Martinez Peria (2007). Reaching Out: Access to and use of banking services across countries. *Journal of Financial Economics* 85, 234-266.

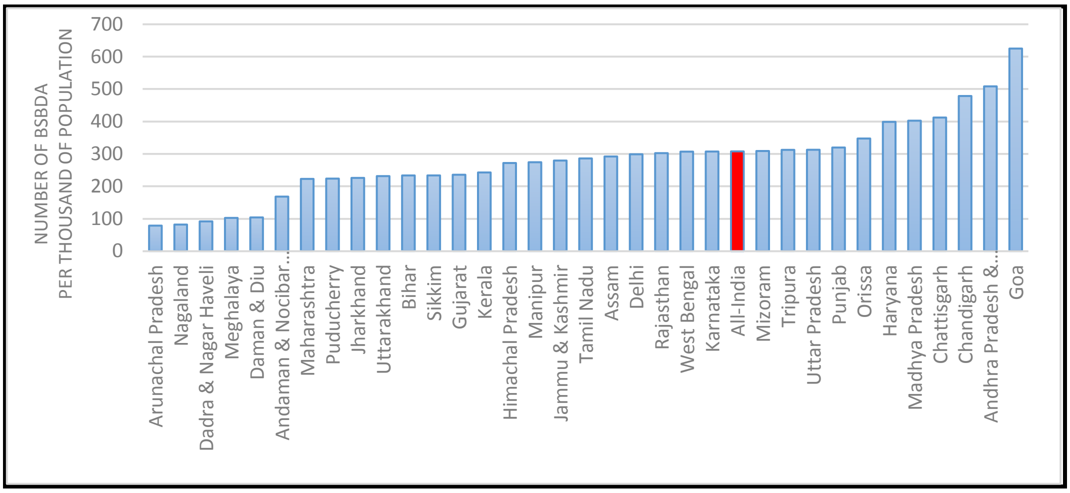
Chart 1.4: Branch Density – March 2015



1. The map was developed using open source software and is used only for presentation purposes. The actual geographical boundaries are not confirmed.
2. Banks include Scheduled Commercial banks (SCBs), RRBs, Urban and State Co-operative Banks (UCBs and StCBs) and District Central Co-operative Banks (DCCBs).
3. An increase in the colour intensity is associated with an increase in the value of the indicator.

While demographic penetration has increased one-and-a-half times during 2006-15, the north-eastern states as also states such as Bihar, Jharkhand, Uttar Pradesh, West Bengal and Madhya Pradesh are less penetrated in terms of the number of branches in relation to their population. Even the state-wise numbers for BSBD account density as on March 2015 suggest that several north-eastern and eastern states lag behind (Chart 1.5).

Chart 1.5: Number of BSBDA per thousand of population



Recommendation 1.2
The Committee felt that although a quantum jump in banking access has taken place, a significant element of regional exclusion persists for various reasons that need to be addressed by stepping up the inclusion drive in the north-eastern, eastern and central states to achieve near-universal access. This may entail a change in the banks' traditional business model through greater reliance on mobile technology for 'last mile' service delivery, given the challenges of to-

pography and security issues in some areas. The Government has an important role to play in ensuring mobile connectivity. In some of the areas, mobile connectivity may not be commercially viable to start with, but the telecom service providers may be encouraged to use their corporate social responsibility (CSR) funds for this purpose. The Committee is of the view that the State-Level Bankers Committee (SLBC) is an appropriate forum to address such infrastructure issues in a collaborative manner. The use of Universal Service Obligation Fund (USOF), a non-lapsable fund designed to support a variety of innovation initiatives, can also be explored in this regard.

Notwithstanding substantial improvements, gender inclusion remains a concern

Over time (2006-15), considerable improvements in terms of account density, i.e., the number of account per thousand of population, have been achieved. Although the account density for females has more than tripled, these numbers are far lower than the account density of males (Tables 1.3).

Table 1.3: Individual Savings Bank Account of SCBs – Female Population

	Total female population			Rural female population			Total female population		
	Number of female's savings bank accounts per thousand of female population			Amount outstanding per female's savings bank account (in thousand)					
	2006	**2010**	**2015**	**2006**	**2010**	**2015**	**2006**	**2010**	**2015**
Minimum among states/ UTs	49	60	277	4	4	3	9	10	6
Maximum among states/ UTs	712	893	1577	25	31	43	31	45	60
Median of States/ UTs	146	189	588	9	10	8	14	18	16
All India	**143**	**196**	**536**	**7**	**7**	**7**	**14**	**17**	**15**

The higher the share of rural and women population, the lower the financial inclusion

The various indicators of financial inclusion point toward differences in the level of financial inclusion across the population group as well as gender. It was found that states having a relatively higher share of rural population and a higher share of female population generally have a comparatively lower level of financial inclusion (Box 1.1).

Box 1.1: The effects of women and rural population on financial inclusion

It is generally known that rural areas and women typically encounter greater constraints in becoming financially included. To examine this empirically, the various indicators of financial inclusion are regressed on the share of rural population (Share_Rural) and the share of female population (Share_Female), respectively, after taking into account state-level controls, such as per capita income and literacy rates. The specification for state i is expressed as follows:

$$Financial\ Inclusion\ Indicator_i = \alpha + Sh\_Rural_i/Sh\_Female_i + \ Controls + u_i$$

The results suggest that states with a larger proportion of females and those with a larger share of rural populace exhibit significantly lower levels of financial inclusion.

Table: Financial inclusion and various characteristics

Variable	Deposit accounts per 1000 of population		Credit accounts per 1000 of population		Per capita credit		Per capita deposit	
Share_rural	-0.18*** (0.05)		-0.10 (0.08)		-0.54*** (0.04)		-0.14*** (0.03)	
Share_female		-0.15 (2.40)		5.89 (4.38)		-10.9*** (3.03)		-5.13*** (0.81)
Controls	YES	YES	YES	YES	YES	YES	YES	YES
N.Obs; R-sq.	32, 0.76	32; 0.73	32; 0.49	32; 0.54	32; 0.77	32; 0.68	32; 0.40	32; 0.52

Controls include per capita NSDP and literacy rate, both expressed in logarithmic form.
Standard errors in parentheses
***, ** and * denote statistical significant at 1, 5 and 10%, respectively.

Recommendation 1.3
Considering the still significant exclusion of women, the Committee recommends that banks have to make special efforts to step up account opening for females. Given the government's emphasis on the welfare of the girl child, the Committee suggests that the government can consider a welfare scheme—Sukanya Shiksha —that can be jointly funded by the central and state governments. The scheme will link education with banking habits by crediting a nominal amount, in the name of each girl child belonging to the lower income group who enrols in middle school. This would make it incumbent on the school and the lead bank and its designated branch to open a bank account for social cash transfer. This scheme can also have the benefit of lowering school dropout rates and empower the girl child.

Not only deposit account penetration, but also commercial bank credit accounts and amount outstanding has improved, especially in rural and semi-urban areas

During 2006-2015, while the number of credit accounts of SCBs increased at a CAGR of 6.0 per cent, the rate of growth was higher for rural and semi-urban areas. Even credit growth was more evenly distributed around the mean, with a particular tilt towards rural and semi-urban areas (Table 1.4).

Table 1.4: Credit Growth of Scheduled Commercial Banks

	Credit accounts (million)				Credit outstanding (₹ billion)			
Population Group	2006	2010	2015	CAGR (%)	2006	2010	2015	CAGR (%)
Rural	29	36	50	6.4	1,261	2,493	5,982	18.9
Semi-urban	21	27	41	7.4	1,514	3,200	7,600	19.6
Urban	13	16	21	5.8	2,458	5,585	11,039	18.2
Metropolitan	23	40	33	4.1	9,905	22,174	44,170	18.1
All India	**86**	**119**	**145**	**6.0**	**15,138**	**33,452**	**68,791**	**18.3**

CAGR is for all scheduled commercial banks (SCBs), including Regional Rural Banks (RRBs), during 2006-15

Individual and small accounts dominate commercial banks' credit portfolio in terms of numbers, making it amenable to biometric Aadhaar linkage to manage credit risk, sniff out multiple lending and curtail over-indebtedness.

At the all-India level, the share of individuals in the total number of credit accounts was 94 per cent in 2015 and the amount outstanding was about one-third of total credit. Small-size loans (i.e., up to ₹1 million) contributed to over 96 per cent of the total number of loan accounts. Occupation-wise, agriculture and personal loans together constitute about 85 per cent of the loan accounts and nearly 30 per cent loan amounts outstanding. Small and marginal farmers account for over 35 per cent of agriculture credit. Small agriculture loans up to ₹ 0.2 million accounted for over 42 per cent of agriculture credit. The information[2] on the Incidence of Indebtedness (IOI), i.e., the percentage of households that had taken cash loans, was 31 per cent in rural areas with their debt-to-asset ratio (DAR) reflecting repayment capacity at 3.2 per cent. In contrast, for rural-cultivators in Andhra Pradesh the IOI was as high as 70 per cent with the DAR at 14.3 per cent. The Committee felt that better information and analysis of indebtedness could have helped mitigate the credit crisis in Andhra Pradesh.

Recommendation 1.4

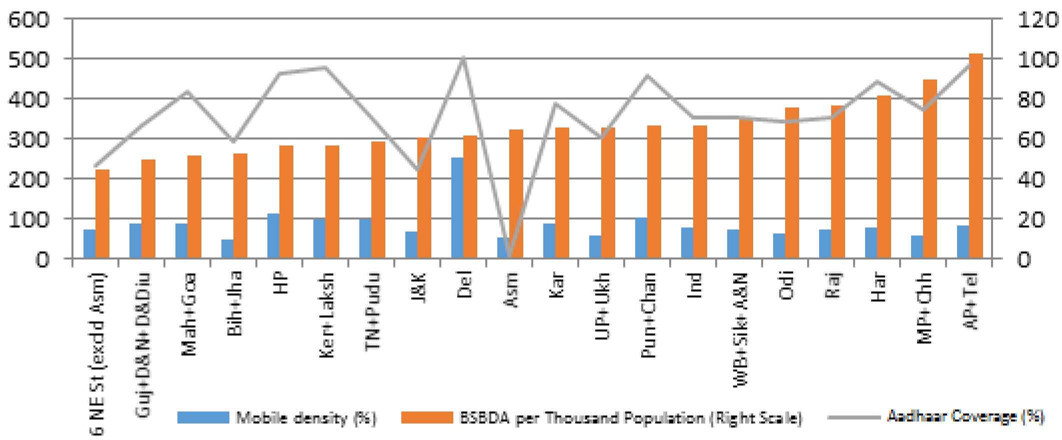
Given the predominance of individual account holdings, the Committee recommends that a unique biometric identifier such as Aadhaar should be linked to each individual credit account and the information shared with credit information companies. This will not only be useful in identifying multiple accounts, but will also help in mitigating the overall indebtedness of individuals who are often lured into multiple borrowings without being aware of its consequences.

[2] Based on All-India Debt and Investment Survey (AIDIS), 2012.

Rapid increase in mobile penetration alongside Aadhaar makes it the ideal tool for low-cost financial service delivery for realising the government's JAM Vision

As per the *latest Census of House Listing and Housing Survey* data 2011, the proportion of households availing of banking services has increased to 59 per cent in 2011 from 35 per cent in 2001. It also indicates that 59 per cent of households possess mobile phones. Subsequently, mobile penetration, Aadhaar coverage and BSBD accounts have accelerated sharply (Chart 1.6)[3]. Empirical evidence suggests that basic banking services could be delivered at low cost through mobile technology and the security of transactions could be enhanced through biometric identification.

Chart 1.6: Mobile density, Aadhaar coverage and BSBDA accounts



Recommendation 1.5
The Committee recommends that a low-cost solution based on mobile technology can be a good candidate for improving financial inclusion by enhancing the effectiveness of 'last mile' service delivery.

At the current juncture of economic development, the bulk of rural households have low income, making their credit needs paramount, which is met to a large extent by the informal sector despite significant improvement in banking. A litmus test for financial inclusion would be to ensure that an increasing share of the credit demand of this segment is met by the formal credit sector.

A primary requirement for opening a bank account is that people should have sufficient income to save after meeting consumption needs. The *Socio-economic Caste Census 2011* reveals that more than half of the rural households depend on manual casual labour and another 30 per cent depend on cultivation for their livelihood. The main income-earning member of around three-fourth of rural households earns less than ₹ 5,000 per month. Only 8 per cent

[3] The mobile density and BSBDA figures are for September 2015 and the *Aadhaar* coverage is for October 2015. In chart 1.6, data is grouped into telecom circles and states/ UTs. As such, mobile connections data for Delhi include that of NCR Delhi.

of rural households earn more than ₹ 10,000 per month. Of 138 million agriculture landholders, 67 per cent are marginal farmers (having land size less than 1 hectare) and on average they operate on 0.39 hectare, which implies that the income earned from agriculture produce for the majority of agricultural households is very low. This constant struggle of households with the credit system is vividly brought out by the All-India Debt and Investment Survey (AIDIS). The available data for 2002 and 2012 show that the reliance on non-institutional credit agencies by rural households was as high as 44 per cent in 2012 (Table 1.5). Given the huge credit demand, the Committee is of the view that this scenario may not have changed materially in the last couple of years.

Table 1.5: Percentage distribution of households' cash loans outstanding by credit agency

Credit Agency	Rural		Urban	
	2002	2012	2002	2012
1. Institutional Agencies	**57.1**	**56.0**	**75.1**	**84.5**
of which:				
Co-operative Society/bank	*27.3*	*24.8*	*20.5*	*18.0*
Commercial bank, including RRBs	*24.5*	*25.1*	*29.7*	*57.1*
2. Non-Institutional Agencies	**42.9**	**43.9**	**24.9**	**15.5**
of which:				
Professional Moneylender	*19.6*	*28.2*	*13.2*	*10.5*
Relatives and Friends	*7.1*	*8.0*	*7.6*	*4.2*
Total	**100.0**	**100.0**	**100.0**	**100.0**

Disaggregated data on sources of cash loans show that in rural areas 61 per cent of households source such loans from non-institutional agencies, whereas in urban areas the number was 46 per cent. In rural areas, non-cultivators face comparatively greater difficulty in sourcing cash loans from institutional agencies than cultivators. Around one-third of rural households requiring credit approach professional moneylenders.

Recommendation 1.6

The Committee recommends that a key component of the financial inclusion policy should be to improve the credit system for the underprivileged, particularly millions of poor agricultural households, so as to ensure a perceptible shift of credit demand from the informal to the formal sector.

The vision of financial inclusion

Driven by the government and financial regulatory initiatives, there has been substantial progress during the past decade in terms of financial inclusion indicators—be it in terms of branch penetration, account density or even credit and deposit numbers. Mobile telephony as a low-cost vehicle of communication and Aadhaar as unique biometric identifier have expanded rapidly. This will also aid focused and targeted distribution of benefits to the intended recipients, so as to improve the efficacy of distribution and minimise leakages.

Notwithstanding these positives, several challenges remain to be addressed. First, in spite of the emphasis on supply, it does not appear to have adequately matched the demand. Nearly 35 per cent of the accounts across all banks were zero-balance accounts as on November 2015. Second, there are still substantial differences in exclusion across regions. Third, a significant gap in financial inclusion across gender persists. Fourth, interest-free banking remains an unaddressed concern. Fifth, access to finance for micro and small enterprises (MSEs) remains a major impediment. Sixth, technology does not appear to have been harnessed to the fullest extent in order to further the cause of financial inclusion.

The Committee believes that the key ingredients of inclusion, the five Ps, as observed by Governor Rajan—a basic suite of products, ease of access and place of delivery, reasonable price of products, certain protection and the right incentive for formal financial entities to operate profitably in this space—still remain distant[4]. As aptly observed by Dr. Y.V. Reddy, harmonising the development objectives of the government with the central bank's policy direction on inclusion with stability remains key to addressing various impediments in "achieving meaningful and universal financial inclusion"[5].

> *Against this backdrop, the Committee sets the vision of financial inclusion as 'convenient' access to a basket of basic formal financial products and services that should include savings, remittance, credit, government-supported insurance and pension products to small and marginal farmers and low-income households at reasonable cost with adequate protection progressively supplemented by social cash transfers besides increasing the access of micro and small enterprises to formal finance with a greater reliance on technology can cut costs and improve service delivery, such that by 2021 over 90 per cent of the hitherto underserved sections of society become active stakeholders in economic progress empowered by the formal finance.*

What follows

The remainder of the Report is structured as follows. Chapter 2 discusses cross-country experiences in order to glean insights into key takeaways that can be suitably adapted to the Indian situation. Chapter 3 highlights the importance of agricultural credit and how policy interventions can further the financial inclusion agenda. Chapter 4 discusses the issue of credit flow to SMEs and what changes in products and policies can augment the flow of credit to this segment. The role of interest-free banking has been the focus of global policy discussions in recent times, an aspect that is dealt with in Chapter 5. The credit infrastructure and the changes that can be brought to bear on this area are examined in Chapter 6. Chapter 7 discusses the payments system. The demand side of the process and, in particular, the issue of

[4] Rajan, Raghuram G. (2014). Finance and Opportunity in India, Twentieth Lalit Doshi Memorial Lecture, August 11.
[5] Reddy.Y.V. (2015). Financial inclusion and central banking: Reflections and issues. Keynote speech at the 14th SEACEN Executive Committee meeting, Port Moresby. Available at [http://www.bis. org/review/ r151029a.pdf]

Government-to-Person (G2P) payments is addressed in Chapter 8. Chapter 9 takes a close look at the issue of financial literacy and consumer protection and finally, Chapter 10 analyses governance issues that need to be addressed in the process.

Cross-Country Experiences

No one size fits all

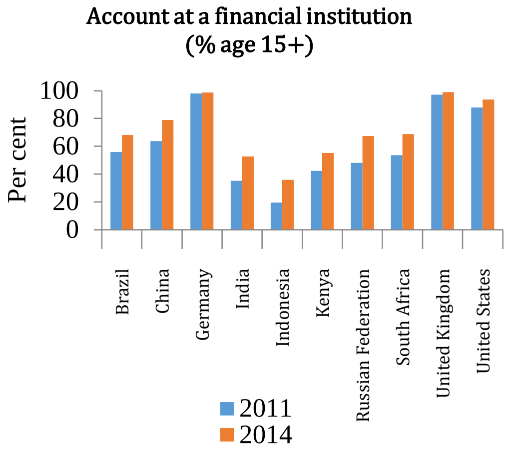
2
Chapter

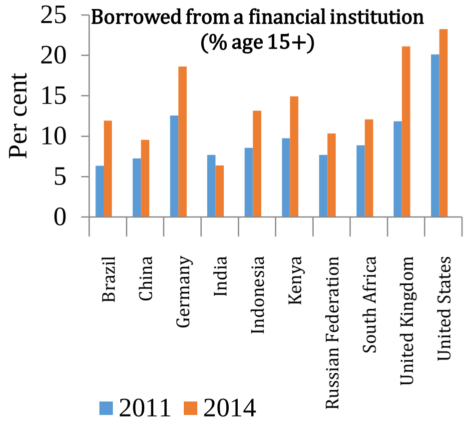
Globally, about 38 per cent of the adult population has no or very limited access to formal financial services. This makes a strong case for poor households to penetrate the boundary of formal finance. Loans or savings can help them to accelerate consumption, absorb unforeseen shocks such as health-related issues, make households investment in durable goods, home improvements or school fees (Collins *et al.,* 2009). Insurance can also help them to cope better with risks. Moreover, macroeconomic evidence suggests that economies with deeper financial intermediation tend to grow faster and reduce income inequality (Beck *et al.* 2007).

India does not compare very favourably with regard to financial inclusion even with peer emerging market economies

In 2014, over 50 per cent of Indian adults held an account with a financial institution, compared to close to 70 per cent of adults in various BRICS economies, and an even higher percentages of adults in the US and UK. Similarly, in 2014, 6 per cent of Indian adults had borrowed from a formal financial institution in the past 12 months compared with 10 per cent or more in other BRICS economies (Chart 2.1).

