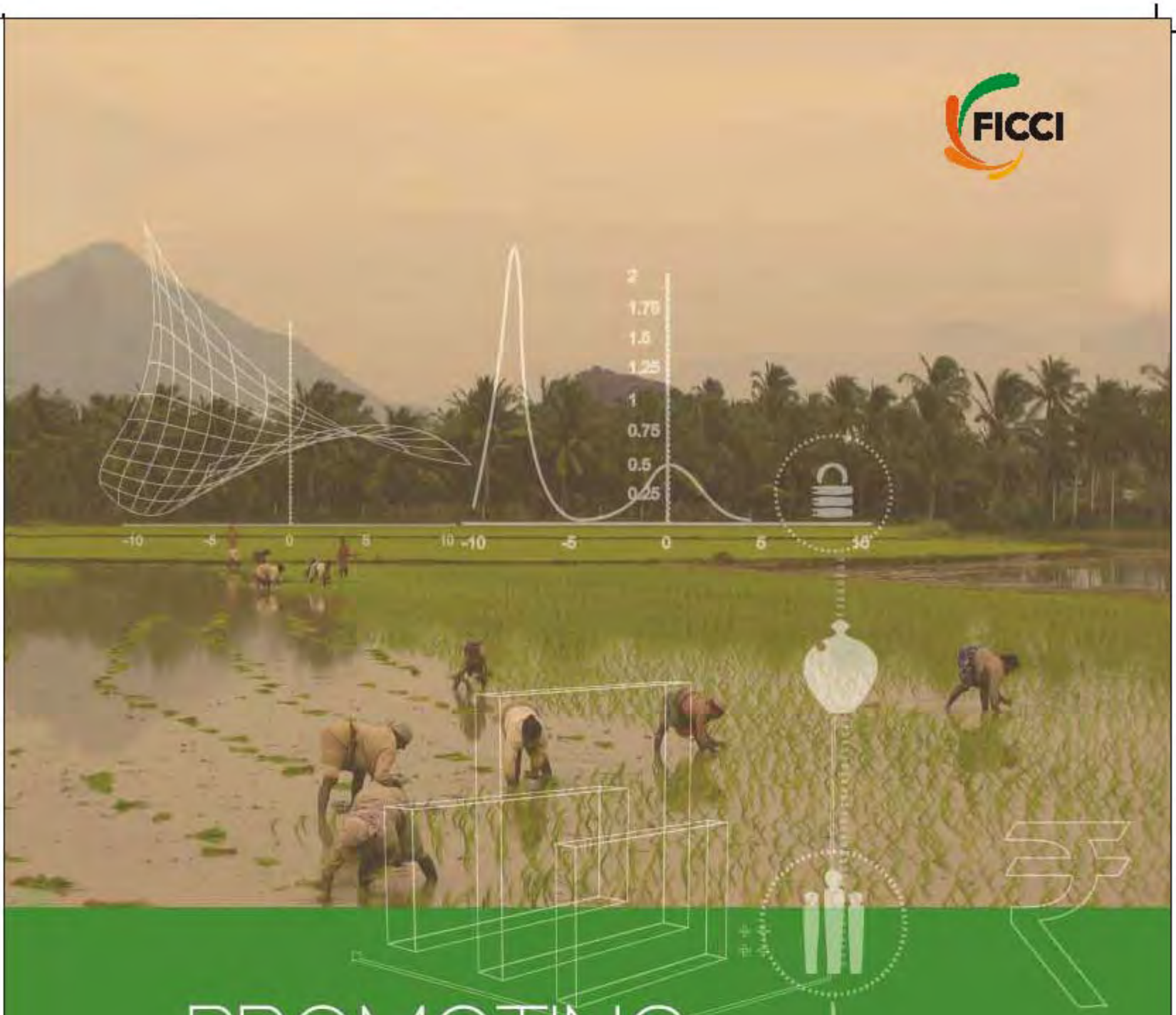

PROMOTING FINANCIAL INCLUSION

Can the constraints of political economy be overcome?

Promoting Financial Inclusion

Can the constraints of political economy be overcome?

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Preface & Acknowledgements

The Paper entitled "Promoting Financial Inclusion", commissioned by FICCI and UNDP, endeavours to explore the status of recommendations made by 'Rangarajan Committee on Financial Inclusion' and 'Raghuram Rajan Committee on Financial Sector Reforms'. The findings presented in the paper are based on review of policy announcements by the GoI, RBI; annual reports of RBI, NABARD and IRDA and other institutions; research papers, academic journals; interactions with senior personnel at RBI and NABARD to understand their perspective on financial inclusion and study of implementation of financial inclusion initiatives of some selected institutions. The Paper has been organized as follows:

Chapter 1 & 2: provide a background to the debate around financial inclusion and captures various perspectives in understanding the concept.

Chapter 3: discusses the extent of financial inclusion by analysing the penetration of banks and other institutions in making available various financial services (including credit, savings and insurance) to the excluded.

Chapter 4: elucidates the policy initiatives of GoI, RBI, IRDA and NABARD towards financial promotion of inclusion initiatives. The chapter also enumerates the limitations and pitfalls of some policies/norms in achievement of financial inclusion targets.