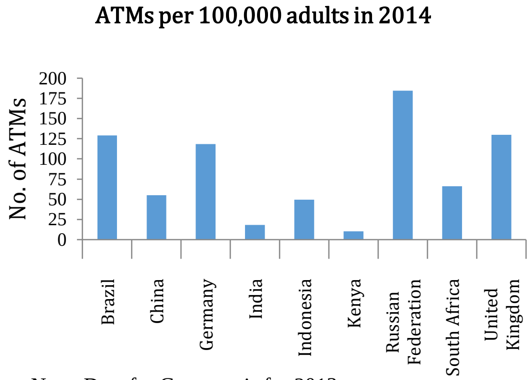
Chart 2.1: Account at a Financial Institution



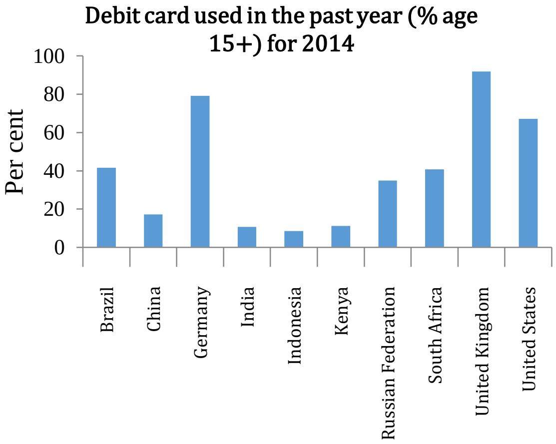


Furthermore, as of 2014 there were only 18 ATMs per 100,000 adult population in India against over 65 in South Africa and over 180 in Russia. Similarly, 10 per cent of individuals aged 15 years and above had made payments through debit cards in India as against approximately 40 per cent in South Africa (Chart 2.2).

Chart 2.2: Use of technology in financial inclusion

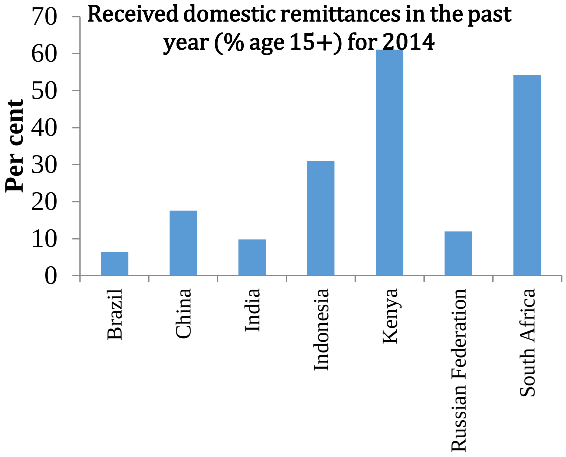


Note: Data for Germany is for 2013.



In terms of remittances, Kenya holds a leading position. In 2014, over 60 per cent of its adult population had received domestic remittances compared with less than 10 per cent in India. Similarly, only 3 per cent of the rural population in India had directly received wages into their accounts, as against 14 per cent in Brazil and 23 per cent in South Africa (Chart 2.3). The low use of accounts in India is also evidenced from the fact that in 2014 over 40 per cent of accounts did not witness any 'movement' (Chart 2.4).

Chart 2.3: Remittances and wage payment



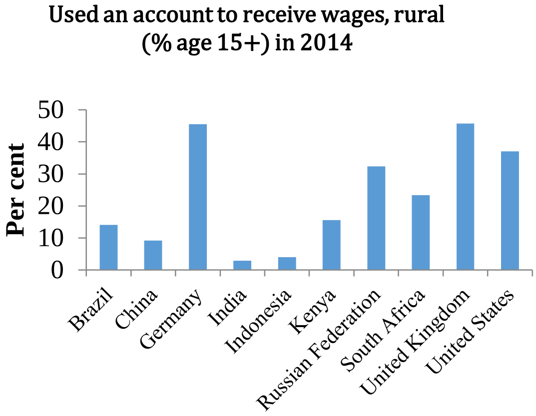
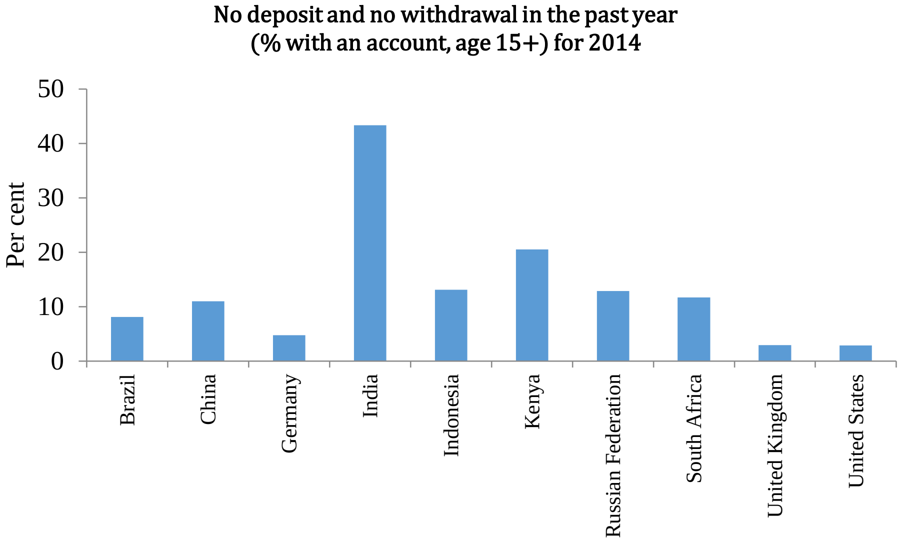


Chart 2.4: Use of accounts



Recommendation 2.1

The Committee observes that despite improved financial access, usage remains low, underscoring the need to better leverage technology to facilitate usage.

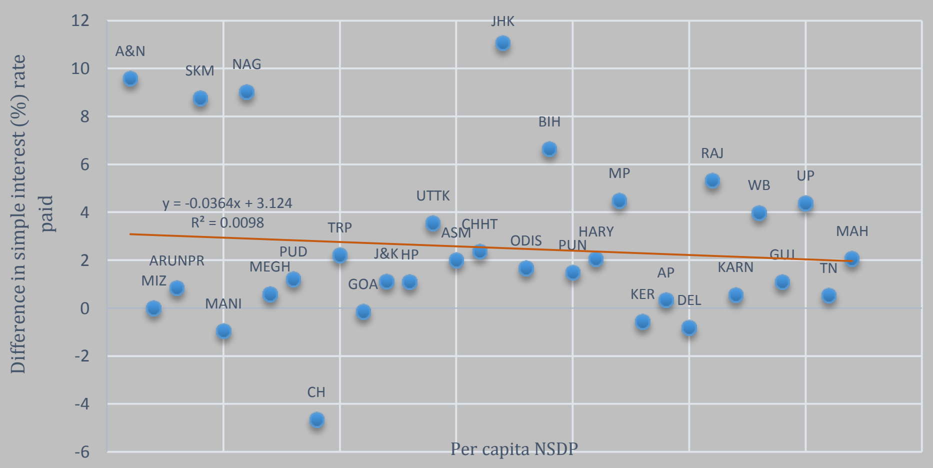
The gender gap is the bane of financial inclusion, particularly in emerging market and developing economies

Gender disparity is common in most economic and social spheres. Evidence suggests that, on average, women earn 10-30 per cent less than men for comparable work (World Bank, 2014). Globally, of the 2 billion adults that do not have bank account, 1.1 billion are women. Recent evidence suggests that, worldwide, 58 per cent of women have an account at a formal financial institution compared with 65 per cent of men (Demirguc-Kunt *et al.* 2015) (Box 2.1).

Box 2.1: Gender and Financial Inclusion

Financial inclusion (e.g., account ownership) has the potential to economically empower women. Yet, the global gender gap in account ownership is not narrowing and has remained at a steady 7 per cent. In developing countries, the gender gap is similarly unchanged at 9 per cent but varies across regions. In South Asia the financial gender disparity is particularly high at 18 percentage points, and in India it is 20 percentage points. Even after controlling for a host of individual characteristics including income, education, employment status, rural residency and age, gender remains significantly related to access and usage of financial services (Demirguc-Kunt *et al.* 2013). Randomised evaluations in South Africa (Karlan and Zinman, 2009) and India (Banerjee *et al.* 2009) indicate that micro-finance schemes can positively improve both womens' economic situations and indicators of broader empowerment.

In India, the All-India Debt and Investment Survey (AIDIS) suggests that interest rates paid by female household head are, on average, higher than those paid by male household heads. The interest rate differential, however, tends to narrow as per capita income improves.



Correspondent banking is used as an effective tool of financial inclusion with varying success

Experience from the banking correspondent model in Latin American countries such as Brazil and Mexico provides us with valuable insights on how to strengthen the Indian model. A conducive legal framework facilitated the healthy expansion of banking correspondents by placing the onus of their training and monitoring on regulated entities. In addition, various innovative ideas were implemented by countries, often with encouraging results (Box 2.2).

Box 2.2: Innovative Ideas for Financial Inclusion

Several countries have experimented with out-of-the-box ideas to increase banking penetration in un- and under-served areas, often leading to very encouraging results. In Chile, for instance, supermarket chains have started writing credit histories for their unbanked clients, by extending small store credit that is expanded based on positive repayment records, which can then translate into broader access to credit. In Brazil, lottery kiosks, pharmacies, supermarkets and other retailers are used as business correspondents for banks. *Bolsa Familia*, a conditional cash transfer programme, is delivered by *Caixa*, a public sector bank, though a large network of small lottery stores called *Lotéricas*. These also accept bill payments and offer additional financial services from *Caixa*. In South Africa, television and radio have been used for the delivery of financial literacy training. One such project involved the distribution of financial inclusion storylines through a popular soap opera called ʻScandal!. The programme was aimed at enhancing knowledge, attitudes and behaviour for making sound financial decisions, with a focus on debt management.

Mobile banking is being used successfully as a delivery channel in several countries

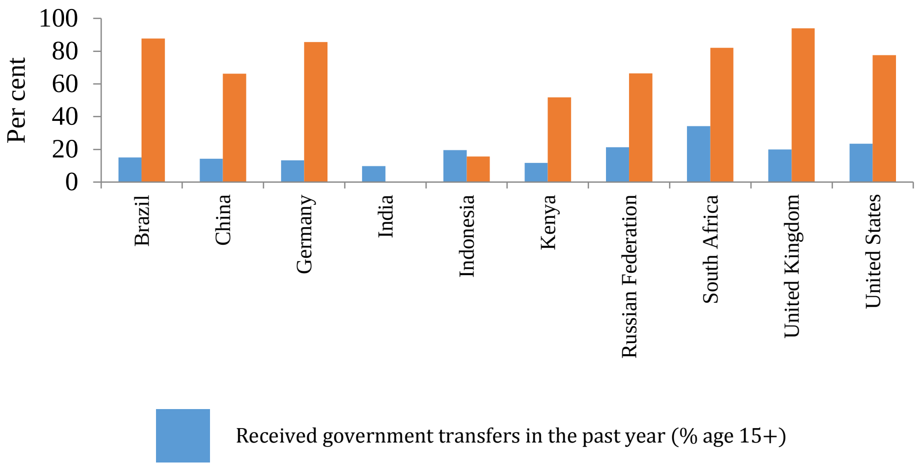
Mobile banking technology has tremendous potential for expanding financial inclusion, especially among the unbanked rural poor. The success of mobile money in Kenya, Uganda, Tanzania and other African nations shows that these innovations can bring about dramatic changes in how people engage in financial transactions, by lowering entry barriers, reducing costs and expanding access (Demirguc-Kunt and Klapper, 2012). Mobile banking can also help bridge the distance of financial institutions by making it more cost-effective for them to locate outlets in more remote areas. While in India and globally only 2 per cent of adults have a mobile money account, in Sub-Saharan Africa and in Kenya, it is 12 per cent and 58 per cent, respectively.

Countries where mobile money accounts—and mobile payment more broadly—have taken off are characterised by a regulatory environment that is supportive of technological innovations and recognises the contribution of all financial sector players, including non-banks. Furthermore, product design matters. When financial services are easy and convenient to use and tailored to the financial needs of people, they enjoy the broadest adoption. As mobile banking and payment applications have network externalities, they become more cost-effective to operate and the diffusion of mobile usage occurs. In addition, as mobile money applications in developing countries have been set up in the context of largely cash economies, other crucial factors determining their adoption are the number of cash-in points and the ease with which cash can be transferred into and out of the mobile system (World Bank, 2014).

Innovations in G2P payments could prove to be a game changer

Mobile banking technologies can also be used for government-to-person (G2P) payments. Digitising G2P payments can have a significant impact on the economy as a whole in terms of efficiency, safety and transparency. It also brings previously unbanked beneficiaries into the fold of formal financial services by channelling a regular flow of money into their accounts. Digital payments can take the form of mobile payments, direct deposits into bank accounts and payment cards. In South Africa, over 80 per cent of beneficiaries receive government transfers into an account and it is as high as 88 per cent in Brazil (Demirguc-Kunt *et al.* 2015). Mexico's shift to digital G2P payments led to a cut in spending on wages, pensions, and social benefits by 3 per cent annually. Compared to this, G2P payments comprised less than 10 per cent of the total transfers for India (Chart 2.5)[6]. Several governments have also experimented with the use of mobile payment technologies, which include Colombia's Familias en Acción Program and Pakistan's Benazir Income Support Program (Box 2.3).

Chart 2.5: G2P payments across countries in 2014



[6] Data on G2P payments into an account at a financial institution for 2014 is not reported for India.

Box 2.3: Pakistan's G2P payments

In 2008, the Benazir Income Support Program (BISP) was launched with the short-term objective of cushioning the adverse impact of the food, fuel and financial crisis on the poor, and the broader objective of providing a minimum income support package to the poorest. BISP is the largest social cash transfer program (G2P) in Pakistan, accounting for about 85 per cent of overall G2P payments. The BISP experimented with several new payment instruments in 2010: first with customised smart cards, later with mobile phones and currently with magnetic stripe-based debit cards and mobile wallets. Mobile wallets are limited functionality bank accounts that are similar to cash out at agent locations. The beneficiary no longer needs a debit card since the G2P transaction is carried out virtually via a mobile wallet account linked to beneficiary's mobile phone SIM card.

SMEs need greater handholding for inclusion

Banks in emerging markets are increasingly providing non-financial services to SMEs. This includes training and consulting services that can improve record-keeping among SMEs which, in turn, enables banks to more easily assess their credit-worthiness, as well as obtain detailed information about their business activity, financial situation and banking needs. In addition, insolvency regimes promote access to finance among SMEs by supporting predictability in credit markets. An effective insolvency framework can help regulate efficient exits from the market, ensure fair treatment through the orderly resolution of debts incurred by debtors in financial distress and provide opportunities for recovery by bankrupt entities and their creditors. Therefore, a comprehensive bankruptcy code is important to ameliorate the SME finance gap.

Consumer protection is an essential ingredient of successful inclusion

In order to promote an enabling environment for financial inclusion, several countries have tried to strengthen their consumer protection laws. In South Africa, the new Consumer Protection Act provides consumers with a greater level of protection against providers of goods and services including banking and financial services. Besides creating bodies that tackle predatory lending and consumer abuses, the Act gave rise to the establishment of the National Consumer Commission, a body assigned to investigate consumer complaints. In 2008, Bank Negara Malaysia (BNM) established an Integrated Contact Centre (ICC) and created a walk-in customer service centre where customers can lodge complaints or obtain information from BNM staff and from self-service kiosks.

Index-based agricultural insurance is a preferred instrument

As a means to enhance financial inclusion for farmers, index-based insurance has gained popularity.[7] The financial product is based on an independently verifiable index that can be linked to (i) local yields, (ii) livestock mortality, possibly observed through remote sensing techniques, or (iii) climatic data collected at meteorological stations, such as rainfall, hail, temperature and wind. Pay-outs on the insurance policy are triggered by pre-specified patterns of the index. This helps overcome problems related to moral hazard and adverse selection and removes the need for in-field assessments, all of which can raise premium costs and delay pay-outs. In Kenya, researchers found index insurance to be a powerful protection against the negative impact of natural disasters. In the face of a serious drought, farmers had to sell fewer assets (minus 64 per cent), missed fewer meals (minus 43 per cent) and were less dependent on food aid (minus 43–51 per cent) (Janzen and Carter, 2013). Similarly in Ghana, the assurance of better returns, thanks to weather-based index insurance, encouraged farmers to shift from subsistence to riskier cash crops (Karlan *et al.* 2014).

New banking institutions could supplement the efforts of existing players

In several countries, innovative institutions were developed in order to increase financial access. In the Philippines, for instance, entry into the banking system for microfinance units was liberalised, allowing the establishment of new banks that are licensed and regulated as regular banks but had to dedicate at least 50 per cent of their loan portfolio to microfinance. This enabled non-profit microcredit institutions to transform into formal financial institutions that are allowed to mobilise savings. Furthermore, bank branch regulations were liberalised, allowing for the establishment of ‘scaled-down’ branches—so-called ‘micro-banking offices’—that facilitate bank presence in areas where a full branch office may not be economically feasible. In 2009, Mexico permitted the establishment of a new specialised intermediary—a so-called ‘niche bank’—that could gather funds from the public, access the payment system and be subject to the same regulatory standards, but with a lower minimum capital requirement. Furthermore, in 2012 Mexico was the first country worldwide to introduce a new

[7] In Kenya, a crop insurance product named *Kilimo Salama* is available in which the process of claim settlement does not take more than four days. The farmers are registered with the agro-dealers using barcode which is linked to Cloud-based system. Farmers who purchase insurance embedded seed bags have to send an SMS to short code with details of unique code, upon which the farmer is automatically registered for insurance. The confirmation message is immediately sent to farmers and they are automatically connected to automated weather stations. Whenever there is a deviation in rainfall, leading to germination failure, the claim amount automatically gets transferred into the accounts of insured farmers.

regulatory framework, enabling a more flexible regime for launching banking products while facilitating the linkage of those products to mobile phones.

Determinants of Financial Inclusion

Studies show that income, inequality, adult literacy, urbanisation, physical and electronic connectivity and information availability could explain the extent of financial inclusion. The Committee conducted a cross-country study of 32 EMDEs, which suggests that access by itself does not ensure usage (Box 2.4).

Box 2.4: How does India fare in financial inclusion?

Using FINDEX and other relevant cross-country datasets provided by the World Bank, we employ an OLS regression to assess the dimensions of financial inclusion in terms of both access and usage. The focus was primarily to ascertain whether India was different in this regard. The determinants included per capita income and CPI inflation as overall indicators of well-being, domestic credit to the private sector as a percentage of GDP as a proxy for financial depth, number of commercial bank branches per 100,000 adults as a proxy for financial infrastructure, Internet usage per 100 people as a proxy for technological penetration, net enrolment rate in primary school as a proxy for educational attainment and a country-specific dummy for India (**INDIA**).

The results suggest that India is an outlier among EMDEs in terms of financial access: the coefficient on INDIA is positive and statistically significant. The estimates suggest that access to finance is, on average, 0.14-0.16% points higher in India compared with its EMDE peers. However, when it comes to use of finance, the evidence is much less compelling. This provides a case for policy intervention to incentivise the use of accounts for financial transactions, after having provided them with financial access.

Table: Determinants of financial inclusion in EMDEs

Explanatory variables	Access Dependent Variable: Fraction of adults (age (15+) with account at a financial institution				Use Dependent Variable: Fraction of adults (age 15+) who have saved at a financial institution in past one year			
	1	2	3	4	5	6	7	8
Log per capita income, 2005 USD	0.32** (0.16)	0.25 (0.16)	0.25 (0.16)	0.18 (0.23)	0.08 (0.09)	0.04 (0.09)	0.04 (0.09)	0.06 (0.14)
Population/1000 sq. km	0.07 (0.11)	0.04 (0.11)	0.04 (0.12)	0.11 (0.11)	0.09 (0.06)	0.06 (0.06)	0.07 (0.06)	0.05 (0.07)
Inflation (CPI)	-1.88* (1.01)	-1.62** (0.69)	-1.62** (0.74)	-1.01 (0.75)	-0.37 (0.81)	-0.13 (0.7)	-0.13 (0.72)	-0.34 (0.86)
Private credit/GDP		0.22*** (0.06)	0.22*** (0.06)	0.21*** (0.06)		0.17*** (0.04)	0.17*** (0.04)	0.16 (0.04)
Adjusted net enrolment, log			0.02 (0.05)	0.04 (0.06)			0.002 (0.01)	-0.005 (0.02)
Number of commercial bank branches/100,000 adults, log			0.01 (0.12)	0.06 (0.12)				-0.04 (0.06)
Internet users/100, log				0.28 (0.35)				-0.05 (0.27)
INDIA	**0.14* (0.07)**	**0.16** (0.07)**	**0.15* (0.08)**	**0.15* (0.08)**	**-0.05 (0.05)**	**-0.04 (0.05)**	**-0.04 (0.05)**	**-0.03 (0.06)**
Constant	-0.83 (1.06)	-0.6 (1.03)	-0.66 (1.16)	-1.31 (0.82)	-0.51 (0.56)	-0.37 (0.52)	-0.38 (0.59)	-0.22 (0.66)
R-squared	0.38	0.56	0.56	0.58	0.11	0.43	0.44	0.44

Note: Robust standard errors in parentheses.
*, **, *** denote statistical significant at 1, 5 and 10 per cent, respectively.

Recommendation 2.2
On the basis of cross-country evidence and our own experience, the Committee is of the view that to translate financial access into enhanced convenience and usage, there is a need for better utilisation of the mobile banking facility and the maximum possible G2P payments, which would necessitate greater engagement by the government in the financial inclusion drive.

Indeed, from a global perspective, India stands out as one of the few EMDEs for which the government has a documented financial inclusion strategy that contains specific commitments (Economic Intelligence Unit, 2014). Moreover, there is a need for new niche players with greater facility of technology and a thrust on inclusion. In this regard, the Reserve Bank has already taken momentous steps by licensing a number of small finance banks and payments banks, which could be a potential game changer not only by their nimble operations but also by triggering competition and ushering in a change in the approach and business strategy of traditional banks towards inclusion. In order to strengthen the credit system, a large void is the absence of a bankruptcy law, which the Committee notes has seized the attention of the government as the Insolvency and Bankruptcy Bill 2015 is awaiting Parliamentary approval.

Agricultural Credit

Credit to the tiller and security to the farmer

3

Chapter

The agriculture sector provides livelihood and food security to an ever-growing Indian population. It figures prominently in the list of sectors included under Priority Sector Lending (PSL) for commercial banks. The PSL target for agriculture is placed at 18 per cent of commercial bank credit with direct lending to small and marginal farmers at 7–8 per cent.

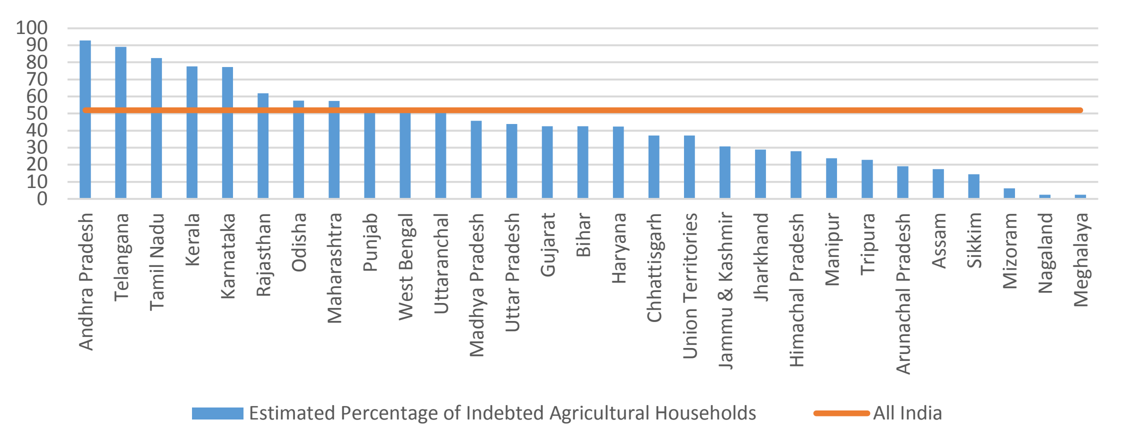
Besides priority sector prescriptions, various wide-reaching government programmes have aimed at universal provision of agricultural credit to farmers. Despite these efforts, a large number of farmers remain outside the purview of formal finance, relying instead on informal sources of credit, such as private moneylenders, friends and family. Yet, access to financial services—in the form of loans, savings, remittance and insurance—are crucial for achieving higher agricultural productivity and livelihood sustenance (Box 3.1).

Box 3.1: Financial inclusion and agriculture in India

As per the 2011 Census, around 60 per cent of the population in India depends on agriculture for a living and the agriculture sector provides employment to 55 per cent of the work force. The importance of productivity enhancement in the agriculture sector as a contributor to economic growth is well established (World Bank, 2007). To this end, access to formal finance is crucial for achieving higher agricultural productivity. Credit in the form of loans is used as working capital at the beginning of the growing season in order to purchase inputs, prepare land or invest in equipment as well for the harvest, processing, transport and to market the produce. Farmers also require savings. Since their income is tied to the harvest, savings can help them smooth consumption during the rest of the year. Furthermore, remittance and local and international money transfers are essential for farm workers and urban immigrants that left behind their rural families. Lastly, insurance can help farmers mitigate risk that stems from weather fluctuations, diseases and crop failure. However, the agriculture sector faces many constraints in becoming financially included. A recent Financial Inclusion Insights Survey, conducted by Intermedia, a global research consultancy, that interviewed over 45,000 respondents across 22 states in India, indicates that 43 per cent of those who work primarily in the agricultural sector do not have access to a bank account. The survey also reveals a large disparity between farmers and farm workers: 36 per cent of farmers vis-à-vis 55 per cent of farm workers do not have a registered bank account.

In terms of loan disbursement to agriculture, the Agricultural Statistics at a Glance 2014 report estimated that 52 per cent of all Indian agricultural households are indebted. When considering the state-wise distribution, large disparities can be detected (Chart).

Chart: Loan allocation to agricultural households across states



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The Government has accorded high priority to agricultural credit

Actual credit flow to the agriculture sector has consistently exceeded the target set by the government for both the general banking sector and commercial banks (Table 3.1)

Table 3.1: Credit flow to agriculture (₹ billion)

Year	Banking sector (includes RRBs and co-operative banks)		Commercial banks	
	Target	Achievement	Target	Achievement
2010-11	3750	4683	2800	3459
2011-12	4750	5110	3550	3686
2012-13	5750	6074	4200	4325
2013-14	7000	7116	4750	5090
2014-15	8000	8406	5400	5997

Although agricultural credit has been rising every year, as reflected in an increase in the number of accounts, the extent of financial exclusion remains large, especially for tenant farmers, share-croppers and agriculture labourers who still have limited or no access to the formal credit system. Additionally, indirect credit has risen more impressively as compared to direct credit, due mainly to more and more categories being brought within the ambit of priority sector lending for agriculture. It therefore, becomes exigent to find out ways to reach the small and marginal farmers for agri-credit, taking due care of risk factors. One of the primary reasons is the reluctance of landowners to formally lease out their land for cultivation for fear of losing their rights over the land. As a result, banks are reluctant to grant credit for want of any evidence of cultivation.

The owner of the land is often not the cultivator even in the case of small and marginal holdings. Anecdotal evidence suggests that the landowner who gets the benefit of subsidised credit at times turns moneylender to his cultivator. This is also evident from macro-level data. The credit intensity of agriculture has increased: the ratio of outstanding loans to agriculture to Gross Value Added (GVA) improved from 36 per cent in 2011-12 to 39 per cent in 2014-15. However, it has not had a commensurate impact on productivity. The Committee is of the view that agricultural credit must flow to the actual cultivator for which substantial reform is necessary (Box 3.2).

Box 3.2: Digitisation of land records

The formalisation of land titles and access to credit are tightly connected. Holding access to land provides an incentive to make investments, and increases the ability of the poor to access financial markets (World Bank, 2003). Exploiting the idea that computerised land registries can improve the flow of credit, Deininger and Goyal (2012) with data from Andhra Pradesh showed a significant impact of computerisation on credit volumes. By and large, it was asserted that positive effects on access to credit from land titling and registration/digitisation would be expected only if such efforts come from all quarters, records remain up-to-date and third parties, such as financial service providers, can gain easy and affordable access to reliable registry information. Digitisation of land records provides for comprehensive scrutiny to make land records tamper-proof

The Department of Electronics and Information Technology, Government of India has already introduced a mission mode project, ‘Land Records, that can include records such as the register of lands, Record of Rights (RoR), tenancy and crop inspection register, mutation register and disputed cases register. In this context, the initiatives taken by the Government of Andhra Pradesh (AP) is noteworthy. The state has digitised the land records, which has provided an interface for banks to view and update charge creation on a real-time basis. In co-ordination with the National Informatics Centre (NIC), the state has created master users of the banks, which in turn can create branch users for viewing the land records of any village in the state. This module is used by banks for creation of charge on land and crops, using the web-based land database. A technical help-desk has also been created for the banks to send their feedback and raise any technical doubts in the operation of this module.

References

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Recommendation 3.1

The Committee recommends that in order to increase formal credit supply to all agrarian segments, the digitisation of land records should be taken up by the states on a priority basis.

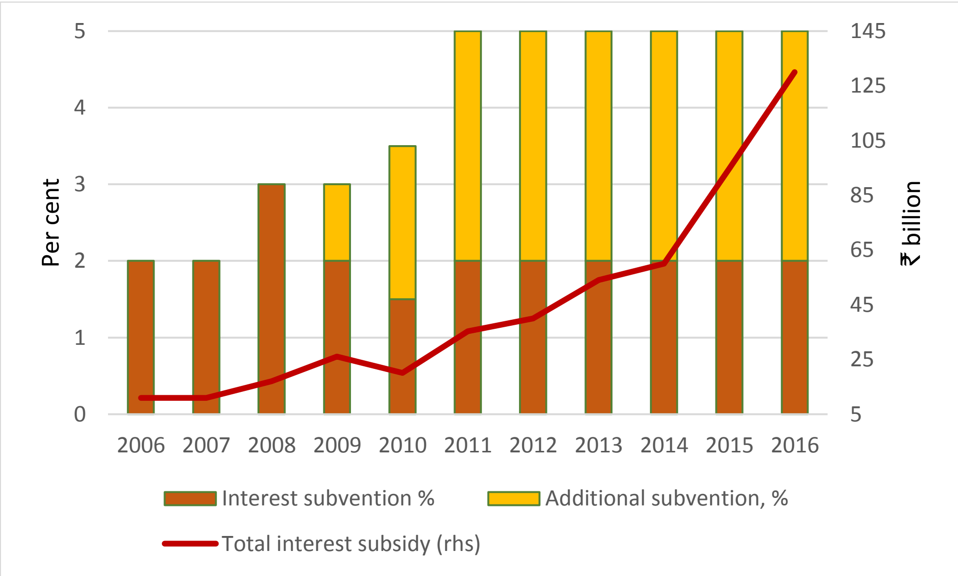
Recommendation 3.2

In order to ensure actual credit supply to the agricultural sector, the Committee recommends the introduction of Aadhaar-linked mechanism for Credit Eligibility Certificates. For example, in Andhra Pradesh, the revenue authorities issue Credit Eligibility Certificates to Tenant Farmers (under 'Andhra Pradesh Land Licensed Cultivators Act No 18 of 2011'). Such tenancy /lease certificates, while protecting the owner's rights, would enable land-less cultivators to obtain loans. The Reserve Bank may accordingly modify its regulatory guidelines to banks to directly lend to tenants / lessees against such credit eligibility certificates.

Interest subsidy should be phased out and ploughed back into an affordable universal crop insurance scheme

With a view to ensuring the availability of agriculture credit at a reasonable cost, the Government of India had introduced an interest subvention scheme at 2 per cent for short-term crop loans of up to ₹ 300,000. Additionally, a 3 per cent incentive is given for prompt re-payment of loans, lowering the effective cost further. The interest subvention claims paid by the government have been increasing rapidly over time (Chart 3.1). The scheme is for short-term crop loans, and as a result it discriminates against long-term loans and thereby, does not incentivise long-term capital formation in agriculture, which is essential to boost productivity. Second, as discussed earlier, subsidised credit does not always flow to the actual cultivator. Third, subsidised credit increases the probability of misuse.

Chart 3.1: Interest rate subvention



Recommendation 3.3

The Committee recommends phasing out the interest subvention scheme and ploughing the subsidy amount into a universal crop insurance scheme for small and marginal farmers.

***Kisan* Credit Card provides a way for flexible agri-credit delivery**

Crop loans are generally disbursed by the banks through the mode of Kisan Credit Card (KCC). The KCC scheme provides a short-term credit limit with simplified renewal every year upto the fifth year, after which a maximum permissible limit is arrived at. The KCC has an in-built consumption component that the Committee believes is essential for the subsistence of small and marginal farmer. The KCC scheme also lends itself well to built-in government sponsored (personal) insurance, with a nominal premium.

Recommendation 3.4

The Committee recommends that the Kisan Credit Card (KCC) should continue to have a built in consumption credit component, recognising that while agricultural income could be lumpy, expenditure is an on-going process that results in negative cash flow for several months. A scheme of 'Gold KCC' with higher flexibility can be introduced for borrowers with prompt repayment records. Expenditure towards organic certification should be allowed under KCC. The government-sponsored personal insurance may be dovetailed with the KCC scheme. Going forward, a digital KCC can be explored which can provide a benefits tracking mechanism.

Small and fragmented land holdings and agrarian distress call for encouraging co-operative farming and universal, affordable crop insurance

As per the Agriculture Census (2010-11), of the 138 million farming holdings in the country, 117 million (85 per cent) are small and marginal holdings. The number of farmers holding marginally sized land has been on the rise, from about 36 million in 1970-71 to 93 million in 2010-11, highlighting the continuous fragmentation of lands due to hereditary practices. Small and fragmented farm holdings discourage mechanisation and increase travelling time between fields, thereby lowering labour productivity and increasing costs. Farmers with small land holdings depend heavily on middlemen for selling their agricultural produce, thereby reducing their income. Moreover, agrarian distress continues. According to the National Crime Records Bureau, from 2000 to 2012 more than 214,000 farmers all over the country committed suicide.

The All-India Debt and Investment Survey (2013) offers an explanation for the causes of enduring agrarian distress, revealing that more than half of the rural households are marginal farmers who own less than one hectare of land. The indebtedness of these farmers is inversely proportional to their land holdings (Table 3.2). The survey findings further suggest that when the land holding is less than 0.01 hectares, only 129 households out of 1000, i.e., 13 per cent, have access to credit from a formal banking institution, while 64 per cent borrow from private moneylenders. When the landholding exceeds 10 hectares, over 60 per cent of rural households have access to credit from formal banking institutions, and only 16 per cent rely on private moneylenders.

Table 3.2: Outstanding loans and land holdings

Size class of land possessed (hectare)	Per 1000 distribution of outstanding loans by source loan								
	Government	Co-operative society	Bank	Employer/ landlord	Money lender	Shopkeeper/ trader	Relatives & friends	Others	All
< 0.01	4	16	129	6	637	14	175	18	1000
0.01 - 0.40	13	146	310	8	324	25	142	31	1000
0.41 - 1.00	17	139	376	8	274	66	106	14	1000
1.01 - 2.00	26	147	475	7	233	15	76	20	1000
2.01 - 4.00	19	156	500	14	238	12	58	3	1000
4.01 - 10.00	38	175	502	4	187	14	65	15	1000
10.00 +	11	143	635	0	161	5	38	6	1000
All sizes	**21**	**148**	**429**	**8**	**258**	**29**	**91**	**16**	**1000**

It is the marginalised for whom eking out a living is a daily struggle (Box 3.3). The Committee is of the view that the financial inclusion initiative would be found wanting without holistically addressing the concerns of small and marginal farmers. This will require fundamental reforms that go beyond finance and involve the government.

Box 3.3: How the marginalised manage their cash flow

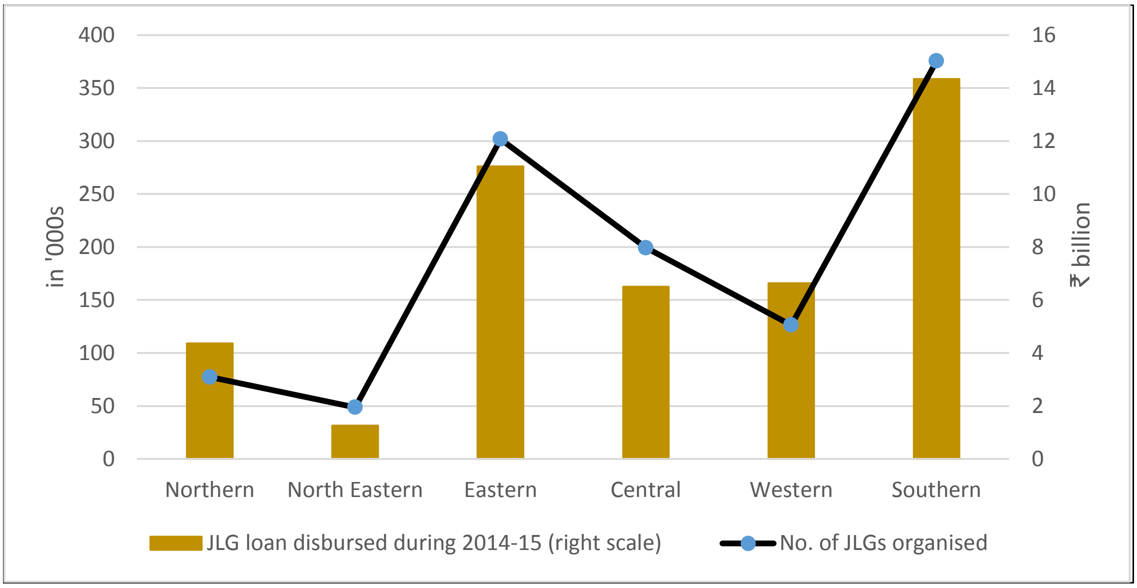
Mrittunjoy from Amnan village cultivates on a very small plot of land (2 bighas i.e. 0.6 acres). His farm production output is not adequate to cover the continuous monthly expenses like education for his children, food, clothes, medicines, even if he is cultivating two crops (Potato and Aman rice) and seasonal vegetables.
His typical cost of cultivation was ₹31,000 and the cost of living was ₹67,000 for a year. The cash receipts from primary sales of his produce was ₹57,000, leaving him with negative ₹41,000 annual cash flow, underscoring the struggle for survival. During difficult times, his family members work harder to earn more income from packet making. To augment his income, Mrittunjoy is also engaged in MNREGA-related works when the sowing of crops is complete. When this does not help, he borrows from moneylenders by mortgaging his household goods. There are millions of Mrittunjoys who perpetually live on the precipice.

Recommendation 3.5
The Committee is of the view that with the digitisation of land records, which secures ownership, co-operative farming should be encouraged at the local level by panchayats. This would enhance the use of mechanisation and reduce input costs and prices. NGOs and Farmer Associations should educate farmers on the benefits of land consolidation. In each district, the efforts of the supply co-operatives, marketing co-operatives and credit co-operatives should be strengthened to encourage co-operative farming.

Joint Liability Groups have a key role in agricultural finance

Joint Liability Groups (JLG) scheme was initiated by NABARD with the expectation of enhancing credit flow in agriculture, especially for share croppers/tenant farmers who do not have land rights. By the end-March 2015, over 1.1 million were provided with a cumulative credit disbursement of ₹ 112 billion. Yet, the progress in financing farmers under the JLG scheme has been rather slow and uneven across regions (Chart 3.2). Unless credit flows to the tiller, agricultural production will not improve.

Chart 3.2: Region-wise JLG Credit Disbursal (2014-15)



Recommendation 3.6
The Committee is of the view that the best way to take JLGs forward would be to have them join hands and form Producer Organisations. Capacity building of JLG members should be made essential and ways should be devised for market linkage of the produce/products.