Chapter 5: is divided into two parts, wherein the first part explains the various broad policy level challenges and the second part explicates the product/service specific challenges faced by implementers and end-beneficiaries in mass dissemination and use of financial products/services offered to promote financially inclusive growth.

Chapter 6: provides the broad perspective of the issues related to financial inclusion and analyses the constraints and tradeoff s related to various policy initiatives related to financial inclusion.

A separate section provides in-depth case studies done with 4 stakeholders such as technology service providers, banking training institutes and banking correspondents to highlight the achievement and gaps in the provision of financially inclusive services.

Annexures on Client protection principles, salient features of BC model, list of projects sanctioned under FIF and FITF, key features and current status of implementation of the cooperative sector revival package provide useful information related to Financial Inclusion are provided at the end of the study.

FICCI would like to express its sincere gratitude to UNDP and NABARD for providing financial assistance to undertake this study under NABARD-UNDP Collaboration for Financial Inclusion in seven UNDP focus states.

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FICCI's Financial Sector Division

List of Abbreviations

ADB	Asian Development Bank
ALW	A Little World
ANBC	Adjusted Net Bank Credit
BC	Business Correspondent
BCSBI	Banking Codes and Standards Board of India
BF	Business Facilitator
BPLR	Benchmark Prime Lending Rate
CAB	College of Agriculture Banking
CARA	Capital to Risk Weighted Assets Ratio
CBS	Core Banking Services
CCB	Central Co-operative Banks
CCS	Cooperative credit structure
CEMG	Channel Empowerment Group
CFT	Combating of Financing of Terrorism
CSC	Common Service Centres
CSP	Customer Service Point
DCC	District Consultative Committee
DCCBs	District Central Cooperative Banks
DLIC	District Level Implementing& Monitoring Committees
DRI	Differential Rate of Interest
EBT	Electronic Benefit Transfer
ECS	Electronic Clearing Service
EIR	Effective Interest Rate
EKO	EKO Aspire Foundation
FI	Financial Inclusion
FICCI	Federation of Indian Chamber of Commerce and Industry
FIEA	Financial Inclusion Education Academy
FIF	Financial Inclusion Fund
FIP	Financial Inclusion Plan

FITF	Financial Inclusion technology Fund
FLCC	Financial Literacy and Credit Counselling Centre
FMCG	Fast Moving Consumer Goods
FSM	Field Sales Manager
GCC	General Credit Cards
GoI	Government of India
HDI	Human Development Index
ICAI	Institute of Chartered Accountants of India
ICRIER	Indian Council for Research on International Economic Relations
ICT	Information and Communication Technology
IFI	Index for Financial Inclusion
IIBF	Indian Institute of Banking and Finance
IIB	Indian Institute of Bankers
IMO	Instant Money Transfer
IRDA	Insurance Regulatory Development Authority
KCC	Kisan Credit Cards
KYC	Know Your Customer
LAB	Local Area Bank
M-CRIL	Micro Credit Ratings International Ltd
MDM	Micro Deposit Machines
MFDEF	Microfinance Development and Equity Fund
MOS	Mobile Operating System
MSP	Mobile Service Partners
NABARD	National Bank for Agriculture and Rural Development
NAFSCOB	National Federation of State Cooperative Banks
NaMFI	National Mission on Financial Inclusion
NBC	Net Bank Credit
NBFC	Non Banking Finance Company
NCCF	National Calamity Contingency Fund
NEFT	National Electronic Fund Transfer
NFA	No Frills Account
NGO	Non Government Organization
NIC	National Information Centre
NIMC	National Implementation and Monitoring Committee
NPA	Non Performing Assets
NREGA	National Rural Employment Guarantee Act
NRFIP	National Rural Financial Inclusion Plan
NSSO	National Sample Survey Organization
OECD	Organization for Economic Cooperation and Development
PACS	Primary Agriculture Credit Society
PCARDB	Primary Cooperative Rural and Agriculture Development Bank
PDS	Public Distribution System

PoS	Point of Sale
PSLC	Priority Sector Lending Certificate
RBI	Reserve Bank of India
RFID	Radio Frequency Identification
RRB	Regional Rural Bank
RSBY	Rashtriya Swasthya Bima Yojna
RTGS	Real Time Gross Settlement
SBLP	SHG Bank Linkage Programme
SCARDB	State Cooperative Agriculture and Rural Development Bank
SCBs	State Cooperative Banks
SCSP	Super Customer Service Point
SGSRY	Swarna Jayanti Shahari Rojgar Rojna
SGSY	Swarnajayanti Gram Swarozgar Yojana
SHG	Self Help Group
SHPI	Self Help Promotion Institution
SIDBI	Small Industries Development Bank of India
SLBC	State level Bankers Committee
SLIC	State Level Implementing and Monitoring Committee
SPTF	Social Performance Task Force
SRMS	Self Employment Scheme for Rehabilitation of Manual Scavengers
ToT	Training of Trainers
TSM	Territory Sales Manager
TSP	Technology Service Provider
UBI	Union Bank of India
UIDAI	Unique Identification Authority of India
UNDP	United Nations Development Program
URN	Unique Relationship Number
VKC	Village Knowledge Centre