Bring in effective, universal and affordable crop insurance for small and marginal farmers to end agrarian distress and improve agricultural production

Although the country has experimented with and implemented several crop insurance schemes, their progress and coverage has been far from satisfactory. Furthermore, due to frequent natural calamities, the central and state governments often have to undertake *ad hoc* relief measures that give rise to 'unbudgeted expenditure' every year. Another consequence of uncompensated crop losses is an increase in indebtedness, resulting in periodic loan write-offs that damage the credit culture, threatening the viability of the agricultural credit system. The Committee believes that with appropriate vision and commitment, an effective universal crop insurance scheme could be put into place starting with small and marginal farmers. If crop insurance is to be successful, it has to be made available and affordable to all farmers with a substantial government subsidy, which could also be commercially viable for insurance companies. Some calculations suggests that the overall premium will fall to less than 3 per cent from the current rates of 8-11 per cent, if the area covered increases to say, 100 million hectares.

Recommendation 3.7

The Committee recommends that a universal crop insurance scheme covering all crops should be introduced starting with small and marginal farmers with a monetary ceiling, say of ₹200,000. The insurance should be mandatory for all agricultural loans. The insurance should be made affordable, with the farmer paying a nominal premium and the balance coming from government subsidy. The government can phase out the agricultural loan interest subvention scheme and plough back that allocation into the crop insurance subsidy. A graded crop insurance could be made available to medium and large cultivators with higher monetary ceiling and lower government subsidy.

Recommendation 3.8

The government may restructure the Agriculture Insurance Company (AIC) to take up the role of a dedicated 'Crop Insurance Corporation'. It should develop/run the programmes, promote competition including inviting bids from private insurance companies, usher in state-of-the art technology at all levels and arrange reinsurance of claims as well as the intensification of Automated Weather Stations (AWS) to ensure that at least one accredited AWS is set up every 10 kilometres. There would also be a need for installing additional rainfall data loggers.

Recommendation 3.9

The Committee feels that the use of technology would make the insurance scheme more efficient. Satellite imagery can be used for 'crop mapping' and to assess damage. GPS-enabled handheld devices can be used for 'ground trothing'. In addition, drones and dove, micro satellites could also be deployed to assess crop damages. This will reduce the number of crop-cutting experiments required and will ensure faster claims settlement.

MSME Finance

Credit deprivation calls for innovative solutions

4

Chapter

Micro, Small and Medium Enterprises (MSMEs) are the engine of growth and development and play a major role in employment generation, next to agriculture. There are an estimated 48 million MSMEs in the country, providing employment to 111 million people. The sector contributes about 45 per cent to the manufacturing sector output and 40 per cent to the nation's exports[8]. The Committee feels that MSMEs are the best vehicle for inclusive growth, job creation and poverty alleviation. Notwithstanding various policy support measures for MSMEs, access to adequate credit still remains elusive for the sector, calling for innovative solutions.

Credit gap in the MSME sector is substantial

While varying estimates point to the potential and need for credit among underserved MSMEs, a study by International Finance Corporation (2012) estimated the overall finance gap in the MSME sector at ₹ 21 trillion in 2009-10. It comprises a debt gap of ₹19 trillion and an equity gap of ₹ 2 trillion. The potential demand for external finance was estimated at ₹ 28 trillion as against the total finance of ₹ 7 trillion from formal sources.

In order to achieve greater financial inclusion and financial deepening in a manner that enhances systemic stability, the Committee felt that there is a need to move away from a limited focus on any single model to an approach where multiple models and partnerships are encouraged to emerge. In the specific context of ensuring greater credit flow to MSMEs, this calls for the emergence and strengthening of specialised institutions such as NBFCs and MFIs that focus on the provision of credit for different types of MSMEs. The regulatory system needs to ensure that such institutions, as long as they are able to do so in a high-quality manner, expand and multiply. These differentiated institutions have a strong understanding of individual

[8] Annual Report Ministry of Micro, Small and Medium Enterprises 2014-15.

sector needs, an ability to assess risk appropriately, typically through proximity-based strategies, and to customise their offerings to suit specific needs.

The likelihood of adverse selection and moral hazard is significant in the 'one size fits all' model of MSE financing

As a ratio to non-food gross bank credit of ₹60 trillion, credit to micro and small enterprises (MSEs) was 16 per cent at end-March 2015, while credit to medium enterprises (MEs) was over 3 per cent (Table 4.1).

Table 4.1: Outstanding credit to MSMEs

(₹ billion)

March-end	Micro and small enterprises				Medium enterprises			
Year	Public	Private	Foreign	All SCBs	Public	Private	Foreign	All SCBs
2012	3970	1090	217	5277	1363	157	16	1536
2015	6979	2324	308	9612	1547	491	60	2098

Figures reported in the table might not necessarily match those reported elsewhere owing to different sources of data.

The challenges that MSEs face are two-fold. First, they are often credit-starved and banks often do not have the requisite skills and time to assess their credit-worthiness. This entails a problem of adverse selection: good credit risk MSEs are often less inclined to access bank finance owing to onerous and complicated documentation procedures. Consultations suggest that there is also voluntary exclusion, with some MSEs not forthcoming with their detailed financing requirements owing to fear of tax complications and harassment by petty bureaucracy. Second, even if banks extend credit to these entities, monitoring of these entities is often lax, since the presence of a credit guarantee provides the borrower with back-up comfort. On the other hand, the credit guarantee institution does not have the wherewithal to conduct independent assessment. Consequently, the 'one size fits all' approach towards risk assessment of MSEs coupled with the paucity of domain knowledge perpetuates a cycle of high costs, low credit and high credit risk.

Recommendation 4.1

The Committee recommends that any policy action for the MSE sector would need to consider several possibilities, be it new institutions or intermediaries who can help bridge the information gaps that plague these entities or even innovative ways of providing finance to this sector.

The present structure of credit guarantee needs to be broadened with the participation of private agencies

The Credit Guarantee Trust for Micro and Small Enterprises (CGTMSE) was made operational in 2000. The Trust, through its credit guarantee scheme (CGS), has been empowering member lending institutions (MLIs) to extend credit based on the viability of the proposal. In return, CGS seeks to assure the lender that in the event that an MSE unit, which availed of collateral-free credit facilities, fails to discharge its liabilities to the lender, the Guarantee Trust would make good the loss incurred by the lender up to 75-85 per cent of the credit facility.

As observed earlier, in view of the challenges that MSEs face, the viability of the CGTMSE has become a matter of concern. First, the CGTMSE has become highly leveraged as against a corpus of about ₹ 50 billion, the amount involved in the guarantees approved stands at nearly ₹ 1.0 trillion, compromising the viability of the scheme. Second, the feedback received from MLIs indicates that the lodging and settlement processes, as also the dispute settlement mechanism, are quite cumbersome. Third, the moral hazard inherent in the process is quite substantial: borrowers are much less inclined to repay when they realise that it is backed by some sort of government funding/guarantee. It would be useful in this context to understand international experience (Table 4.1).

Table 4.1: Credit Guarantee Scheme: Cross-country experiences

Parameters	Malaysia[9]	Korea[10]	China[11]	Japan[12]
Ownership	Credit Guarantee Corporation Malaysia Berhad (CGCMB) operates as the sole agency that provides guarantee cover to SMEs.	Korea Credit Guarantee Fund (KODIT) is a public financial institution providing comprehensive support for SMEs.	Credit guarantee scheme in China consist of credit guarantee agencies (CGAs), mutual guarantee funds (MGFs) and commercial guarantee companies (CGCs). CGAs can be further classified into Provincial Credit Re-Guarantee Agencies (PCGAs) and Municipal Guarantee Agencies (MCGAs). CGAs account for about 90% of the total credit guarantee business for SMEs, while MGFs and CGCs equally share the remaining 10%.	There are 52 Credit Guarantee Corporations (CGCs) in Japan, one in each of Japan's 47 prefectures, and five in major cities.
Corpus/ funding	Private sector funding is made available. CGCMB is at present a commercially driven institution.	The capital fund of KODIT as of the end of 2005 was around KRW 3 trillion. The capital fund is composed of contributions from the Korean government and financial institutions.	The funding sources for MCGAs are mainly from (1) funds appropriated by municipal government's fiscal budget; (2) the right to the use of land and other state-owned operational and non-operational immovable properties appropriated by municipal government; (3) funds raised from the public and (4) membership fees (guarantee fees) or shares subscribed.	There are two sources of funds: supporting contributions, which credit guarantee schemes collect from local governments, financial institutions, and industry organisations, and standard contributions from financial institutions. Standard contributions from the financial institutions to CGCs are treated as tax-deductible under the law.
Type	The shareholders are Bank Negara Malaysia (76.4%) and financial institutions (23.6%) operating in the country.	KODIT has a decision-making system that is divided into a body for outside stakeholders and for inside stakeholders whose rights and obligations are prescribed by relevant regulations.	Government-owned.	Each of the 52 CGCs have been independently engaged in business activities to support local SMEs, responding to the specific needs of its own region as well as promoting a standardised guarantee system.

9 Credit Guarantee Corporation Malaysia Berhad Steering SME Development in Malaysia, 2007

10 Korea Credit Guarantee Fund and Its Contribution to the Korean Economy, Yong Pyung Park, Korea Credit Guarantee Fund (KODIT), 2006

11 Impediments to SME Access to Finance and Credit Guarantee Schemes in China, 2002, Yibin MU, Financial Economist, The World Bank

12 Credit Guarantee System in Japan, 2012 - Credit Guarantee Corporation

Fees	Guarantee fee based on SME borrowers' risks.	The basic fee rate ranging from 0.5% to 2.0% per annum of the guarantee amount is computed by the corresponding rating of the applicant.	The government stipulates that the guarantee fees charged by CGAs in principle shall be no more than 50% of the bank loan interest rate for the same period.	There are nine different guarantee fee rates, and the rate applied reflects the financial position of the SME, which is assessed based on their financial statements as well as qualitative, non-financial factors specific to the SME.
Cover	30-100	The cover provided to an applicant is tied to the credit rating.	CGSs provide 100% cover to banks in respect of loans.	The Responsibility-sharing System comprises two methods Under the partial guarantee method, the CGC guarantees 80% (except in the case of certain guarantees) of each loan. Under the burden charge method, the CGC initially guarantees 100% of the loan, but if the CGC repays the loan on behalf of the SME, the financial institution pays the CGC a burden charge later. Therefore, both methods result in an equivalent risk to the financial institution.

Recommendation 4.2

Keeping in view the extant over-extension of guarantees by the CGTMSE as well as the international evidence, the Committee recommends that multiple guarantee agencies, both public and private, that can provide credit guarantees in niche areas may be encouraged. This will not only reduce the burden on the CGTMSE but also make the extant insurance scheme economically viable.

Recommendation 4.3

In order to deepen the credit guarantee market, the role of counter guarantee and re-insurance companies should be explored.

Recommendation 4.4

MSEs that can provide collateral should not be put under the guarantee scheme, thereby reducing the pressure on the CGTMSE.

Concurrently, there is a need to improve the credit system with unique identification of MSMEs to check wilful default, multiple borrowings and indebtedness (Box 4.1).

Box 4.1: Unique identifier for MSMEs

Under the present dispensation, each company operating in India has to be registered with the Ministry of Corporate Affairs and is provided with a unique corporate identity number (CIN), which is a 21-digit alphanumeric code. Until very recently, such a unique identifier was lacking for MSMEs operating in the country. In a recent initiative, the Ministry of Micro, Small and Medium Industries has addressed this lacuna. In a notification issued in September 2015, it has stated that every micro, small and medium enterprise shall file a Udyog Aadhaar Memorandum in a prescribed format and the Ministry has started providing an Udyog Aadhaar Number (UAN) to each MSME. The UAN is a 12-digit alphanumeric code that is a combination of the state code, district code, activity code and a running serial number. Around 3.8 million MSMEs have been assigned a UAN. It is expected that, going forward, the UAN would serve as a unique identifier for all registered MSMEs. Either the CIN or the UAN along with the PAN can serve as unique identification for registered entities. For unregistered entities, the Aadhaar numbers of proprietors/partners should serve as identification.

Recommendation 4.5

Accordingly, the Committee recommends a system of unique identification for all MSME borrowers and the sharing of such information with credit bureaus. While such identification and tracking is not an issue with registered MSMEs where the CIN/UAN can be used alongside their PAN number, biometric Aadhaar identification should form the basis for proprietary and partnership concerns. Even in the case of registered MSMEs, it will be useful to collect and link the Aadhaar identification of directors so as to check possible fraudulent operation by the same set of persons.

Since MSMEs are typically enterprises with weak credit histories and with inadequate expertise in managing cash flows or preparing financial statements, credit intermediaries can facilitate the process by helping these entities in drawing up their financial statements and assessing their viability. Along with the soft information that these intermediaries will generate, it can provide useful input for the bank while deciding on loan applications (Box 4.2).

Box 4.2: Credit intermediaries

Information asymmetry and the perception of high risk are two major constraints on the flow of credit to the MSME sector. This can be addressed by permitting credit intermediaries to act as facilitators and enablers to micro and small entrepreneurs, so that they can access the formal financial system channel with greater ease and flexibility. The credit intermediaries can assign part of this role, with adequate checks and balances, to Small Business Advisors who may advise the entrepreneurs by (a) offering help in preparing business proposals; (b) helping to prepare financial documents and financial statements; (c) sharing information on suitable credit instruments available in the market and (d) supporting with non–financial or semi-financial business decisions such as business expansion plans.

They can also (i) recommend to the banks the business proposals of entrepreneurs; (ii) perform preliminary credit appraisal on behalf of the banks and (iii) collate additional supporting information required by the banks/ credit institutions.

While the extent of responsibility assigned to the credit intermediary could be defined through 'Master Agreements', the responsibility for due diligence and risk assessment will reside entirely with the banks concerned. In other words, legally the relationship will have the character of a 'Principal–Agent' relationship. In order to provide choice for the entrepreneurs and prevent monopoly, there should be multiple players in the market that perform the role of credit intermediary in the MSME sector. Initially, it would be preferable to have corporatised credit intermediaries so as to ensure better regulation and supervision of these entities. Over time, competitive forces would force out the inefficient players, leaving a more competitive set of credit intermediaries with viable and niche-driven business strategies. The commission and other relevant qualifications can be suitably worked out under a scheme governed by the Reserve Bank. Employing the services of such intermediaries, however, should be voluntary for the banks and borrowers. These intermediaries are expected to be proactive and should be left to come up with their business model based on their expertise and value added service. An illustrative range of intermediaries' activities and the value addition that they can provide is summarised in the table.

Area	Value addition	
	For borrowers	For lenders
Economies of scale	Collecting documents Filing credit applications Other administrative tasks	Collecting documents Formalising contracts Other administrative tasks

Lowering search and matching costs	Searching products for borrowers Providing customers with price quotations	Establishing links with clients Distributing credit products Promoting and advertising lenders' products
Alleviating asymmetric information problems	Suggesting suitable products Cautioning about the risk involved in specific products Explaining contract terms	Direct assessment of credit-worthiness Confirming whether customers meet credit-worthiness requirements set by the lender
Alleviating moral hazard concerns	Monitoring lenders' compliance with contract terms Assisting borrowers in filing consumer complaints	Monitoring borrowers' post-contractual performance Collecting borrowers' repayments Recovering credit from defaulting consumers

Source: Study on Credit Intermediaries in the Internal Market by Europe Economics, 2009

Recommendation 4.6

The Committee recommends exploring a system of professional credit intermediaries/ advisors for MSMEs, which could help bridge the information gap and thereby help banks to make better credit decisions. The credit intermediaries/ advisors could function in a transparent manner for a fee and be regulated by the Reserve Bank.

Innovations in financing required to add depth to MSME financing

A major concern for MSMEs is the 'one size fits all' approach adopted by banks in extending credit. The Reserve Bank has recently given 'in principle' approval to three applicants for setting up a Trade Receivables Discounting System (TReDS). Bringing together MSME sellers, corporate buyers and financiers under a common platform is expected to ease the flow of credit to this sector. Globally, innovative alternative forms of SME finance have emerged, which hold lessons for SME financing in India (Box 4.3).

Box 4.3: Innovations in SME financing

Innovations in SME financing can be categorised under four heads: (i) new lending and equity financing initiatives; (ii) innovative financing structures and instruments; (iii) new proxies for credit information and (iv) legal and regulatory infrastructures.

Under new lending and equity financing, new organisations outside the banking system start lending to these entities, thereby alleviating their credit concerns. In 2010, the Chinese e-commerce giant Alibaba launched a micro-credit company, Alipay Financial, to offer loans from its own cash resources to existing SME users of its e-commerce services. Likewise in the US, Amazon has reportedly begun offering funding to some of its largest sellers under a programme called Amazon Lending.

Under innovative financing structures, the most recent development is supply chain finance (SCF). This involves a relationship between a finance provider and a large company under which the financier agrees to provide short-term funding against invoices issued by the large company's suppliers once these have been formally approved for payment. According to *Financial Times*, Nestle, Syngenta, Volvo are regular users of this kind of finance.

Information asymmetries are often a major cause of lack of access to finance for SMEs. To overcome information deficiencies, e-commerce platforms have been relying on transactions and payment data by borrowers on their proprietary payments platform. For example, platforms such as eBay, Amazon and PayPal are harvesting user data to build similar predictive models on their users.

The introduction of innovative financing solutions can be impeded if appropriate legal and regulatory structures are not in place. The creation of movable asset registries is a good example of such a practice. Reforming the movable collateral (e.g., inventory, accounts receivable, livestock, crop, equipment, and machinery) framework would enable these entities to leverage the greatest part of their assets and obtain credit for growth. Presumably the most ambitious case has been the establishment of the National Asset Registries in China. In 2007, The People's Bank of China launched its online asset registry for accounts receivables, enabling short-term loans secured against specific receivables.

These findings highlight the key role that innovative solutions in access to finance can play in propelling the growth of SMEs.

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Recommendation 4.7
Besides exploring innovative financing methods, the Committee recommends that a framework for movable collateral registry for MSEs may be examined to step up financing to this sector.

Interest-Free Banking

Reaching out to a wider base

5

Chapter

One area that has not been adequately addressed is the role of interest-free banking in financial inclusion. Globally, interest-free banking, also known as Islamic banking, has witnessed a significant increase, especially in the wake of the financial crisis. According to Lagarde (2015), total Islamic finance assets are estimated at around USD 2 trillion, practically a ten-fold increase from a decade ago, and outperforming the growth of conventional finance in many places.

Many interest-free banking products are familiar to conventional banks

The central concept in interest-free banking and finance is justice, which is achieved mainly through the sharing of risk. Stakeholders are supposed to share profits and losses, and charging interest is prohibited. The following five elements give interest-free banking its distinctive identity: (i) Riba: The most important aspect of interest-free banking is the prohibition of interest; (ii) Haram/halal: A strict code of 'ethical investments' operates for interest-free financial activities. Such investment to give priority to the production of essential goods that satisfy the needs of the population, such as food, clothing, shelter, health and education; (iii) Ghrarar/maysir: Gambling in all forms is prohibited. Another feature condemned under interest-free banking is economic transactions involving elements of speculation; (iv) Zakat: This is the most important instrument for the redistribution of wealth in the form of a compulsory levy.

Certain basic types of financial contracts considered being in compliance with the principles of interest-free finance, are highlighted below (Table 5.1).