Executive Summary

1 A LONG WAY TO GO…

Inclusive growth has been a priority of the Government of India (GoI) over the past decade. The policymaking and regulating institutions (Government of India, RBI, IRDA, PFRDA (for micropensions) have developed regulations and guidelines for strengthening financial inclusion but these are yet to have a substantial impact on outreach to the excluded population. It appears that while some effort has been made to develop a facilitating regulatory framework, it has not yet gone far enough to overcome the substantial cost implications there are in outreach to large numbers of people, often in dispersed locations, with small value accounts. As a result, the institutions responsible for providing financial services do not yet perceive the financial inclusion business as really sustainable. Some effort has been made by the banks to reach the financially excluded sections of the population, but there is still a long way to go before they can achieve their first target of covering 55.8 million excluded households and all villages with >2,000 population by 2012. Progress towards this goal has been relatively limited so far and it is apparent that the government's effort to encourage the banking system to promote financial inclusion in an intensive manner needs a substantial impetus if it is to achieve adequate results.

Highlights of progress in achieving financial inclusion

Credit: As of March 2009, the number of borrowers with accounts less than ₹25,000 was 39.2 million while those with less than ₹200,000 were 95.8 million. The total number of credit (borrowal) accounts with banks was around 110.1 million, covering 18.3% of the adult population.

The banks had issued a total of 42.4 million KCC with sanction limits aggregating to ₹233,190 crore by 31 March 2010. These contributed to 39% of the total priority sector portfolio lent to agriculture though only 3.1% is in tiny accounts (<₹25,000) and a total of 17% in loans less than ₹200,000. The proportion of priority sector lending estimated to be contributing to financial inclusion is 31% which constitutes just 13% of all lending by commercial banks.

Savings/deposits: Overall, there were around 517 million deposit accounts with banks, 86% of the country's adult population. But, a sizeable number of savers have multiple accounts in urban and

metropolitan centres so this does not give the true picture of savings services for the financially excluded. The number of "no frills" accounts opened by 31 March 2010 was 50.6 million. However, studies have shown that a large majority of accounts are basically dormant.

Microfinance: The SHG-Bank Linkage Programme (SBLP), implemented through banks provided credit facilities to 59 million borrowers. The 6.12 million SHGs on 31 March 2009 had deposits of ₹5,545 crore with banks while 4.22 million SHGs had ₹22,680 crore in loans outstanding with the bank. In addition to this the banks have also financed MFIs for on-lending to their clients. The total outstanding loans to MFIs by banks was ₹16,000 crore on 31 March 2010.

SHGs and MFIs taken together (and after accounting for overlap) cover around 60 million households, some 50% of the 120 million financially excluded households in India. However, average credit outstanding with the nearly 40 million borrowers in SHGs is limited to ₹3,400 per borrower while their average savings with banks are negligible.

Credit outstanding with MFI borrowers is a more respectable ₹7,800—more than twice as much as the figure for the SHGs—but even this is just 12.5% of GNI per capita and probably no more than 20% of the annual income of the typical MFI client, insufficient to make a significant difference to her life. **It is this small size of the credit facility from MFIs to individuals that pushes many microfinance clients into multiple borrowing.**

MFIs are not allowed to provide deposit services to their members, but have contributed significantly to the penetration of micro-insurance products through collaborations with insurance companies, though this is mainly to provide the credit-life facility to their borrowers and, thereby, to limit the MFIs' own credit risk.

Overall, customer protection (including price transparency, collection practices and over-indebtedness) continues to be the primary focus in financial intermediation.

Micro-insurance: By November 2009, there were 23 micro-insurance products offered by 13 insurance companies, accounting for 28% of new business. Life micro-insurance policies cover around 15 million lives, which is about 13% of the 120 million excluded households.

PACS: The PACS, supported by District Central Cooperative Banks, are probably one of the largest rural financial systems in the world providing financial services (savings as well as credit) to 132 million members and 46 million borrowers through more than 95,000 societies. However, the health of these societies is a major bottleneck in effective services to their members. The Portfolio at Risk of the PACS is very high at 59.2% and more than 55% of the societies are loss making.

RRBs: The Regional Rural Banks were established specifically for the purpose of accelerating financial inclusion but, precisely for this reason, ended up being used as "policy lending" institutions, resulting in their reporting poor performance on outreach and indifferent financial health from the start.

Thus, total financial inclusion, a laudable goal, remains currently a distant dream.

2 INCLUSION CONSTRAINED BY REGULATORY PRUDENCE

While a number of experiments and pilot projects have been launched for testing potential delivery and business models the rolling out of inclusive financial services on a large scale will require the development of some significant experience in this field. More specifically, an analysis of regulation shows that

There has been a significant set of regulatory and promotional efforts which, taken together, could be expected to have a substantive impact on financial inclusion. In sum, these are the

- Big push for the business correspondent model by Banks
- Mandatory Government to Person (G2P) payments in Banks and Post Office accounts using electronic transfers
- Rolling out of the concept of a "no frills" account for small value transactions
- Enabling of the provision of micro-insurance services through facilitating regulation
- Establishment of funds to finance promotional activities that support the above measures and reinforce the work of microfinance institutions
- Attempt to revive the cooperative credit system

along with a number of small steps that facilitate inclusion within the existing system like

- Simplified Know Your Customer (KYC) norms and interest rate deregulation for small value accounts
- An increased emphasis on devising payment systems that address the needs of low income families
- Small investments but increasing realization of the significance of financial literacy to ensure meaningful financial inclusion and increased emphasis on consumer protection.