Table 5.1: Basic financial contracts under interest-free banking

No	Term	Description
1	Equity participation (Musharakah)	It is a partnership agreement between the bank and the customer where equity is contributed jointly, either in cash or in the form of goods or assets. Profits and losses are shared on agreed terms.
2	Trust-based finance (Mudarabah)	An investment that represents the ownership of units of equal value in the equity. In this case, one partner provides the capital, while the other party offers labour and expertise. Profits are shared in a predetermined ratio, whereas losses are borne entirely by the capital's owner.
3	Cost-plus financing (Murabahah)	The buyer approaches the bank to acquire goods. In turn, the bank (seller) purchases them from a third party (a supplier) and then resells them to the borrower (buyer) at an agreed mark-up for immediate or deferred payment. The total cost is usually paid in instalments and the product belongs to the buyer until the last instalment is paid.
4	Leasing (Ijarah)	The bank (lessor) buys and leases out an asset or equipment required by its clients (lessee) for a rental fee. The responsibility for maintenance/insurance rests with the lessor.
5	Deferred payment, deferred delivery (Istisna)	Under this type of contract, the manufacturer (contractor) agrees to produce (build) and to deliver a certain good (or premise) at a given price on a given future date. The price may be paid in instalments or may be part-paid in advance with the balance paid later, depending on the preferences of the involved parties.
6	Participation securities (Sukuk)	This represent Shariah-compliant securities that are backed by tangible assets. *Sukuk* has a face value linked to the value of the underlying asset and can be traded in the secondary market. As with conventional bonds, *Sukuk*s have maturity and the issuer buys them back on the maturity date. However, initial investment is not guaranteed and the returns or principal repayment depends on the performance of the underlying assets.
7	Agency (Wakala)	This is a money market concept used in deposit products. The depositors place funds with the bank to invest in suitable Shariah projects. The bank acts as agent to invest these funds into various assets and projects. The bank as an agent is entitled to receive a fee for its services while the returns will be given to the depositors or investors.
8	Demand deposits (Al-Wadiah)	This refers to a concluded contract between the owner (depositor) of the goods (the money) and the custodian (bank) for safekeeping. The depositor grants the bank their permission to utilise the money for whatever purpose permitted by *Shariah*. Depending upon the financial results, the bank may decide to pay a premium at its discretion, to the account holders.
9	Benevolent loan (Qard Hassan)	Under this arrangement, a loan is extended on a goodwill basis, with the debtor (bank) only required to repay the amount borrowed. Banks are allowed to charge borrowers a service fee to cover the administrative expenses of handling the loan.

Source: Based on IMF (2015), *Handbook of Islamic Banking* (2007) [13]

[13] M.Kabir Hassan and Mervyn K Lewis (2007). Eds. *Handbook of Islamic Banking*. Edward-Elgar Publishing.

Thoughts on interest-free banking in India are not new

In tandem with its expansion elsewhere, interest-free banking has also expanded in the Asian continent. Notwithstanding the growing footprint of interest-free finance elsewhere, it has witnessed a lukewarm response in India. It was only as late as 2008 that the Committee on Financial Sector Reforms (Chairman: Dr. Raghuram G Rajan) opined the need for a closer look at this issue. In the words of the Committee:

> Another area that falls broadly in the ambit of financial infrastructure for inclusion is the provision of interest-free banking. Certain faiths prohibit the use of financial instruments that pay interest. The non-availability of interest-free banking products (where the return to the investor is tied to the bearing of risk, in accordance with the principles of that faith) results in some Indians, including those in the economically disadvantaged strata of society, not being able to access banking products and services due to reasons of faith. This non-availability also denies India access to substantial sources of savings from other countries in the region (Ch. 3: *Broadening Access to Finance*, p.72).

Significant voluntary exclusion due to lack of interest-free banking products and services

Using household-level data we employ a multivariate regression framework to examine the inter-relationship between interest-free banking and the two major dimensions of formal financial inclusion: access and use (Box 5.1).

Box 5.1: Interest-free banking: Empirical Evidence

To understand the differences in access to and use of finance, data from the All-India Debt and Investment Survey (AIDIS) was employed. Akin to Demirguc-Kunt *et al.* (2013), the following relationship for household *h* in state *s* was specified:

$$FI_{h,s} = \alpha\, Muslim_h + \beta\, [Characteristics]_h + \gamma\, [State]_s + \varepsilon_{h,s}$$

where FI captures the two major dimensions of financial inclusion, i.e., access (supply) and use (demand). *Characteristics* is a set of household characteristics such as those relating to education, work status, location, age profile and household immovable (building and other construction) asset status (disaggregated into four quartiles), *State* is a set of state-specific variables such as income, proportion of Muslim population, road infrastructure and literacy rate as well as household size. The median household size in the sample equals 4 and the maximum is 38. As a result, household size fixed effects by considering four size classes—up to 4, [5,7], [8,10] and above 10—are included. The size class becomes extremely skewed when it exceeds 10. The coefficient of interest is α, which identifies the response of the Muslim household to financial inclusion.

The analysis also investigated the use of formal cash loans by Muslim households. A double-hurdle model was employed, where in Stage 1 the dependent variable is a dummy depending on whether the household uses formal finance, else zero, and in Stage II the regression is estimated only for non-zero numbers.

Table: Access to and use of finance

Variable	Formal	Formal_ Bank	Formal_ Govern-ment	Formal_ Long term	Formal (Stage I)	Formal (Stage II)
	Access				Use	
	(1)	(2)	(3)	(4)	(5)	(6)
Muslim	0.087	-0.388	-0.081	0.860***	-0.162*	0.109
	(0.059)	(0.375)	(0.068)	(0.270)	(0.089)	(0.212)
Characteristics	YES	YES	YES	YES	YES	YES
State	YES	YES	YES	YES	YES	YES
Household size FE	YES	YES	YES	YES	YES	YES
Pseudo R-sq.	0.041	0.236	0.030	0.059		
Log likelihood					-2753	
Observations	5,719	2,299	3,476	3,476	1,698	

Standard errors (clustered by state) within parentheses
***p <0.01; ** p <0.05; * p<0.10

The evidence suggests that Muslims are less inclined to access formal finance, in general, although they might be accessing long-term formal finance. This could be happening presumably because they perceive long-term financing sources as being more *Shariah*-compliant.

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It would be desirable to offer an interest-free banking window in conventional banks

In interest-free banking, the bank accepting deposits of money from the public is not engaged in lending as a purely financial activity but undertakes operations on the basis of profit and loss sharing (PLS) by engaging in equity financing and trade financing[14]. It has been argued by experts on interest-free finance that the nature of the Profit Sharing Investment Account (PSIA) could vary from being deposit-like products (in the conventional sense) to pure investments. Lease (Ijarah) and cost plus sale (Murabahah) are also simple and relatively easy to monitor. Conventional commercial banks in different financial jurisdiction are opening separate windows to cater to interest-free banking (Box 5.2).

14 With respect to interest-free finance, the Financial Services Authority (FSA) in the UK, for example, does not provide guidance on Shariah principles, nor on whether particular products are Shariah-compliant. The FSA does, however, provide an explanation of products and the associated risks.

Box 5.2: Interest-free windows

An increasing number of commercial banks around the world are considering the possibility of offering interest-free financial products. In many countries, this reflects the banks' desire to offer services to a growing population interested in such products, but in several instances it is also motivated by the wish to tap the growing pool of international investors attracted to *Shariah*-compliant products. At first, a commercial bank may only want to probe the potential of this market, and thus may be interested in launching a pilot project. The bank can take advantage of its existing branch network to open so-called interest-free windows, through which they can reach out to potential new clientele.

An interest-free window is simply a window within a conventional bank through which customers can conduct business utilising only *Shariah*-compatible instruments. At the inception of the window, the products typically offered are safekeeping deposits —on the liability side of the bank —and relevant trade-finance products for small and medium companies —on the asset side of the bank. It also requires the bank to institute appropriate firewalls to avoid the commingling of interst-free and conventional funds.

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Recommendation 5.1

The Committee recommends that commercial banks in India may be enabled to open specialised interest-free windows with simple products like demand deposits, agency and participation securities on their liability side and to offer products based on cost-plus financing and deferred payment, deferred delivery contracts on the asset side.

Recommendation 5.2

In the event that interest-free banking is allowed in India, the extant regulatory guidelines in respect of capital and liquidity as applicable in the case of commercial banks would have to be made applicable to those as well.

Credit Infrastructure

Multiple players driving prices and services

6

Chapter

As discussed in Chapter 1, credit flow from the formal sector has been less than adequate to meet the huge credit demand, leaving a substantial credit gap that is met by the informal sector often to the detriment of small borrowers. The Committee therefore, focused on ways to expand formal channels of credit delivery and what needs to be done to achieve the 'last mile' challenge, while guarding against over-indebtedness.

Multiple delivery channels of formal credit should be encouraged

Broadly speaking, the major players for delivering formal credit are: (i) commercial and regional rural banks; (ii) co-operative banks, both urban and rural; and (iii) non-banking financial companies (NBFCs). By and large, at end-March 2015, Scheduled Commercial Banks (SCBs) dominated credit supply with nearly 71 per cent of total credit flow, followed by NBFCs with about 12 per cent (Table 6.1).

Table 6.1: Credit outstanding by various entities

Entity type	Credit outstanding (₹. billion)	Per cent to total
Scheduled commercial banks	61,023	70.7
Regional Rural Banks	1,848	2.1
Co-operative banks	6,394	7.4
Urban*	2,243	2.6
Rural**	4,691	5.4
NBFCs	10,063	11.7
Total	**86,262**	**100.0**

* Includes both scheduled and non-scheduled banks

**Includes both long-term (State Co-operative Agriculture and Rural Development Banks and Primary Co-operative Agriculture and Rural Development Banks) and short-term (State Co-operative Banks, District Central Co-operative Banks and Primary Agricultural Credit Societies) entities

While financial inclusion policies have overwhelmingly relied on commercial banks to extend credit services, they were often found wanting in their provision of financial services to rural areas due to high costs for originating and servicing small-ticket loans. Furthermore, in order for banks to succeed in the low-ticket credit market, they need to be able to effectively use soft, locally available information for screening loan applicants from small businesses and low-income households. Notwithstanding these challenges, commercial banks will continue to play a pivotal role in providing credit to a large section of the under- and un-banked households and small businesses, both directly and indirectly through other institutions. The Committee felt, however, that the overall infrastructure for credit delivery should improve and various impediments need to be removed for ensuring better credit delivery.

Recommendation 6.1

Multiple models and partnerships covering different niches should be encouraged. This is particularly the case among national full-service banks, regional banks of various types, NBFCs and semi-formal financial institutions, as well as the newly-licensed payments banks and small finance banks.

Changes are required in the Business Correspondent Model for effective ‘last mile’ service delivery

As discussed in Chapter 1, the business correspondent (BC) model has enabled banks to expand their outreach to far-flung areas. The global experience suggests that BCs can help bridge the ‘last mile’ service delivery gap (Box 6.1).

Box 6.1: Business correspondent models – Cross-country evidence

Globally, policy makers are grappling with ways to provide least-cost financial services to the financially excluded segments of society. One channel that has been widely tried and tested across countries with varying degrees of success is the business correspondent (BC) model. The BC model can potentially help serve the unbanked by allowing banks to reach out to them through a network of ‘external agents’. For banks, it has the advantage of lowering the costs involved in servicing low-value accounts and extending physical infrastructure to remote, otherwise unbanked areas. For customers likewise, the saved costs (in terms of both time and money) for reaching the nearest bank branch are no less compelling. Regulators across countries have promoted the BC framework, keeping in view the twin considerations of striking a balance between promoting financial inclusion through profitable, low-cost delivery channels on the one hand and protecting consumers and the integrity of the financial system, on the other.
Furthermore, the practice of business correspondents varies markedly across countries, not only in terms of availability, but also in terms of their roles, responsibilities and remuneration structures, as evident in the table below. Cross-country practices revealed that in Colombia, collections (of utility bill payments) accounted for the majority of transactions (around 1.8 million in July 2011), whereas in Brazil in 2008, agents made 1.6 billion transactions (CGAP, 2010). Compared to this, in Peru BCs carry out roughly 3.8 million transactions per month. In Kenya, the total value of transactions by mobile network operators was roughly USD 75 million per month (Central Bank of Kenya, 2011).

Country	BCs/ 100,000	Type	Roles and responsibilities	Remuneration structure	Illustrative list of permissible activities
Colombia	29	Bank-based: Retail outlets	Bank fully liable for agent’s actions and ensuring compliance with AML/ CFT, customer liability and customer protection.	Specific details are confidential between the bank and the agent	Cash-in/ cash-out/ processing bill payments/ money transfers (domestic and foreign)/ disbursing credit/ accepting loan repayments
Brazil	84	Bank-based: post offices, lottery outlets, retail outlets	Bank fully liable for agent’s actions and ensuring compliance with AML/ CFT, customer liability and customer protection.	USD 0.39 per day (agents for Banco de Brasil)	Cash in/ cash-out/ processing bill payments/ money transfers (domestic and foreign)/ disbursing credit/ accepting loan repayments

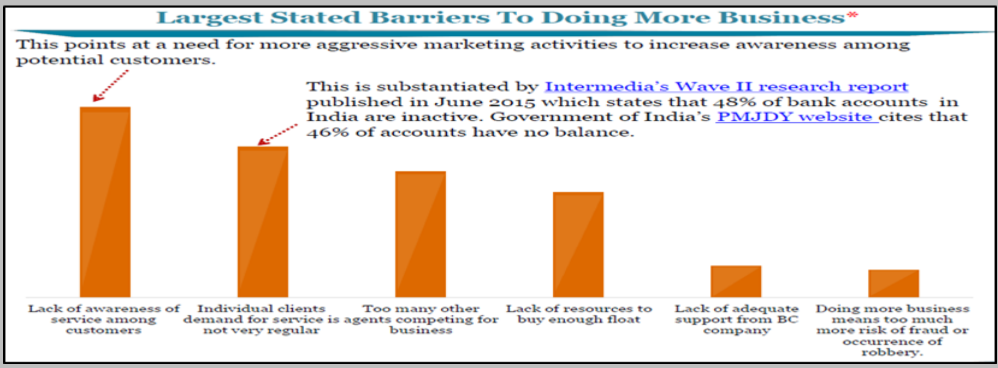
Peru	50	Bank-based: Retail outlets	Bank fully liable for service delivery, risk management and legal compliance for all agent operations.	USD 45-200 per month	Cash-in/ cash-out/ processing bill payments/ money transfers (domestic and foreign)/ accepting loan repayments
Kenya	112.5	Both bank- and non-bank based: Retail outlets, post offices, telco companies, hotels (entities or sole proprietorship)	Bank fully liable for agent's actions and responsible for ensuring compliance with AML/ CFT and risk management	USD 3.9 per day (based on an average of 61 transactions for a M-PESA agent)	Cash-in/ processing bill payments/ money transfers (domestic)/ disbursing credit/ accepting loan repayments

In India, the experience with the BC model has been mixed, with some of them registering notable successes, whereas the evidence of others is not so compelling (Box 6.2).

Box: 6.2: The business correspondent model: India in comparison

A recent MicroSave (2015) survey highlighted the difference between BC models used in Africa (Kenya, Nigeria, Tanzania, Uganda) and Asia (India, Bangladesh, Indonesia, Pakistan). In India 2,682 banking agents were interviewed. Agent networks in India are still comparatively young and differ from other countries in that their rapid expansion has been mainly spurred by government policy, rather than business incentives. This has led to a very high proportion of agents in rural areas. The number of banking agents in India has grown considerably in both urban and rural areas in the last few years, and continues to do so. However, Indian agents have the second lowest transactions per day, the lowest profits and are the least trained among the six countries surveyed. This reveals a need for scaling up BC's business activities. The survey also highlighted the dominant barriers that Indian BCs face for increasing business, among which a lack of awareness of the BC's services among customers and irregular service demand feature as the highest.

Chart: Barriers for BCs in India



References
Consultative Group to Assist the Poor (CGAP) website and websites of the respective central banks
MicroSave. Agent Network Accelerator Survey- India Country Report 2015.

By and large, banks have adopted the Corporate BC Model, wherein individual banks have a corporate-level agreement with institutional BCs. Under this model, the institutional BC is given the responsibility of appointing and remunerating BC agents who operate at the customer service points. Thus, banks are neither directly involved in monitoring the quantum of remuneration paid to agents, nor in screening the BC's business effort and financial literacy. This has resulted in a large number of attritions and unreliable services. Consequently, the BC model has not generated sufficient levels of trust. At the same time, educated and reputed BCs operating from fixed touch points have succeeded much more in gaining the confidence of local people (Box 6.3).

Box 6.3: Elements of successful BC operations:
Evidence from Kancheepuram, Tamil Nadu

Kancheepuram is a district in the southern state of Tamil Nadu with a thriving agricultural sector. Close to 50 per cent of the population is engaged in this activity, with paddy being the major crop cultivated, along with other commercial crops, such as groundnuts, sugarcane and pulses. A major livelihood of workers is weaving silk sarees.
Although banks have a reasonable presence in the district, there are pockets of significant unbanked areas. In order to cover these unbanked areas, banks have utilised the services of Business Correspondents (BCs). The nature of BCs varies across regions: while some of them have opted for the Corporate BC model, others have gone in for the Individual BC Model, wherein the bank has taken upon itself the responsibility of identifying and appointing the BC for each village being serviced by them. Both these models were found to be working successfully and all the BCs were generating good revenues.
Discussions with the local people suggested that some of the key factors that were responsible for the successful operations of these BCs were (i) their continuous availability at fixed locations and at fixed times; (ii) the direct involvement of the base branch officials in co-ordinating with the BCs and also with customers and (iii) initiatives taken by the bank in extending training to BCs, including financial literacy initiatives for educating customers about the advantages of getting linked with banks and the role of BCs.

It is often perceived that by merely ensuring access to formal finance in the form of a bank branch, the process of financial inclusion is addressed. In practice however, this might not necessarily be the case. Viewed from that standpoint, BCs can play a crucial role in promoting financial inclusion by providing convenient access to people (Box 6.4).

Box 6.4: Access does not necessarily imply use: Evidence from Sihphir

People in Sihphir village in Mizoram have high literacy rates and are mostly engaged in vegetable cultivation and milk production. The village has a bank branch and most households have at least one bank account. However, villagers were found to be not be utilising the banking services and were sometimes observed to even availing of services from informal sources.

One of the major issues hampering effective utilisation of banking services was the inability of the bank branch to provide timely availability of banking services at the doorstep of the customers. Additionally, those villagers who are mainly involved in field activities found themselves unable to sacrifice their daily earnings for the purpose of visiting the bank branch. The villagers said that they generate a lot of daily cash by selling their produce, such as vegetables and milk, but there is no facility for the collection of cash at the *mandis*. In such a scenario, a Business Correspondent would help enhance financial inclusion that goes beyond mere access to financial services through the availability of a bank account by providing doorstep services.

One of the major constraints that the BC model faces concerns the availability of BCs at a fixed location, which improves the reliability of the model. Therefore, it is important that banks create fixed location BCs. The trust and reliability of the model can also be augmented by 'branding' akin to post offices. The BC outlet should prominently display, among others, the name of the bank, the name of the link branch, contact details of the branch manager, timing of operations, customer grievance redressal mechanism, types of products and services offered and the rate of interest on deposit and loan products. Banks have to ensure that BCs are available at fixed timings at the outlets, preferably in the latter half of the day when villagers have finished their daily activities and can more easily visit the outlets for conducting transactions. BCs could use the first part of the day for visiting the customers in order to acquire /source more business for the bank as well as to provide urgently needed doorstep delivery of services.

Recommendation 6.2

The Committee recommends that BCs should increasingly be established at fixed location BC outlets: the BC outlet/Customer Service Point (CSP) could be opened in the Village Panchayat Office, kirana shop, personal residence or any other convenient location that could win the confidence of the customer.

Recommendation 6.3

Monitoring of BCs should be allotted to designated link branches in the area. This will help strengthen BC operations and bridge the trust deficit.

Recommendation 6.4

The competence of BCs should not be taken for granted. Accordingly, the Committee recommends a graded system of certification of BCs, from basic to advanced training. BCs with a good track record and advanced training can be trusted with more complex financial tasks such as credit products that go beyond deposit and remittance. The BC model increasingly needs to move from cost to revenue generation to make it viable.

It was observed that banks have established a practice wherein BCs are required to pre-fund their entire operations, either by providing security deposits to banks or by seeking overdraft facilities from banks. This practice has proved to be a hindrance to well-functioning

BCs because they are not able to scale up their business. Very often BCs reach a threshold beyond which they are unable to transact more business for the day.

Recommendation 6.5
The Committee recommends that banks will have to consider introducing a cash management system that can help to scale up BC operations.

Over time, several corporate and individual BCs have come into business. However, the details of the BCs deployed are not fully captured.

Recommendation 6.6
The Committee recommends that the Indian Banks' Association (IBA) may create a Registry of BC Agents wherein BCs will have to register before commencement of operations. The registration process should be simple online process with photo and Aadhaar identification. It could include other details such as name of the BC, type of BC, location GIS coordinates of fixed point BCs, nature of operations, area of operation and, at a subsequent stage, their performance record including delinquency. This database can be made dynamic with quarterly updates, including a list of black-listed BCs which no other bank should approach or work with. This would help banks and other agencies to track the movement of BCs and supervise their operations more efficiently.