In practice, each regulatory and promotional measure has been constrained by overemphasis on prudential aspects by regulators:

- The BC model met with limited success for four years before the decision to liberalise it was taken. Even today, its future success is yet to be determined given the non-existence of an established replicable business model. Use of the no frills account is minimal despite its linkage to government welfare payments
- Micro-insurance is yet to be rolled out in a big way outside the limited confines of micro-credit cover
- The funds allocated to promote financial inclusion are administered within the traditional framework and do not sufficiently emphasise innovation and
- The cooperative credit system has undergone several rounds of revival and yet its true potential remains to be tapped.

3 WHAT ARE THE CHALLENGES AND HOW CAN THEY BE OVERCOME?

It is apparent from the discussion in this section that the task of increasing and maximising financial inclusion faces major challenges. These cover a range of issues including

- Social exclusion of low income families results in illiteracy, inhibition and poor physical access. It also limits awareness, ability to overcome prejudice about their bank-worthiness and enhances the transaction costs incurred these families for using the financial services available in the country
- The small value of accounts and transactions expected by the banking system from financially excluded families results in high cost of operations and limits the incentive to serve them
- The lack of understanding of products and services appropriate to the needs of low income families results in static approaches like the no frills account where it has become apparent that mere availability is not the issue
- Limited experience with business models suitable for small value accounts and doorstep service delivery results in the slow adoption of mechanisms such as the business correspondent model

- Historical problems such as the governance issues facing the cooperative credit system need substantial efforts to discipline and reorient thinking. The expected long lead time that will be needed by measures such as financial literacy programmes to make a difference. The introduction of these programmes has been a laudable effort and it has the potential to revolutionise the financial services environment.

It is apparent that there is a huge task ahead in overcoming the challenges to financial inclusion.

4 THE POLITICAL ECONOMY OF FINANCIAL INCLUSION

The Government of India is committed to ensuring financial inclusion for the whole population as a policy objective. This is apparently reflected in the policy initiatives taken over the last few years. These policies have been stimulated by the recommendations of the committees set up for suggesting strategies for promoting financial inclusion and improving the health of rural financial structures.

Over the past 4-5 years, as financially inclusive policies have been put in place financial institutions have started experimenting with different models for reaching the excluded and for offering various services to the target population. It is now time to roll out implementation on a large scale. However, as discussed in the previous section, and based on the collective experience so far, it is apparent that there continue to be issues that negatively impact on progress towards financial inclusion.

4.1 Do Banks See the Business Potential of Financial Inclusion?

The banks have been advised by the RBI to submit their financial inclusion plans for reaching 72,825 financially excluded villages by 2012 and to integrate these with their normal business plans. While this measure undoubtedly puts on some pressure to give the activity impetus, the question remains whether the banks see business potential in the delivery of financially inclusive services or whether it is just another regulatory burden for them to bear? Over the decades since the first wave of bank nationalization in 1969, the regulations have required the financial institutions to go deeper in the rural, semi-urban and other financially excluded areas.

While much has been achieved, as is the norm in any regulatory regime, what has been done by the banks has been the minimum necessary to gain approval (or at any rate regulatory forbearance). Thus significant areas of the rural hinterland of the major states are now reasonably served with banking services. However, parts of central India, the hill regions and the northeast as well as many of the poorest areas of eastern India are sparsely banked. Even where banking services are available they cater to the needs of the creamy layer of large farmers, traders and, where relevant, production activities. The engagement of banks with low income families has been essentially in response to directed programmes such as IRDP and, more recently, KCC and No Frills Accounts along with a plethora of schemes for marginal farmers, youth, micro-enterprises and so on. All are high cost activities and are seen as impositions upon the normal business of the bank both by staff and (less openly) by managements. Wherever possible, regulatory arbitrage, such as the buyout of MFI portfolios by banks in order to boost their priority sector lending, takes place.

Thus, as the discussion in this report shows, such schemes usually have very limited if not negligible impact. When there is some traction, as in the case of the KCC, it is the upper band of the target clientele

that benefits. The fact is that banks do not view such activities as profitable and, as a result, the roll out of the schemes is limited in scope and insipid in direction. For reasons of political economy this may not be the official line of bank managements but ultimately it is local managers and staff who determine the momentum of a rollout. If bankers saw significant potential business in these activities a more dynamic rollout with real momentum would be apparent. Thus, even the untested and unproven business correspondent model remains still born for lack of a business model, being limited largely to technology service providers opening "no frills" accounts that are largely dormant.

So what is the solution? As an institution whose promoters have been engaged with issues of microfinance and financial inclusion for more than three decades, M-CRIL has a deep understanding of the issues. The two key problems emerging from this report and M-CRIL's overall experience are set out in the following sub-sections.