Given the size of the country and the effort by banks to provide banking access points across all villages, it is necessary to track the number of newly opened access points.

Recommendation 6.7
The Committee recommends that the Reserve Bank should take the lead in creating a geographical information system (GIS) to map all banking access points which would help improve the efficiency of regulating, supervising and monitoring of banking operations. Over time, a harmonised database of financial inclusion footprints, in terms of outlets, service points, devices and agent networks, may be put in place using a GIS platform.

Need to integrate BC business into banks' overall business strategy

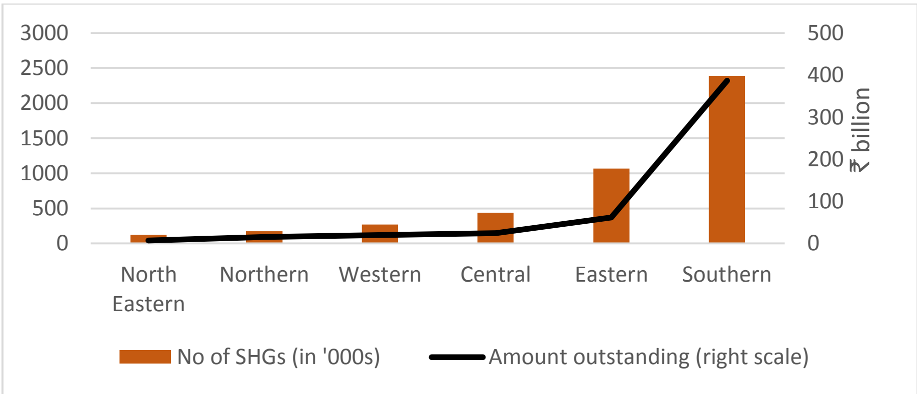
Banks have invested substantial resources on the BC model, which should not be considered peripheral to their banking business. Responsibility for the operations conducted by the BCs lies with the banks for whom the BCs are functional. Once it is considered an integral part of the strategy, it ensures accountability, ownership and commitment.

Recommendation 6.8
The Committee is of the view that it is imperative for banks to conduct periodic reviews of its efforts under their financial inclusion plans (FIPs) at the Board level. This would facilitate banks to take timely corrective steps and prepare concrete strategic action plans.

Livelihood models like Self-Help Groups (SHGs) need to be vigorously pursued by all stakeholders

While initiatives like PMJDY, DBT and other schemes may connect individuals directly to bank accounts with regard to activities related to deposits and payments, the financial infrastructure is still not robust enough to enable unbanked individuals to avail of credit facilities. Therefore, the Self-Help Group (SHG)-Bank Linkage Programme (SBLP), which had been at the forefront of the financial inclusion initiatives for the past two decades, continues to hold unique significance even in the current discourse of facilitating individual access to financial services. The SBLP is a group savings-linked programme with its main thrust on the provision of micro-credit. At end-March 2015 it had a loan portfolio of over ₹.500 billion. However, the success of the SBLP programme has been uneven across the country, with the southern region accounting for over half of the SHGs (Chart 6.1). In addition, the NPA levels of SHGs have more than doubled from about 3 per cent of total loans in March 2010 to 7.4 per cent in March 2015.

Chart 6.1: Region-wise SHG-Bank linkage (end-March 2015)



The SBLP has a broader development objective of providing livelihood to the marginalised while simultaneously bringing them into the formal financial channel. Accordingly, there are several stakeholders such as Self-Help Promoting Institutions (SHPIs), NGOs and government development agencies like the National Rural Livelihood Mission (NRLM) and the Swarnajayanti Gram Swarozgar Yojana (SGSY), besides banks and NABARD.

Recommendation 6.9
The Committee recommends that NABARD may work out a programme along with other stakeholders to step up the SBLP, particularly in regions with less penetration. In this context, the District Consultative Committee (DCC) and SLBCs are the appropriate forum to sort out inter-institutional issues and set monitorable and implementable targets (see Chapter 10).

The engagement of bankers with SHGs seems to have weakened with the introduction of Business Correspondents (BCs) who lack the necessary skills for dealing with SHGs.

Recommendation 6.10

The Committee is of the view that training of BC should also include their sensitisation towards SHGs.

Recommendation 6.11

Keeping in view the indebtedness and rising delinquency, the Committee is of the view that the credit history of all SHG members would need to be created, linking it to individual Aadhaar numbers. This will ensure credit discipline and will also provide comfort to banks.

Recommendation 6.12

The Committee sees the SHG-corporate linkage working as 'micro-factories' of corporates. An example is ITC's 'Mission Sunehra Kal'. Corporates can be encouraged to nurture SHGs as part of their Corporate Social Responsibility (CSR) initiatives.

Microfinance institutions should continue to be encouraged

Microfinance institutions (MFIs) fill the niche that is mostly under-served by main-stream financial institutions and to that extent play a critical role in furthering financial inclusion. Microcredit programmes throughout the world defied conventional wisdom about financing the poor, by designing products and channels adjusted to their needs. They showed that the poor had excellent repayment rates and also revealed the benefits of extending credit to women.

In the past few years, the Indian microfinance sector has experienced phenomenal growth. This is evident from the fact that as many as eight MFIs have been granted 'in principle' approval by the Reserve Bank to set up Small Finance Banks and one MFI has already started functioning as a bank. The number of institutions providing microfinance services has gone up from a handful to a few hundred. At end-March 2015, 478 MFIs were operating in 33 states and Union Territories and 568 districts in India and reached out to 37 million clients with an outstanding loan portfolio of roughly ₹ 490 billion.

In terms of regional dispersion of client outreach, roughly 40 per cent was located in the Southern region and 25 per cent in the Eastern region. NBFC-MFIs contribute to 85 per cent of the total client outreach and 88 per cent of the outstanding portfolio, while NGO/MFIs contribute to the remainder. The proportion of urban clientele was 67 per cent in 2014-15 and female borrowers constituted 97 per cent.

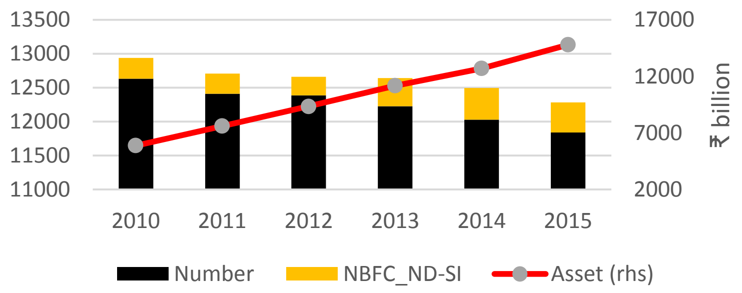
This sector faced a major crisis because high interest rates, coercive recovery and multiple lending practices which led the Government of Andhra Pradesh to clamp down on the sector. To address the concerns arising thereof, the Reserve Bank undertook an in-depth analysis of the issue, and based on the recommendations of the Malegam Committee, brought clarity in regulation and confidence to investors. As discussed in Chapter 1, the Andhra Pradesh MFI crisis was brought about by, among other things, high indebtedness, which implies the need for better credit information of borrowers.

Recommendation 6.13
The Committee recommends that bank credit to MFIs should be encouraged. The MFIs must provide credit information on their borrowers to credit bureaus through Aadhaar-linked unique identification of individual borrowers.

Non-Banking Financial Companies have an important role to play in bridging the credit gap

Non-Banking Financial Companies (NBFCs) constitute an integral part of the financial inclusion agenda. The sector is characterised by a remarkable diversity of players that act as effective financial intermediaries, penetrating into areas that are otherwise unbanked or under-banked. NBFCs play a key role in inducting informal sector borrowers into the formal financial system and, therefore, assume a meaningful role in shaping borrowers' financial behaviour. The sector's consolidation has led to a rationalisation in the total number of registered NBFCs against an overall expansion in their asset base (Chart 6.2).

Chart 6.2: Evolution of the NBFC segment



Recommendation 6.14
The Committee thinks it important to ensure adequate funding from channels that have stronger access (e.g., banks) to channels that are equipped and have the appetite to extend small-ticket loans, but may not have the same access to funding (e.g., NBFCs). The suitability of the products for the customer needs to be kept in view in this regard. Encouraging the development of the securitisation market for such small-ticket loans could be useful in this respect and help commercial banks acquire loans that qualify for priority sector lending.

All credit flow from the formal sector must be provided to credit information companies to facilitate credit risk assessment, check indebtedness and promote financial stability

Information on the total indebtedness of a borrower and the nature of such indebtedness is an essential prerequisite to assessing whether a loan, in the manner in which it is structured, would be suitable for the borrower. Given the lack of information about the creditworthiness of borrowers who do not have a track record of borrowing from the formal financial system, any originator will have to ensure that it has enough information about the borrower. Banks need to ensure that the risk profiles of customers are understood correctly in order to assess their suitability and to ensure that the risk is priced correctly into the bank's loan.

Credit Information Companies (CICs) help to overcome the information asymmetry problem, improve access to credit and check indebtedness.

Recommendation 6.15
The Committee is of the view that in order to preserve institutional neutrality, credit reporting requirements need to be harmonised across all credit providers. For instance, all lenders to the small borrower segment must be mandated to report to credit bureaus as has been the case with NBFC-MFIs. Therefore, the picture of indebtedness of the borrower must also include outstanding KCC, GCC and SHG loans. Once a realistic picture of the total indebtedness of the borrowers has been obtained, restrictions such as the maximum number of lenders per borrower can be removed, paving the way for competition to push down interest costs for the small borrower.

Recommendation 6.16
CICs also have a significant role to play in enabling credit flow to MSMEs, especially those without formal registration and standard accounting practices by helping them build a sound credit history (Chapter 5 provides details).

Recommendation 6.17
In the absence of a framework for sharing of information among CICs, the same credit information is required to be provided to all CICs, which not only leads to avoidable duplication but also magnifies the reporting burden. The Committee recommends that a mechanism for mutual sharing of basic credit information for a fee among CICs should be mandated so that the lender could report to any of the CICs.

Encouragement of risk-transfer markets will facilitate multiple specialised originators, thereby enhancing the efficacy of the overall credit system

Credit underwriting requires a deep understanding of the borrower and requires adequate risk capital to serve as cushions for unexpected losses. However, credit intermediation can benefit greatly from the payment services, chiefly by using transaction data to enhance the credit underwriting capabilities of providers serving segments that do not have traditional credit scoring histories and are therefore excluded from accessing credit.

Recommendation 6.18
The advent of Payment Banks, an increasing number of cash-in and cash-out points through BCs, micro ATMs, mobile wallets and Rupay in the rural areas will enable customers to increase their access to the formal payment system. Over time, this would make it easier for banks to assess customers' repayment capability, as most of the cash flows will become digitally recorded. This, in turn, will lead to lenders being able to conceive and build automated credit decision models, which reduces the cost of credit underwriting. This would also enable banks to better monitor cash flows on an ongoing basis and to step up risk mitigating measures.

Recommendation 6.19
The Committee is of the view that the tax-exempt status for securitisation vehicles needs to be restored so that such entities do not have to pay distribution tax, given their critical role in efficient risk transmission. This will not lead to a loss of tax revenues since the income will still be fully traceable and taxable in the hands of the investors. Besides reviving and strengthening the securitisation market, these vehicles will allow a wide range of investors to participate in financing the pool of assets by means of Special Purpose Vehicles and rated Pass-through Certificates (PTCs). These would need to be structured such that the originator has continued incentives to monitor the project while having reduced their own exposure to the full extent of the project

risk. This instrument can facilitate the growth of the retail credit market, particularly in areas such as home loans, farm loans and loans to landless labourers.

Recommendation 6.20

The current restriction requiring that the all-inclusive interest charged to the ultimate borrower by the originating entity must not exceed the base rate of the purchasing bank plus 8 per cent per annum must be removed, because this dissuades originators from expanding to low-access regions and sectors due to the high operating and borrowing costs.

Payments System

Move to cashless and convenient service delivery

7

Chapter

India has followed bank-led model to achieve financial inclusion (FI) and made steady gains.

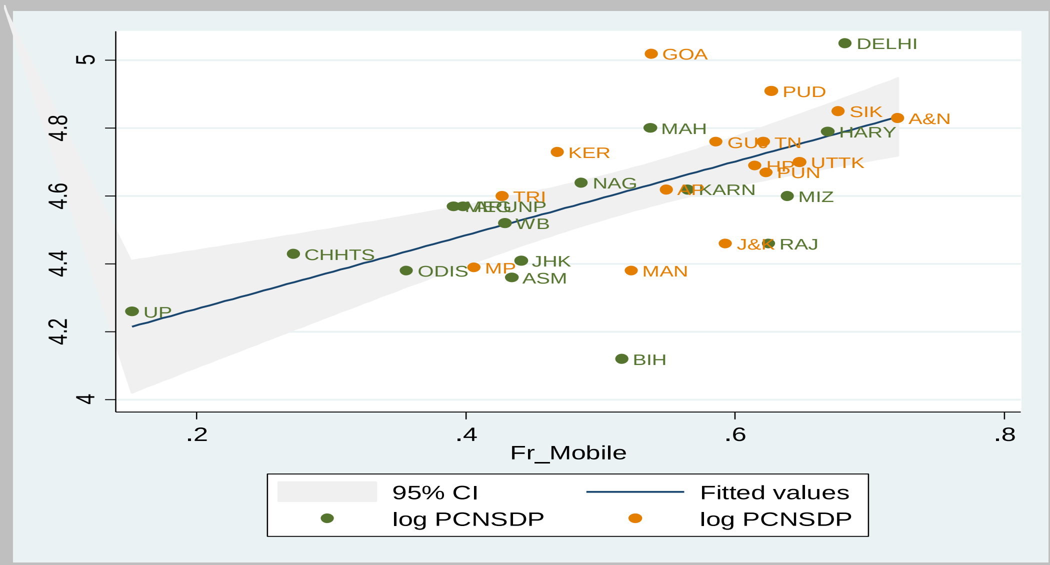
However, given the enormous population and the demographic and geographical diversity of the country, there is still substantial ground to be covered. A synergetic approach is the need of the hour with banks leveraging the high mobile density in the country to offer basic banking services on the one hand and both banks and non-banks offering mobile-based prepaid instrument (PPI)/e-money products for easy accessibility on the other. In addition, a simple mobile banking registration process and the use of application-based mobiles as a Point of sale (PoS) are potent instruments for achieving the goal of financial inclusion. The Committee is of the view that the desirable level of financial inclusion would be difficult to achieve without a combination of the sustained efforts of conventional banking as well as mobile-based products and services offered by both banks and authorised non-bank entities.

Mobile technology provides the way forward for inclusion

In recent times, a significant volume of literature has emerged regarding the role of information and communications technology (ICT) on economic growth. With the JAM trinity taking hold, this provides considerable scope to exploit mobile-based technologies and channels to promote the delivery of financial services. According to the Telecom Regulatory Authority of India, the total wireless subscriber base stood at 997 million at end-September 2015. At the same time, the average per minute cost of mobile cellular calls has declined. Therefore, leveraging this cost-effective solution will not only address the ‘last mile’ challenges, but also enable the country to leapfrog from its present financial inclusion levels (Box 7.1).

Box 7.1: Mobile phones, financial inclusion and growth

It is possible to envisage several channels through which mobile technology can further economic growth. First, by supplying telecom services, mobile telephony contributes directly to output and employment expansion. Second, by allowing firms to adopt flexible structures and location, mobile telephony allows for improved productivity. Third, although mobile telephony might entail initial fixed costs, the variable costs associated with their use are significantly lower, enabling an overall reduction in transactions costs (Aker and Mbiti, 2010).
One aspect of ICT that has attracted the attention of researchers is the usefulness of mobile telephony in enhancing financial inclusion and thereby, *via* the finance-growth interlinkage, augmenting economic growth (Levine, 2005). Using cross-national data, Waverman *et al*, (2005) found that cellular services contribute significantly to national output. In the case of India, Kathuria *et al.* (2009) show that mobile penetration in Indian states is associated with a positive and statistically significant improvement in output
We explored the impact of mobile telephony on state income. Accordingly, we combined Census 2011 data on mobile telephony with state per capita income and financial inclusion. For financial inclusion, following Beck *et al.* (2007) we considered six indicators: two each relating to penetration, access (deposit and loan accounts) and use (deposit-to-income and loan-to-income). For 32 states and Union Territories (excluding Daman & Diu, Dadra & Nagar Haveli and Lakshadweep, owing to paucity of data), we normalised these indicators using a maxi-min strategy and took a simple average of these indicators to arrive at a financial inclusion index (see, for example, Government of India, 2013). We classified states as having high or low financial inclusion (based on the median index value) and juxtaposed it with (log of) state per capita NSDP and fraction of persons in the state using mobile telephony (Fr_Mobile). The evidence suggests that states with a higher proportion of mobile users (in green) have a higher per capita NSDP, after accounting for differences in financial inclusion.



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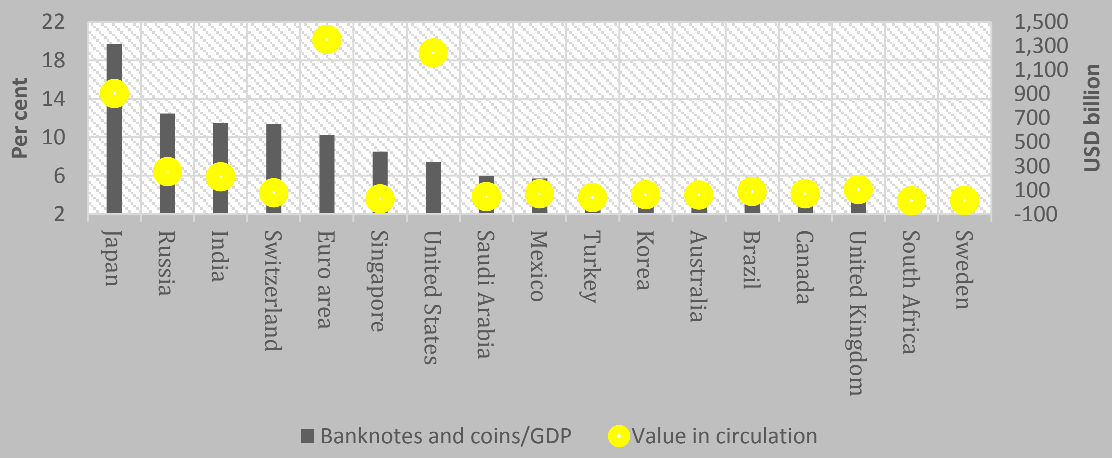
The higher the share of cash, the larger the national cost and, hence, the payments policy should facilitate the transition towards a less-cash society

An important component of the payment segment has traditionally been cash, which entails significant costs in terms of production, distribution and other logistics that are not apparent to the final consumer and, therefore, not factored in while choosing this alternative over others since the cost is borne by the intermediaries (Box 7.2). While cash cannot be fully eliminated, the question is how to move to a less-cash society or at least slow down the growth of the cash volume. This is being realised now in segments of urban India with the rapid expansion of e-commerce. Rather than carrying cash in physical wallets, people are loading it on their mobile wallets. The number of smart phone users has increased manifold during the last three years, touching 160 million by July 2015. With technological advancements and the ensuing lower costs, the smart phone proliferation across the country will further increase, gradually making deeper inroads in rural areas as well. With the Digital India initiative aspiring to provide free wi-fi across India over the next few years, mobile money/e-money will have the advantage of lowering transactions costs while offering convenience of access and thereby enhancing financial inclusion. Thus, in the near future, mobile money has the potential to offer a low-cost alternative to cash.

Box 7.2: Holding cash: How big are the costs?

Notwithstanding the growing digitisation of the economy, Indian is among the most cash-intensive economies in the world, with a cash-to-GDP ratio of close to 12% in 2013 (Chart), which is 5 times that of Sweden, a country known for its electronic payment friendliness, and roughly two-and-a-half to three times that of other emerging economies, such as Brazil (2.7%), the UK (3.2%) and South Africa (3.3%). According to a research report, 87% of all transactions in 2012 in India were in cash; less than 10% of people have ever used any kind of non-cash payment instrument (Institute for Business in the Global Context, 2012). The Intermedia Financial Inclusion Insights Survey also highlights the fact that barely 0.3 per cent of adults were using mobile money.