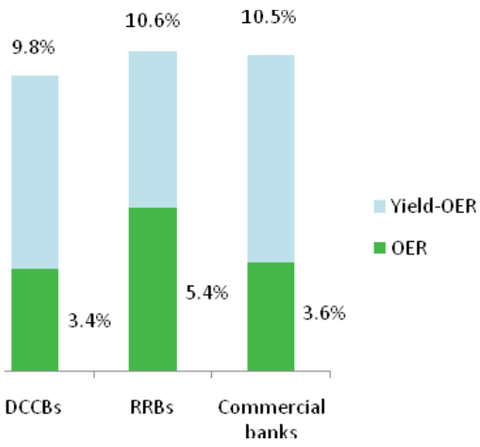
4.2 The Impact of Interest Rate De-regulation – What about the Political Constraints?

It has been repeatedly observed in this report that low transaction volumes in small value accounts entail very high proportionate costs for the banks. For many years bankers were forced by regulation to cross-subsidise financial inclusion activities. They were required to offer small value services to low income families at the lowest interest rates in the system. The well known differential rate of interest scheme (requiring banks to lend at 4% interest, well below their cost of funds) still exists, though it now accounts for a minuscule proportion of their total portfolio. Even after general interest rate deregulation in the late 1990s, interest ceilings (defined as the prime lending rate, the minimum, "risk free rate" to be charged by the bank) continued for small value accounts. As a result of decades of social control of interest rates, it has become ingrained in the public mind that "loans for the poor" should be subsidized. The reality of credit rationing resulting from such subsidies is lost on the average observer.

Within the past months, all interest rate regulation has been abandoned. This must be welcomed in that it constitutes official recognition that bankers must be allowed to determine the parameters of their own business. However, the rhetoric of "reasonableness" pervades all circulars from the Reserve Bank of India and pronouncements by the government. While there is no case for profiteering from those living on low incomes, the message of this rhetoric is inevitably that some element of cross-subsidisation must continue. But the result of any such action is a higher than optimal price for those provided services on a viable basis and a lower than optimal volume for those receiving subsidised services.

It is notable that the rural banking system (consisting of the District Central Cooperative BanksDCCBs and Regional Rural Banks - RRBs) has not had to follow interest rate regulation for over a decade now. Yet, at no point has it felt free to charge much more than the commercial banks for the apparently more inclusive services it provides. A study by M-CRIL in 2008-09 showed that the average yields of DCCBs and RRBs were not significantly more than the 10.5% average yields of commercial banks (in 2007-08) despite the RRBs having operating expense ratios (OER) that were significantly higher (see **Figure**). While DCCB operating expense ratios were lower this was largely on account of most origination expenses being borne by the loss making Primary Agricultural Cooperative Credit Societies (PACS). It is apparent that the lower yields of the

FIGURE Yields in the Banking System



cooperative banks come at the expense of the very people whom the banks are trying to protect by charging lower interest rates since it is the members who must ultimately bear the losses of the PACS.

There is no evidence so far of bank managements charging higher interest on financial inclusion products despite the higher costs of such services. This limits the business potential of financial inclusion. Thus, the services available remain limited in volume (SHG loans of minuscule value, non-functional no frills accounts) and lacking in innovation. Ultimately, as a result, low income families remain excluded and the legendary, rapacious moneylender flourishes in providing the only real financial services available to low income families.

4.3 Prudence in Regulation and Promotion is Perhaps a Case of "No Risk, No Return"

The discussion in the earlier sections has shown extensively how financial regulators and the government in India have opted for prudence in relation to financial inclusion rather than bold, even adventurous, experimentation. While the easing of KYC norms and the launching of an extensive financial literacy programme are excellent long term measures, prime examples of the excessive concern with prudence are

1. As discussed above, the prevailing environment of low cost, cross-subsidised inclusive finance products to the detriment of volumes and ultimately to the detriment of experimentation to improve the availability of financial services to low income families.
2. The temptation to control the business relationship between financial service providers and clients. Thus, experimentation with the business correspondent model was held up for four years both by price restraints and by stipulations on who could and could not be a correspondent. The prevention of microfinance NBFCs from playing this role continues to be a limitation both on outreach, since it is these institutions that have a financial relationship with the largest number of low income families, and on the functioning of MFIs since they continue to have a uni-dimensional credit only relationship with their clients. A more holistic relationship would protect such families as the MFIs would become partly dependent on them for on-lending resources and could no longer treat them as supplicants for credit. It would also create a more secure savings environment for the low income segments of the population.
3. Similarly, in the case of the micro-insurance regulation there are significant rules governing the relationship between the insurance company, their agent and the client. Again microfinance NBFCs are allowed to be distributors of insurance but not agents resulting in significant, and unproductive, attempts at regulatory arbitrage rather than a direct concentration on the rolling out of products to large numbers of clients. These are unnecessary irritants in a market that remains minuscule.

4. The KCC, an excellent idea from the perspective of the user, is constrained and ill-administered on account of the limited interest rate (just 9% on crop loans) earned by the banks. The margin between the cost of funds and the lending rate is insufficient to cover both the administrative cost and the high risk associated with agricultural lending. Hence, all the problems in the KCC with credit limits that are too low and with onerous documentation procedures.
5. Repeated attempts to revive the cooperatives with cash injections to wipe out losses, provide training to managers, now also to improve the information technology environment while the real issue is the governance failure of such institutions. This is a matter that is unlikely to be effectively addressed in an environment repeatedly re-charged by elections at multiple levels of the political system. It is politically correct to "revive" cooperatives but perhaps the re-vitalisation of the RRBs through a politically difficult process of privatisation would be more effective for financial inclusion.

In most of these issues, regulators and governments have sought to protect the poor and incidentally their own reputations (regulators) or popularity (governments) by the adoption of low risk strategies. While this may be seen as a prudential approach, the welfare minimising implications of such strategies need to be considered.

- Does the lack of deposit services for the poor result in more loss of savings through theft from their homes than what would result from any institutional misappropriation?
- Does the lack of cover due to an inefficient claims management system for microinsurance cause more welfare losses for the poor through variable incomes and insecurity than any claims misappropriation by local institutions would cause?
- Do low priced products necessarily mean low volume availability?
- Do 120 million low income families deserve to be financially excluded?

Perhaps the price of prudence in the regulation and promotion of financial services for low income families is substantial welfare foregone. Perhaps this price is substantially higher than the cost likely to be incurred on regulation and supervision of a more dynamic system of inclusion through the formal financial system risk associated with a bolder, more experimental approach. It is a matter of consideration for all stakeholders involved.

1

Background

Inclusive economic growth has been one of the priority agendas of the Government of India (GoI) over the past decade. It is widely acknowledged that inclusive economic growth cannot be accomplished without achieving financial inclusion for the nearly two-thirds of India's population who are unbanked. In order to develop a strategy for achieving financial inclusion and, therefore, inclusive economic growth the GoI set up two committees to discuss issues and recommend action.

In 2006, the Committee on Financial Inclusion under the Chairmanship of Mr C. Rangarajan (Chairman, Economic Advisory Council to the Prime Minister) was to suggest:

- A strategy to extend financial services to small and marginal farmers and other vulnerable groups, including measures to streamline and simplify procedures, reduce transaction costs and make the operations transparent.
- Measures including institutional changes to be undertaken by the financial sector to implement the proposed strategy of financial inclusion.
- A monitoring mechanism to assess the quality and quantum of financial inclusion including indicators for assessing progress.

In the following year, the Planning Commission constituted a High Level Committee on Financial Sector Reforms under the Chairmanship of Dr Raghuram G. Rajan, Professor, Graduate School of Business, University of Chicago.[1] While its focus was on identifying emerging challenges in meeting the financing needs of the Indian economy as a whole, several of its recommendations also emphasized the need for and strategies for achieving financial inclusion.

Over three years have gone by since the reports of these two committees were completed. This report reviews the progress of financial inclusion in the context of the recommendations of these committees, in light of the initiatives of the central government, RBI and NABARD for promoting financial inclusion. It analyzes the initiatives of regulators and banks in promoting financial inclusion and explores issues, challenges and factors that hinder the progress of financial inclusion.

[1] Planning Commission, Sep 2008. "A hundred small steps: Report of the Committee on Financial Sector Reforms"; www.planningcommission.gov.in/reports/genrep/report_fr.htm.

2

What is Financial Inclusion?

The two committees defined financial inclusion in the following ways:

Box 1: Rangarajan Committee – Working Definition of Financial Inclusion

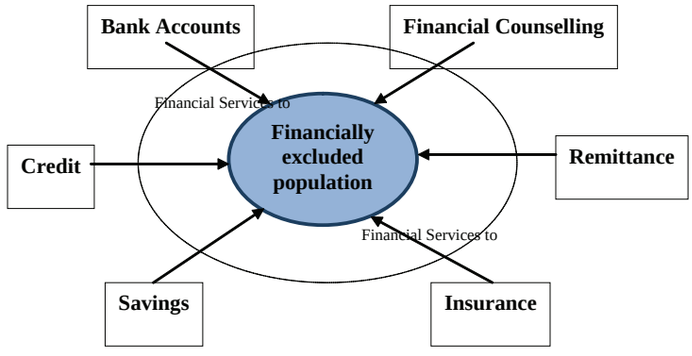
Financial inclusion may be defined as the process of ensuring access to financial services and timely and adequate credit where needed by vulnerable groups such as weaker sections and low income groups at an affordable cost.

Box 2: Raghuram Rajan Committee's Definition of Financial Inclusion

Financial inclusion, broadly defined, refers to universal access to a wide range of financial services at a reasonable cost. These include not only banking products but also other financial services such as insurance and equity products.

The provision of different types of financial services to the excluded population, for ensuring financial inclusion is depicted in Figure 2.1.

FIGURE 2.1 Financial Inclusion.



Source: Adapted from the Rangarajan Committee report.