This love for cash entails significant costs that are not very apparent. One is the need to frequently reissue notes due to poor handling: the median life span of a note across all denominations is about 3.6 years. As a result, roughly one-third of the current currency stock of 83.6 billion pieces gets replaced every year at a huge national cost. In 2014-15, the Reserve Bank spent ₹38.6 billion to print 23 billion pieces notes across all denominations, entailing an average cost of ₹ 1.7 per piece.

Further, it is estimated that a single transaction at an ATM costs ₹ 18-20. For simplicity, if one draws a ₹100 bill in one transaction at an ATM, the underlying cost works out to ₹20, i.e., one-fifth of the nominal value of the note.

From a policy standpoint, there is a need to generate greater customer awareness and incentivise electronic payment modes, so as to incentivise acceptance and ensure a definitive switch away from cash-oriented transactions.

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Mobile technology has its own set of technological and regulatory challenges, which should be addressed for wider adoption

In India, mobile banking has seen rapid growth over last few years with number of transactions rising from 4.72 million in November 2012 to 27.11 million in September 2015 (Box 7.3).

Box 7.3: Mobile banking and mobile money

To date, innovations in mobile money across the world have taken place in a largely isolated way to meet specific local needs. Starting in 2000, with the introduction of Smart Money —the world's first electronic cash card linked to a mobile phone —in the Philippines, mobile payment services have gained traction across countries and continents (Ernst and Young, 2014).

Although emerging markets were the first to develop and offer transformational mobile money transfer services, innovations in developed markets enabled them to leapfrog ahead, supported by developments in infrastructure, innovations and instruments. Rapid growth is expected in the value and volume of mobile payments transactions globally, with non-banks accounting for a rising share (Ernst and Young, 2014).

Although India is a relatively late starter in the mobile technology space, the mobile market has exploded in recent times, supported by enabling government policies and practices,. According to a recent document by Morgan Stanley (2015), India's e-commerce market is set to expand from USD 3 billion in 2013 to more than USD 100 billion by 2020. Of the 354 million Internet users in India in June 2015, over 200 million were first-time users (Internet and Mobile Association of India website). The confluence of these positive factors offers tremendous opportunities for banks and mobile service providers to leverage their strengths and explore the expanding opportunities.

The available information suggests that the mobile penetration of banks, especially public sector banks, is quite limited at present. Out of the mobile banking transactions worth Rs. 270 billion in September 2015, the share of public sector banks was 14%, whereas private banks accounted for 84%; the remainder was accounted for by foreign and other banks (co-operative and *Grameen*). The market is quite concentrated, with the top three banks accounting for three -fourth of the total value of mobile banking transactions and the share of the top 5 at more than 90%. This suggests that there is significant room for market players to grow, both in terms of the overall size of the pie as well as for individual entities to expand their business.

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Digitising payments is not without challenges. These include making upfront investment in infrastructure, ensuring a reliable and consistent digital experience and above all creating customer awareness about the various channels and how to operate in a digital environment. In such a scenario, each channel of electronic payment offers its own set of issues, which need to be resolved to ensure popularisation and mass proliferation of electronic payment systems. For example, the installation and maintenance of ATMs has its associated costs, especially in rural areas where the footfalls are low. The number of Point of Sale (PoS) machines is far lower than the number of merchants. Several small businesses actively forego debit/credit card acceptance due to the initial costs of set-up and as a tax avoidance measure.

In order to achieve financial inclusion, the unbanked should be covered by any channel that provides financial service of which payment and remittance is a critical component. However, the number of bank accounts that are mobile number seeded is quite low. A simple process of mobile banking registration is required to facilitate customer adoption. Since a huge segment of the population has been added to the formal banking system under the PMJDY, banks can provide them with ease of banking by introducing mobile banking applications that are non-smart phone-based for simple financial transactions. One example is the *99# NUUP channel that operates on a USSD platform; it offers a non-network, non-device-specific, mobile phone-based banking alternative for customers. This has huge potential for reducing the dependence on cash as well as brick-and-mortar branches and should be promoted by getting issues of session drop and call/session rates resolved. A multilingual application needs to be developed for better acceptance and ease of access to people across the country.

In India, m-wallet constitutes a significant proportion of the PPIs issued, accounting for 49 million transactions of a 58 million PPI transactions during the month of September 2015. To achieve faster financial inclusion through PPIs, the opportunity lies in the quasi-ubiquitous availability of mobile phones and the rapid growth witnessed in this segment. PPI interoperability is permitted for bank-issued PPIs, but not for non-bank issued PPIs. Allowing interoperability will facilitate the ease of access and use of mobile-based financial services by the common people. Several countries, both in Asia (Pakistan, Sri Lanka, Indonesia) and elsewhere (Tanzania) have allowed PPI interoperability to enable anytime-anywhere ease of access for consumers. Cash-out is permitted for bank-issued open PPIs, whereas non-bank PPIs do not have this feature. Allowing limited cash-out even to non-bank PPIs with appropriate KYC would result in greater acceptance. This will enable cash to be circulated locally, thereby reducing overall cash demand and greater usage of mobile payment.

Against these opportunities, the Committee makes the following recommendations:

Recommendation 7.1
The Committee is of the view that given the low penetration of ATMs, installing more ATMs in rural and semi-urban centres will create more touch points for customers. The Financial Inclusion Fund (FIF) may be utilised to encourage rural ATM penetration.

Recommendation 7.2
The Committee recommends that interoperability of micro ATMs should be allowed to facilitate the usage of cards by customers in semi-urban and rural areas across any bank micro ATM and BC. For this, connectivity of micro ATMs to the National Financial Switch should be enabled. Adequate checks and balances should be put in place to ensure customer protection and system safeguards.

Recommendation 7.3
Considering the widespread availability of mobile phones across the country, the Committee recommends the use of application-based mobiles as PoS for creating necessary infrastructure to support the large number of new accounts and cards issued under the PMJDY. Initially, the FIF can be used to subsidise the associated costs. This will also help to address the issue of low availability of PoS compared to the number of merchant outlets in the country. Banks should encourage merchants across geographies to adopt such application-based mobile as a PoS through some focused education and PoS deployment drives.

Recommendation 7.4
The Committee feels that banks need to introduce a simple registration process for customers to seed their mobile number for alerts as well as financial services. The Reserve Bank has already required banks to enable an interoperable ATM channel for mobile number registration.

Recommendation 7.5
The Committee recommends that the National Payments Corporation of India (NPCI) should ensure faster development of a multi-lingual mobile application for customers who use non-smart phones, especially for users of NUUP; this will address the issue of linguistic diversity and thereby promote its popularisation and quick adoption.

Recommendation 7.6
The Committee is of the opinion that the government may undertake initiatives to resolve the issues of number of steps per session in a transaction on NUUP, session drops and session charges; the Reserve Bank and NPCI may co-ordinate with the Telecom Regulatory Authority of India (TRAI) on this matter. Aadhaar and e-KYC should be the uniform KYC accepted by concerned regulators including TRAI.

Recommendation 7.7
For smart phone users, the Committee recommends that the NPCI work on developing a standardised interface application, which will ensure interoperability in mobile-banking transactions for customers. It should be implemented with proper due diligence and the required security checks.

Recommendation 7.8
The Committee recommends that pre-paid payment instrument (PPI) interoperability may be allowed for non-banks to facilitate ease of access to customers and promote wider spread of PPIs across the country. It should however require non-bank PPI operators to enhance their customer grievance redressal mechanism to deal with any issues thereof.

Recommendation 7.9
The Committee is of the view that for non-bank PPIs, a small-value cash-out may be permitted to incentivise usage with the necessary safeguards including adequate KYC and velocity checks.

Recommendation 7.10
Currently, many merchants discriminate against card payment by levying a surcharge on credit card transactions, which should not be allowed once the merchant has voluntarily agreed to participate in such modes of payments.

Recommendation 7.11

As there is a gap not only between product availability and awareness about such products but also about the precautions to be followed while using a digital or electronic payment product, the Committee recommends a wider financial literacy drive that exploits all possible communication channels to educate customers. The financial support for such campaigns can be drawn from the FIF.

Government-to-Person (G2P) Payments

Social cash transfers essential for inclusion

8

Chapter

In a number of countries, governments have sought to increase the use of electronic means for payments and to promote greater financial inclusion. While the two agendas have by no means converged, in practice they have often been translated into a single objective of increasing the proportion of recipients of government social cash transfers who receive payment directly into their bank accounts. This direct government cash transfer into bank accounts serves two benefits. Electronic payments are likely to reduce the cost of payment for government and make delivery more targeted and convenient for recipients compared to the prevalent cash-based schemes, which require recipients to be in a particular place at a particular time to receive payment. On the other hand, a bank account is viewed as a means to enter the wider world of formal financial services such as savings, insurance and credit. Using these services appropriately would enhance development benefits from social cash transfer schemes (Bold et al. 2012).

Meaningful financial inclusion is not feasible without social cash transfer

Given the low level of personal disposable income particularly for the bottom quartile of the population, the Committee is of the view that meaningful financial inclusion will be elusive without social cash transfers from the Government-to-Person (G2P). Substantial infrastructure has already been put in place by the opening of accounts and biometric identity creation through Aadhaar.

Recommendation 8.1

The Committee recommends that the deposit accounts of beneficiaries of government social payments, preferably all deposits accounts across banks, including the 'in-principle' licensed payments banks and small finance banks, be seeded with Aadhaar in a time-bound manner so as to create the necessary eco-system for cash transfer. This could be complemented with the necessary changes in the business correspondent (BC) system (see Chapter 6 for details) and increased adoption of mobile wallets to bridge the 'last mile' of service delivery in a cost-efficient manner at the convenience of the common person. This would also result in significant cost reductions for the government besides promoting financial inclusion

The Committee believes that this approach is consistent with the government's vision. This would entail increasing the digitisation of government payments and the consolidation of various benefits, which could put significant disposable income in the hands of the marginalised sections of society at regular intervals.

Digitisation of government payments and electronic transfer should be at the heart of social welfare programmes

In its evaluation report on the targeted public distribution system (PDS) in 2005, the government observed that for every kilogramme of grains delivered to the poor, the amount actually released from the central pool was 2.4 kilogrammes. In the case of fuel subsidies, it was found that the richest 10 per cent of households benefitted seven times more than the poorest 10 per cent (Anand *et al.,* 2013). The flagship Mahatma Gandhi Rural Employment Guarantee Scheme (MNREGS) has also encountered massive diversion of funds. Chauhan *et al.* (2009) found cases where workers performed one day's job, but their attendance was marked for 33 days. Dr´eze *et al.* (2007) found in a survey of three districts of Odisha that only 60 per cent of the days of employment recorded in the muster rolls could be confirmed by the concerned labourers. A study by NIPFP (2012) on the cost-benefit analysis of Aadhaar-linkage in checking leakages in various central government schemes estimated that the benefits overwhelmed the costs, touching ₹203 billion (at constant prices) in 2020-21.

These concerns have increasingly made governments resort to the digitisation of transfers. Besides being efficient, safe and transparent, they also aid in the pursuit of other public policy objectives, such as the modernisation of the national payments system and the promotion of financial inclusion. Cross-country experiences are replete with evidence on how G2P payments have led to significant gains. Estimates by the Consultative Group to Assist the Poor (CGAP), a partnership of organisations that seeks to advance financial inclusion, suggests that switching to electronic G2P payments into financially inclusive accounts would lead to substantial savings (Box 8.1)[15].

Box 8.1: Digitisation of Government Payments – Cross national evidence

Irrespective of the state of economic progress, governments across countries make payments to and collect payments from individuals and businesses. These flows typically encompass a wide range of economic sectors and activities. However, only a quarter of low-income countries worldwide process cash transfers and social benefits electronically. By going electronic, governments can save significantly on costs and reap efficiency gains.
Perhaps the best-known example is that of *Bolsa Familia* in Brazil: by switching to electronic benefit cards, the programme helped lower administrative costs from nearly 15% to less than 3% of the value of the grants disbursed. In Niger, researchers found that making social safety net payments *via* mobile phones reduced overall travel and wait time by 75%, resulting in people being able to spend this time on more productive tasks. Switching from cash to mobile also saved 20% on administrative costs (Aker *et al.*, 2014). In South Africa, approximately 36% of the recipi-

[15] The scenario is for a hypothetical social transfer programme that pays a monthly amount of USD 40 to 1 million recipients.

ents of social transfers made by the Social Security Agency were banked in 2005. A few years later, this percentage had risen to 60% and continues to increase, due in large part to the agency's reinforced strategy of using electronic payments.
Digital payments also reduce corruption. When Argentina moved payments for a large national social programme from cash into accounts, the demand for kickbacks virtually disappeared. When the payments were made in cash, 4% of recipients reported paying kickbacks; after the switch, that number dropped to less than 0.5% (Duryea and Schargrodsky, 2008).
Digital payments also reduce leakage. In India, digitising social security transfers caused demands for bribes to drop by 47%, and led to beneficiaries receiving higher payments (Muralidharan *et al.* 2014). A major positive externality of digitising government payment is the development of a robust payments infrastructure, which in turn can support the safe and efficient processing of government payments.

Following the recommendations of the 14th Finance Commission (FFC), the share of the states in the central divisible pool has been substantially enhanced to 42 per cent from the earlier 32 per cent. As a consequence of the higher devolution and a resultant reduction in the fiscal space for the Centre, several state schemes were delinked from Central support. However, the central government decided to continue to contribute to schemes that represent national priorities, especially those targeted at poverty alleviation.

Recognising the leakages in various welfare and anti-poverty schemes, in January 2013 the central government introduced direct benefit transfer (DBT) for better targeting of beneficiaries, elimination of waste in subsidy transfer, ensuring greater accountability and improving the efficiency of social transfer payments. This was done in select districts encompassing 26 central sector (CS) and centrally sponsored schemes (CSS). At present, 34 CS and CSS schemes and 3 subsidy-related schemes are covered under the DBT and its coverage is gradually being expanded. According to the Ministry of Finance, ₹ 463 billion was released under Direct Benefit Transfers (DBT) for the identified schemes between January 2013 and March 2015, which were transferred through the Aadhaar Payment Bridge (APB) and other electronic modes. In the long run, DBT will consolidate income support to households that get benefits from multiple sources and in multiple forms[16]. However, in the various social welfare programmes of the state governments, social transfers and subsidies are made mostly through traditional channels (Box 8.2).

Recommendation 8.2

Given the increased role of the states in public welfare and the elimination of poverty and the higher transfer payments by the state governments following the 14th Finance Commission recommendations, the Committee recommends that the states need to adopt direct benefit transfer (DBT) more vigorously. In this context, the State-Level Bankers Committee (SLBC) can play an active role in addressing issues relating to convenient banking access, Aadhaar linking of beneficiary accounts and related infrastructure challenges

[16] Government of India (2014). Handbook on Direct Benefit Transfer. Planning Commission, New Delhi.

Box 8.2: Welfare schemes of the State governments: Select examples

Madhya Pradesh: The Government started the Laadli Laxmi Yojna in 2007 to lay a strong foundation for the girls' future by improving their educational and economic status and changing the social mindset towards the birth of a girl. Under the scheme, the state government purchases National Savings Certificates worth Rs. 6,000 in the name of a girl every year after she is born until the amount reaches Rs. 30,000.
Maharashtra: The government launched the Bhagyashree scheme, which is targeted at the girl child in the BPL population. Under this scheme, the government will contribute Rs.21,200 to each account of the girl child, which would grow to Rs.100,000 when the child attains 18 years.
West Bengal: The government runs a conditional cash transfer scheme, Kanyashree Prakalpa, for the empowerment of adolescent girls. Under the scheme, zero-balance bank accounts are opened in the name of girls through simplified account opening procedures and fund transfer occurs directly into the account of the beneficiary. This is a good example of direct benefit transfer in one of the states.
Uttar Pradesh: Under the Rani Laxmi Bai Pension scheme initiated in 2012, women heads of a Below Poverty Line (BPL) family (comprising of five members) would get a pension of Rs.400 per month. The annual income of the family should not exceed a defined threshold. The money will be paid every six months directly to the bank account of the person who is entitled to the scheme.
Andhra Pradesh: Launched by the government in 2013, the Golden Girl (Bangaru Talli) scheme supports the BPL family of a girl child from her birth until her graduation. Until the girl reaches the age of five, the family will be given Rs.1500 every year. When she is admitted in school, she will be paid Rs.1,000 and Rs.2,000 every year until she completes fifth standard. The amount gradually increases and if the girl stops her education at the plus two level, Rs.50,000 will be paid towards her marriage expenses, and it will be Rs.100,000 if she opts for marriage after graduation.
Tamil Nadu: To assist pregnant women in BPL families, the government runs the Dr. Muthulakshmi Reddy Maternity Benefit Scheme. Under the scheme, cash assistance of Rs.12,000 is given to pregnant women.
Telengana: The government has introduced the AASARA pension scheme for the disabled, widows and aged. The monthly pension amount is remitted into the bank / post office account of the pensioner.

Merit in replacing agricultural input subsidy with income support through social cash transfer as a part of second generation reforms

Given the importance of agriculture, most countries —both developed and developing —have subsidised this sector. However, the form of subsidisation has varied, with many countries having moved or moving from price support to income support. China is still in the transition process. However, India extends support to agriculture primarily through price policy, be it for output or inputs, leading to vast leakages. On the input front, India subsidises fertiliser, irrigation, power and credit.

The total value of fertiliser subsidies, for instance, increased from around ₹185 billion in 2005-06 to ₹ 730 billion (Budget Estimates) in 2015-16. While fertiliser subsidy in India has succeeded in achieving its objective of increasing fertiliser consumption in agriculture, it has also led to some distortions and may not be financially sustainable in the long run. Subsidising farmers by reducing the price of inputs could ultimately be regressive, i.e., rich households could benefit more from the subsidisation than their poorer counterparts. The Committee feels that the government could simply transfer cash to farmers equivalent to the fertiliser subsidy, in proportion to the individual's net sown area. If the government wants to make this progressive, farmers with holdings of below 4 hectares can be given the subsidy entitlement at a rate higher than those with above 4 hectares of holding size. This can entail huge savings by arresting the diversion of urea for non-agricultural uses. It will also have a signalling effect for farmers for the balanced use of nutrients, thereby raising the productivity of fertiliser use.

Similarly, cash transfer can be tried to address problems in the irrigation sector. If water charges are levied so as to recover the operation and maintenance (O&M) costs, cash can be transferred to the beneficiary account again on a per hectare basis. The electricity sector faces many problems such as poor plant load factor, high T&D losses and high commercial losses even after cross subsidisation, besides theft and pilferage. Instead of charging abnormally low electricity tariffs for agricultural use, equivalent cash can be transferred into beneficiaries' accounts.

Recommendation 8.3
The Committee recommends that the government may phase out the agricultural input subsidy and replace it with an income transfer scheme, which could potentially transform the agriculture sector besides promoting financial inclusion. This would first require digitisation of land records for clear titles and credit linkage to establish evidence of cultivation.

Financial Literacy and Consumer Protection

Knowledge empowers and protects

9

Chapter

The linkages among the triad of financial inclusion, financial literacy and consumer protection are globally recognised as important pillars in ensuring financial soundness. The US sub-prime crisis provides graphic evidence of how even in a highly advanced economy, unbridled financial inclusion without safeguards in the form of financial knowledge and consumer protection can spread distress and undermine financial stability. Understanding the importance of these linkages helps in promoting responsible financial inclusion as well as buffering the broader development goals of the country.

Financial literacy and consumer protection are critical for financial stability

The report of the Financial Stability Board (FSB, 2011) on Consumer Finance Protection observed, "policies that protect the interests of consumers of financial products and services contribute to enhanced risk management by households, more competitive financial markets, and greater financial stability.[17] Consumer protection and financial literacy can support financial inclusion by encouraging competition, which improves product quality and thereby increases consumer confidence, because they know remedies exist when things go wrong (Box 9.1).

[17] Financial Stability Board (2011). High level principles on financial consumer protection. FSB: Basel.