VIEWS OF OTHER INSTITUTIONS/ SECTOR EXPERTS

A World Bank[2] report states, 'Financial inclusion, or broad access to financial services, is defined as the absence of price or non-price barriers in the use of financial services.' The report stresses the distinction between 'access to' and 'use of'

[2] 'Finance for All? Policies and Pitfalls in Expanding Access', *World Bank Report*, 2008. The report provides a survey of problems, measurement problems and issues in financial inclusion in a cross country framework.

financial services as it has implications for policy makers. 'Access' essentially refers to the supply of services, whereas use is determined by demand as well as supply. Among the non-users of formal financial services a clear distinction needs to be made between voluntary and involuntary exclusion. The problem of financial inclusion addresses the 'involuntarily excluded' as they are the ones who, despite needing financial services, do not have access to them. [NABARD 2009. *Financial Inclusion – an overview*]

M-CRIL's perspective on financial inclusion (*based on its experience of the rating of MFIs*) is that financial inclusion is not just a matter of providing various financial products and services (described in the above definitions) to the excluded population but *doing so in a responsible manner*. Being responsible entails providing financial services based on the six principles of client protection [*CGAP/ACCION: Campaign for Client Protection*] – (i) prevent over-indebtedness, (ii) transparent pricing, (iii) appropriate collection practices, (iv) ethical staff behaviour, (v) mechanism for client protection and (vi) privacy of client data.

According to the United Nations the main goals of Inclusive Finance are:

1. Access at a reasonable cost of all households and enterprises to the range of financial services for which they are 'bankable', including savings, short and long-term credit, leasing and factoring, mortgages, insurance, pensions, payments, local money transfers and international remittances.
2. Sound institutions, guided by appropriate internal management systems, industry performance standards, and performance monitoring by the market, as well as by sound prudential regulation where required.
3. Financial and institutional sustainability as a means of providing access to financial services over time.
4. Multiple providers of financial services, wherever feasible, so as to bring cost-effective and a wide variety of alternatives to customers (which could include any number of combinations of sound private, non-profit and public providers).

3

Financial Inclusion – Is It just a Distant Dream?

An ICRIER study by Mandira Sarma [Sarma 2009] placed India at a low 29th rank (out of 55 countries) on an Index of Financial Inclusion with a value of 0.2. The index used information on three comparable dimensions across the countries covered – (i) accessibility (measured by penetration of the banking system, number of bank accounts per 1,000 people), (ii) availability (number of bank branches/ATMs per 100,000 people) and (iii) use of banking services (volume of credit plus deposits relative to GDP). The study also highlighted the correlation between human development and financial inclusion. With low financial inclusion the author concluded that it was not surprising that the human development index of India, ranked 119 [UNDP, 2009] out of 169. Hence, it becomes clear that improving the nation's financial inclusion status will require a concerted effort from all stakeholders – the government, regulators, banks and others.

The Rangarajan Committee report had highlighted the extent of financial exclusion in terms of access to credit. Based on the analysis of the National Sample Survey Organisation (NSSO) data[3] it was evident that:

- Around 52% of the farmer households (*45.9 million out of 89.3 million households*) do not access credit either from institutional or non-institutional sources,
- 73% of farm households do not have access to formal credit sources,
- Non-indebtedness was particularly high among marginal farmers (*<1 hectare of owned land*) with 70.6% not having access to formal/non-formal sources. Across social groups exclusion was high among Scheduled Tribes (63.7%) and Scheduled Castes (49.8%),
- Incidence of financial exclusion among all non-cultivator households (*~59.6 million households*) was estimated at 78.2% which comprises of 78.8% of agricultural labourer households, 71.4% of artisans and 79.7% of other rural households.

The above data provides an idea of exclusion from access to credit, but as suggested by both committees, financial inclusion is a much broader term which encompasses access to other financial services such as savings, insurance, remittance and financial counselling. The main targets/strategies recommended for ensuring access to financial services for the excluded population were the following:

[3] MoSPI, GoI, NSS 59th Round, 2003. 'Indebtedness of Farmer Households'.

- Providing financial services access to 50% of the total number of excluded households – around 55.8 million households by 2012.
- Credit to 11.15 million cultivator and non-cultivator households per annum (*250 such households per bank branch per annum*) with an emphasis on poor and marginal farmers.
- Opening of no-frills accounts for providing savings and payments services.
- Use of Business Facilitators (BF) and Business Correspondents (BC) for increasing the coverage of financially excluded families by banks. This includes the creation of BC touch points in 600,000 villages across India.
- Promoting financial literacy by introducing financial terms in school books and educational programmes on television.
- Expansion of the bank branch network (commercial banks as well as RRBs) to the excluded/unreached districts.
- Furthering progress under the SHG Bank Linkage Programme (SBLP) of NABARD and maximising the coverage of Microfinance Institutions (MFIs).
- Use of technology and telecommunications for increasing access/coverage of excluded families and bringing down the cost of small transactions.
- Providing risk cover to the excluded population through micro-insurance.

3.1 PENETRATION OF BANKS – SCOPE FOR IMPROVEMENT

The achievement of financial inclusion is directly proportional to the demographic penetration of bank branches. As cited by Dr K. C. Chakrabarty, Deputy Governor, Reserve Bank of India, although the financial penetration indicators of India have improved over the years there is still much scope for improvement when compared to OECD economies – as shown in **Table 3.1**. In his view, the efficiency of the banks has shown limited improvement indicating that the cost of low value transactions has not reduced.. Business from urban and big city areas accounts for more than 75% of the banks' business and has been growing over the years. The size of deposits and advances per account has also increased significantly indicating that the increase in business is not due to the acquisition of additional customers at the bottom of the pyramid.

TABLE 3.1 Penetration of Banks in India.