Box 9.1: Consumer protection and financial literacy:
What does global evidence suggest?

The World Bank in 2013 conducted a Global Survey on Consumer Protection and Financial Literacy for 114 economies covering legal and regulatory framework, institutional arrangements, disclosure practices and financial education.
The balance of evidence indicated that in countries with broad consumer protection legislation in place, the agency responsible for implementing this legislation also had the responsibility for consumer protection in financial services. Disclosure requirements at opening of loan and deposit accounts are focused on rates and fees, plain language, local language and recourse rights and processes. More than half of the countries had an agency that had the responsibility to implement/oversee any aspect of financial education/ literacy. The findings suggest that regulations on financial consumer protections are of recent origin and several countries across income groups are pursuing this area with great vigour.

Around the world, people with access to formal finance are expected to assume greater responsibility for their financial well-being. In this regard, an appropriate financial education programme could play an important role (Box 9.2).

Box 9.2: Eight elements of a successful financial education program

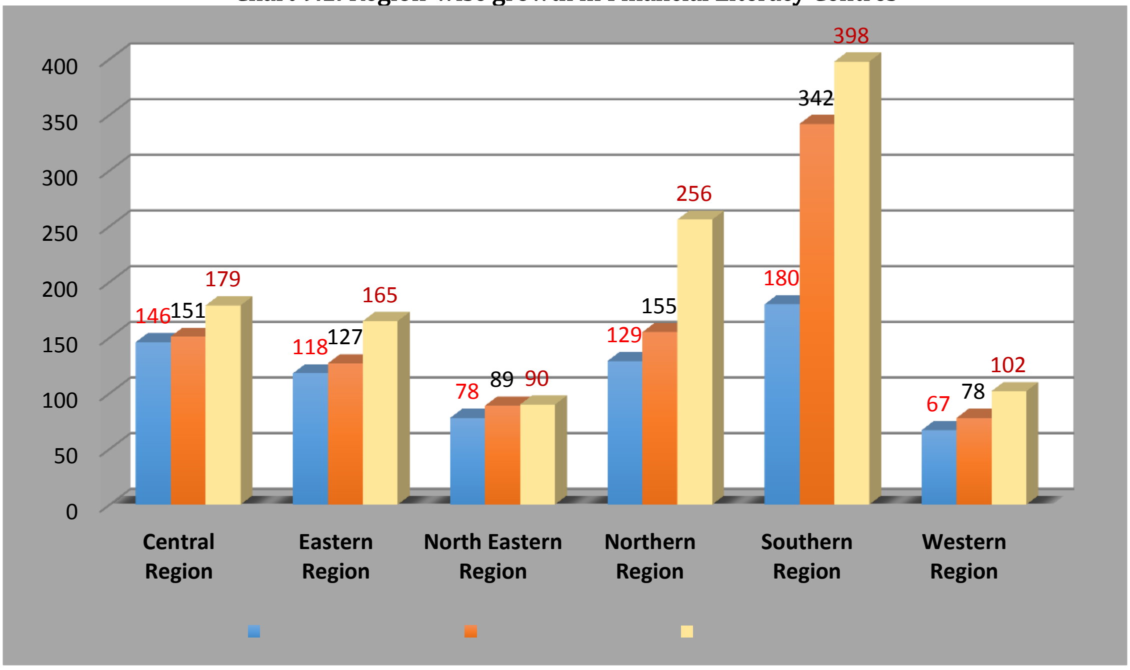
The guidelines by the United States can be used by any government or organisation to steer the development of new programmes or to enhance existing programme strategies. These eight elements of a successful financial education programme, developed by the Treasury Department's Office of Financial Education, suggest that to be successful programmes need to be focused, be tailored to intended audiences, reflect a commitment to public outreach, set specific goals, and have results that can be replicated. The eight principles are as follows:
Basic tenets: Focus on one or more of the four building blocks to achieve financial security: basic savings, credit management, home ownership and retirement planning.
Target audience: For greater efficacy, it is important to take account of the language, culture, age and experience of the target audience.
Local distribution: Deliver the programme through a local distribution channel that makes effective use of community resources and contacts.
Follow up: To reinforce the message and ensure that participants are able to apply the skills taught, it is important to follow up with the participants.
Specific programme goals: Establish specific goals and use performance measures to track progress towards meeting those goals.
Demonstrable impact: Use testing surveying and other objective evaluation to demonstrate a positive impact on participants' attitudes, knowledge or behaviour so as to prove a programme's worth. The demonstrable impact would be whether participants increased savings, opened bank accounts or saved for a home, among others.
Replicability: The programme can be easily replicated on a local, regional or national basis.
Built to last: Programmes have continuing financial support, legislative backing or integration into an established course of instruction.

Institutional framework on financial literacy needs to focus on delivery on the ground

The financial literacy efforts of the Reserve Bank are steered by the Technical Group on Financial Inclusion and Financial Literacy (TGFIL) of the FSDC Sub-committee. A National Centre of Financial Education (NCFE) was established for implementation of the national strategy for financial education. Awareness programmes in the form of a national financial literacy assessment test, financial education training programme for teachers and greater use of social networks is contemplated. The TGFIL is planning special financial literacy campaigns for adults who are newly inducted into the financial system, financial literacy through mass media and financial education in the school curriculum. The Central Board of Secondary Education (CBSE), in consultation with the regulators, has developed a financial education workbook for Classes 6 to 10.

At the local level, as on June 2015, 1,226 financial literacy centres (FLCs) set up across the country by lead banks conduct financial literacy camps (Chart 9.1). Comprehensive financial literacy material was prepared by the RBI that consists of a financial literacy guide for trainers, a financial diary and a set of posters, all translated into 13 languages.

Chart 9.1: Region-wise growth in Financial Literacy Centres



Recommendation 9.1

The FLC network needs to be strengthened to deliver basic financial literacy at the ground level. Banks need to identify a few lead literacy officers who could train the people manning FLCs. The lead literacy officer in turn could be trained by the Reserve Bank in its College of Agricultural Banking (CAB) for which simple course material can be developed by CAB in collaboration with the concerned department in the Reserve Bank, i.e., the FIDD. Since simplicity in communicating complex financial issues is important, CAB can associate creative communication experts in the design of key messages, exploiting innovative technologies and relevant content based on customer segments.

Recommendation 9.2
A 'one size fits all' approach for financial education might be less than ideal as different target groups need different kinds of financial education. As a result, the content needs to be customised for different target groups. These will need to be followed up at periodic intervals to ascertain its impact.

Recommendation 9.3
There is a need for a structured programme for holding periodic financial literacy camps in pre-identified areas in every district, which should be regularly monitored by the DCCs. The lead bank for the district should play a leading role in identifying and allocating areas among the participating banks.

Recommendation 9.4
Local resources such as NGOs and theatre groups can be tapped to spread the message of literacy in an interesting manner to the local population for which funding can come from the financial inclusion fund.

Recommendation 9.5
A technology-driven system through interactive screens/kiosks to encourage self-learning by people newly inducted into the financial system can be explored. The content can be updated from a central location. Possible locations for such kiosks, such as post offices, community health centres and panchayat offices, can be explored.

Recommendation 9.6
A financial literacy week can be observed every year in which participants demonstrate and exhibit the financial literacy tools and techniques that they use and share their success stories. This will bring out best practices in the system to achieve large-scale financial literacy. This will serve as a platform for co-ordination among different stakeholders of financial literacy.

Recommendation 9.7
Rural Self Employment Training Institutes (RSETIs), which have a dedicated infrastructure in each district of the country to impart training and skill upgrading of rural youth, can also be used for financial education of MSMEs.

While recognising the need for financial literacy is easy, it is often challenging to clearly define what constitutes financial literacy. From the standpoint of India, it is important that the questions asked are simple, easy to understand and can provide useful responses (Box 9.3).

Box 9.3: Illustrative list of questions on financial literacy

Financial literacy comprises three elements: financial knowledge, financial attitudes and financial behaviour. The global evidence suggests that some countries score high on the behaviour aspect, whereas others tend to do better in terms of financial knowledge. It is important to undertake a holistic view of financial literacy in India so as to better understand the awareness of consumers. An illustrative list of questions can be as follows.

Item	Refused	Don't know	Incorrect	Correct
Panel A: Financial knowledge				
Division				
Time value of money				
Interest paid on a loan				
Panel B: Financial knowledge				
Calculation of interest plus principal				
Compound interest				
Definition of inflation				
Diversification				
	Yes		No	
	Refused	Sometimes	Always	Never
Panel C: Financial behaviour				
Before I buy something, I carefully consider whether I can afford it				
I pay my bills on time				
I keep a close personal watch on my financial affairs				
I set long-term financial goals				
	Refused	Sometimes	Agree	Disagree
Panel D: Financial attitudes				
Money is there to be spent				
I find it more satisfying to spend money than to save it for the long term				
I tend to live for today and let tomorrow take care of itself				

Recommendation 9.8
The Committee recommends that the Reserve Bank commission periodic dipstick surveys across states to ascertain the extent of financial literacy and identify gaps in this regard. The results can provide policy-makers with a better understanding of the demand-side challenges.

Banks and financial service providers need to be sensitised to consumer protection and grievance redressal with adequate monitoring

The Reserve Bank has a dedicated Department—the Consumer Education and Protection Department (CEPD) —for both customer complaints about banks and complaints about the Reserve Bank. Further, the Banking Ombudsman Scheme (BOS) is the main system in place for grievance redressal under which the 15 Offices of Banking Ombudsmen (BO) located across the country receive and examine complaints on 27 grounds specified under the Scheme. Complaints that fall outside the purview of the BO Scheme (non-BOS complaints) are handled by the Consumer Education and Protection (CEP) Cells of the Bank's regional offices.

To give formal recognition to consumer protection, the Charter of Customer Rights was released by the Reserve Bank in December 2014. These rights encompass over-arching principles for better customer service to be extended by banks and comprise five basic rights: Right to Fair Treatment; Right to Transparency, Fair and Honest Dealing; Right to Suitability; Right to Privacy and Right to Grievance Redress and Compensation. Almost all banks have put in place such policies.

Banks are required to constitute a Customer Service Committee of the Board and have a Board-approved policy in key areas, such as those with respect to deposits, cheque collection, customer compensation and grievance redressal. Banks have been advised to establish customer service committees at the branch level. The Reserve Bank has also advised all public sector banks, select private banks and foreign banks to appoint an Internal Ombudsman. On review, the Committee felt that although an institutional framework on grievance redressal exists, both in the Reserve Bank and in banks, the mechanism needs to focus on delivery at the ground level.

Recommendation 9.9
The first pillar of complaint and grievance redressal is the branch, failing which it is the bank's internal ombudsman. Each branch should, therefore, be required to prominently display the name, phone number and email address of the designated officials for such complaints. The Reserve Bank should ensure compliance through random branch visits.

Recommendation 9.10
The Reserve Bank Banking Ombudsman at regional offices may make periodic field visits to directly receive customer complaints.

Recommendation 9.11
While continuing with the existing mechanism, all regulated entities would be required to put in place a technology-based platform for SMS acknowledgement and disposal of customer complaints, which can provide an audit trail of grievance redressal. All banks must have an online portal for customers to file complaints.

Recommendation 9.12
Banks may be required to submit the consolidated status of number of complaints received and disposed off under broad heads to the CEPD, and the Reserve Bank, in turn, can release an annual bank-wise status in the public domain.

Recommendation 9.13
The Banking Codes and Standards Board of India (BCSBI) in collaboration with the Banking Ombudsman and the Indian Banks' Association (IBA) can explore the possibility of devising a scheme based on transparent criteria that incentivises banks to expeditiously address customer grievances.

Governance Framework

Focus discussions on delivery and problem solving

10
Chapter

The financial inclusion initiative as envisioned by the Committee is much broader in scope, going beyond the traditional domain of the Reserve Bank and encompassing the governments at the central, state and local levels and, to some extent, other financial regulators as well. Of course, there are issues that are within the exclusive jurisdiction of the government as also the Reserve Bank, but there are areas of significant overlap that need co-ordination for effective implementation of the financial inclusion initiative.

At the apex of the current framework of inter-agency co-ordination is the State-Level Bankers Committee (SLBC), which is normally chaired by the Chief Secretary of the concerned state. At the local level, it is the District Consultative Committee (DCC) chaired by the District Collector, which operates under the aegis of the Lead Bank Scheme (LBS) and is supported by the regional offices of the Financial Inclusion and Development Department (FIDD) of the Reserve Bank. Overall policy issues are handled by the Central Office of FIDD, and more recently the financial literacy and grievance redressal issues are handled by the Consumer Education and Protection Department (CEPD).

For sustained progress in financial inclusion, the overall governance structure needs to be refocused

The Committee is of the view that this overall governance structure needs to be refocused to make sustained progress on the financial inclusion initiative. The approach should be one of 'problem solving' rather than of 'passing the parcel', as there are several impediments at the implementation stage. While the role of the government is more on the development aspects, that of the Reserve Bank is on the financial stability aspect. At the same time, it is the responsibility of the Reserve Bank to ensure that banks, being the main conduit of delivery, have the right incentive to implement the inclusion initiatives so that the 'last mile' delivery of service takes place in a reliable and secure manner and the customer is not short-changed.

The usual refrain of banks is that the financial inclusion accounts are not economically viable, being of very low value, and several of those being dormant. However, the Committee believes that with increasing social cash transfer, inclusion accounts would soon acquire the critical mass to make them commercially viable, which could actually open up immense business possibilities. The commercial banks should take a cue from e-commerce firms, which are aggressively acquiring customers. Even if some of these accounts are not commercially viable at present, the cost can be considered as a down payment towards customer loyalty for the future.

The traditional commercial banks should also see the writing on the wall with the introduction of small finance banks and payments banks, because, going forward, the competition would be immense to acquire and retain customers who would gravitate towards quality service. Hence, traditional commercial banks would need to exploit these emerging opportunities and suitably integrate financial inclusion initiatives within their overall business models. At the same time, it is desirable for the government to defray the agreed cost of the social cash transfer programme so that the banks are enthused to participate in the financial inclusion drive. In any case the cost of delivery through the banking channel is much lower than through the conventional channels.

In light of the above, the Committee believes that the extant governance structure needs to be reformed to deliver on a medium-term, sustainable, financial inclusion path. The governance structure should strive to identify gaps in the present set-up, redress these through policy, infrastructure and incentives and be more accountable. In this direction, the Committee makes the following recommendations:

Recommendation 10.1

The Information Monitoring System needs to be strengthened. Currently, data flow takes a bottom-up approach wherein the branches of the banks in a district submit data to the lead bank and the lead bank consolidates the data manually and prepares the district-level database for review in meetings. Further, all lead banks submit data to the SLBC, which consolidates the state-level data for review in SLBC meetings. The Committee believes that it is equally important to explore a top-down approach for data flow, in a simple, uniform and meaningful format, with the help of the Core Banking Solution of the regional offices of the concerned bank. The monitoring process needs to be standardised in terms of reports, and also include usage parameters. The data can flow from the central database of banks to various lower levels to ensure data consistency and integrity.

Recommendation 10.2

District credit plans need to be more realistic. The district-level credit plans should be prepared by lead banks, taking into account the potential linked plans prepared by NABARD every year which should take into account the availability of infrastructure, marketing facilities and policies/ programmes of the government, including the support by the concerned government departments of the local level in the spirit of the lead bank scheme.

Recommendation 10.3
At present, public sector banks have been given the lead bank responsibility with the exception of one private bank. The Committee feels that the responsibility of the SLBC / lead bank scheme should be given to different banks on a rotation basis for a fixed time-frame (of say 3 years) to facilitate fresh thinking and initiative as well as to instil a spirit of competition.

Recommendation 10.4
The Committee is of the view that banks with lead bank responsibilities can create a separate webpage with respect to their lead bank operations including the conduct of business in DCC meetings.

Recommendation 10.5
The current policy discussions across most SLBCs put substantial emphasis on the credit-deposit (CD) ratio. Rather, greater focus should be on development aspects for which the CD ratio could be a by-product. Such deliberations can include livelihood models, social cash transfer issues, gender inclusion, inclusion of different groups, Aadhaar seeding and universal account opening. There can also be other sets of issues that are region-specific and can focus on areas such as policy towards fraudulent deposit/ investment schemes, physical/network infrastructure and recovery management.

Recommendation 10.6
Given the focus on technology and the increasing number of customer complaints relating to debit/credit cards, the National Payments Corporation of India (NPCI) may be invited to SLBC meetings. They may particularly take up issues of Aadhaar-linkage in bank and payment accounts.

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ANNEX
Major Recommendations of previous Committees on Financial Inclusion

No	Name of Committee/ Year of Report/Chairman	Key Recommendations	Implementation
1	Internal Group on Rural Credit and Micro Finance, 2005 (Shri H.R. Khan)	• Recommended Business Facilitator and Business Correspondent Model.	RBI issued guidelines in 2006 permitting banks to utilise the services of Business Correspondents and Business Facilitators as agents for extending banking services outside the brick & mortar branch premises.
2	Committee on Financial Inclusion, 2008 (Dr. C. Rangarajan)	• Targeted branch expansion in identified districts	RBI issued instructions to SLBC Convener Banks in all states to identify unbanked villages and to draw a roadmap for allocating these villages among banks so as to ensure the presence of at least one banking outlet in each village of the country in a time-bound manner. Banks reported having covered all unbanked villages.
		• To appoint MF-NBFCs, ex-service/retired bank staff as their BCs/BFs. Use of PACS and other co-operatives as BCs and to adopt group approach for financing excluded groups	RBI has since allowed for-profit companies, Non-Deposit taking NBFCs, MFIs, PACS etc. to be appointed as BCs
		• Creation of Financial Inclusion Funds	Financial Inclusion Fund created.
		• Setting up of a National Rural Financial Inclusion Plan.	The RBI in January 2010 advised domestic scheduled commercial banks including RRBs to draw up three-year Board-approved Financial Inclusion Plans (FIPs) and include self-set targets on various relevant parameters.
3	RBI Sub-Committee of its Central Board of Directors to study issues and concerns in the Micro Finance Institutions Sector, 2011 (Shri Y.H. Malegam)	• Creation of separate category of NBFC-MFI's providing short-term and unsecured loans to low-income borrowers.	In December 2011, the RBI introduced a new category of NBFCs, viz., NBFC-MFI and issued detailed guidelines for regulation of these entities.
		• Regulation at NBFC-MFIs	RBI has since implemented the recommendations also allowed bank credit to NBFC-MFIs for on-lending to individuals and also to members of SHGS/JLGs for categorisation as priority sector advance under their respective categories.

4	Committee on Comprehensive Financial Services for Small Businesses and Low Income Households, 2013 (Dr.Nachiket Mor)	• Universal Electronic Bank Account (UEBA) to all Indian Residents • Ubiquitous Access to Payment Services and Deposit Products at Reasonable Charges • Sufficient access to affordable formal credit. • Universal access to a range of deposit and investment products at reasonable charges • Universal access to a range of insurance and risk management products at reasonable charges. • Allowing NBFCs to work as BCs and removing distance criteria of 30 km. • To create vertically differentiated banking institutions.	Based on instructions issued by the RBI for opening of BSBDAs and PMJDY, account density has increased sharply. A roadmap at the instance of the RBI has been prepared by SLBC Convener Banks for opening of banking outlets in all the unbanked villages of the country. As per data reported by banks under their FIPs, nearly 0.55 million banking outlets have been opened across the country by September 2015. Under the FIPs banks have already been advised to offer a comprehensive suite of products and services, which includes basic savings bank deposit accounts, small overdrafts and entrepreneurial credit in the form of Kisan Credit Cards and General Credit Cards. Fully implemented. RBI has issued licences to 11 entities to operate as Payment Banks. In addition, the RBI issued licences to 10 entities to operate as Small Finance Banks to further financial inclusion through high-technology, low cost operations.
5	Internal Working Group to revisit the Existing Priority Sector Lending Guidelines, 2015 (Smt. Lily Vadera)	• Medium Enterprises and Renewable Energy to form part of the priority sector. • A sub-target of 8 per cent for lending to small and marginal farmers. • A sub-target of 7.5 per cent for lending to Micro Enterprises.	RBI issued a circular in April 2015 incorporating the major recommendations of the Committee.