Indicators	2005	2006	2007	2008	2009	Benchmark (OECD)
Branches per 100,000 people	6.33	6.37	6.35	6.60	6.33	10–69
ATMs per 100,000 people	1.63	1.93	2.4	3.28	4.3	47–167
Deposit accounts per 1,000 people	432.11	442.87	459.52	467.35	n.a.	976–1,671
Loan accounts per 1,000 people	71.42	78	83.59	89.03	n.a.	248–513
Branches per 1000 km^2	22.99	23.46	24.13	25.49	26	1–159
Trends in Operating Exp./ Ratios						
Operating exp. (% of total assets)	2.1	2.1	1.9	1.8	1.7	
Deposits per account (₹)	37,421.7	43,108.3	50,020.2	55,873.9	59,217.3	
Advances per account (₹)	149,378.2	177,190.2	206,168.8	225,907.5	258,751.3	
Urban+Metro Business/Total Business (%)	71.99	74.97	76.70	76.83	77.63	

Kiatchai Sophastienphong , Anoma Kulathunga, The World Bank 2010. 'Getting Finance in South Asia'
Trend and Progress of Banking in India 2008-09, Basic Statistical Returns of SCBs in India.

Note: The Benchmark Indicator ranges are for selected high-income OECD member countries (Australia, Canada, France, Germany, Italy, Japan, the Republic of Korea, New Zealand and the United States).

The intermediation costs of banks in India are still higher than those of developed banking markets.

Further, as stated in the latest annual report[4] of RBI, even in the 26 districts that were declared 100% financially included by the State Level Bankers Committees (SLBCs), actual financial inclusion was not achieved to the full extent in all the districts. An RBI-sponsored evaluation study indicated that most of the accounts that were opened in these districts under the financial inclusion drive remained inoperative for various reasons and awareness with regard to no-frills accounts continued to be virtually non-existent in many districts.

3.2 CREDIT – NEEDS A HUGE IMPETUS

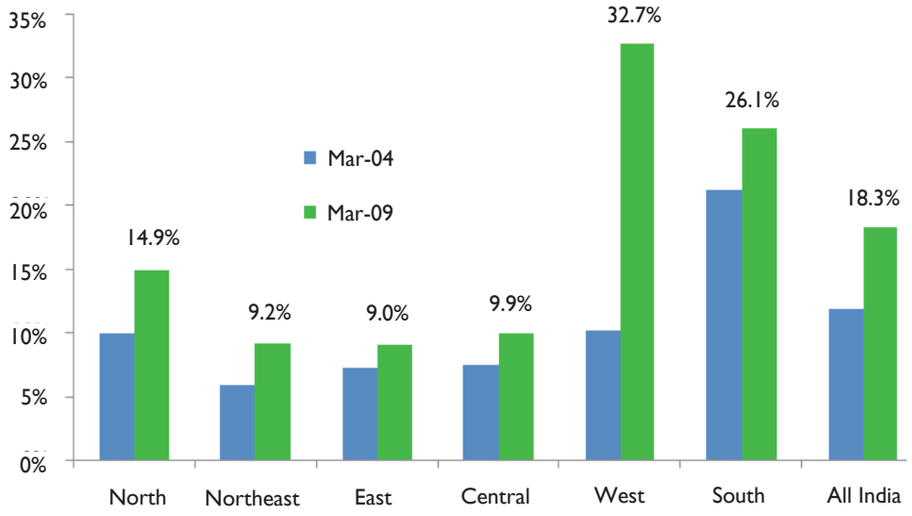
In another paper,[5] Mrs Usha Thorat, Deputy Governor, RBI admitted that while there has been positive growth in covering excluded households, a vast majority of the population remains un-served.

The growth in the number of small credit (borrowal) accounts shows that:

- The number of such accounts of size '₹25,000 & below' in the banking system rose from 36.8 million in 2004 to 39.2 million in 2009 – an increase of 2.4 million (just 6.5%).
- The number of borrowers with credit accounts of 'less than ₹200,000' increased from 61.9 million in 2004 to 95.8 million in 2009 – an increase of nearly 34 million (or 54.8%).

It becomes apparent that for the coverage of those borrowing less than ₹200,000 to increase to at least 50% of the adult population in the next three years, the number of credit accounts would have to increase annually by at least 41.3%.

FIGURE 3.1 Credit: Coverage of the Adult Population, by Region.



Note: No. of Borrowal accounts is as per place of sanction as on 31st March 2004 & 2009; Adult population estimate is on the basis of Census 2001 and assuming a growth rate of 1.3% (World Bank, World Development Indicators, 2008).

[4] RBI, *Annual Report 2009–10.*

[5] Panel Session on 'Setting New Paradigm in Regulation' at the FICCI-IBA Conference on 'Global Banking: Paradigm Shift' on September 8, 2010.

The analysis of region-wise credit (borrowal) accounts in **Figure 3.1** shows an improvement in all regions. In terms of the number of such accounts relative to the adult population in the region, the western region showed significant improvement from 10.2% (credit accounts/adult population) in 2004 to 32.7% in 2009. The southern region consolidated its coverage from 21.2% in 2004 to 26.1% in 2009. The coverage in other regions remained quite low, and yet this assumes that each borrowing adult has just one account. The proportion is likely to be much lower considering that many individuals have multiple accounts.

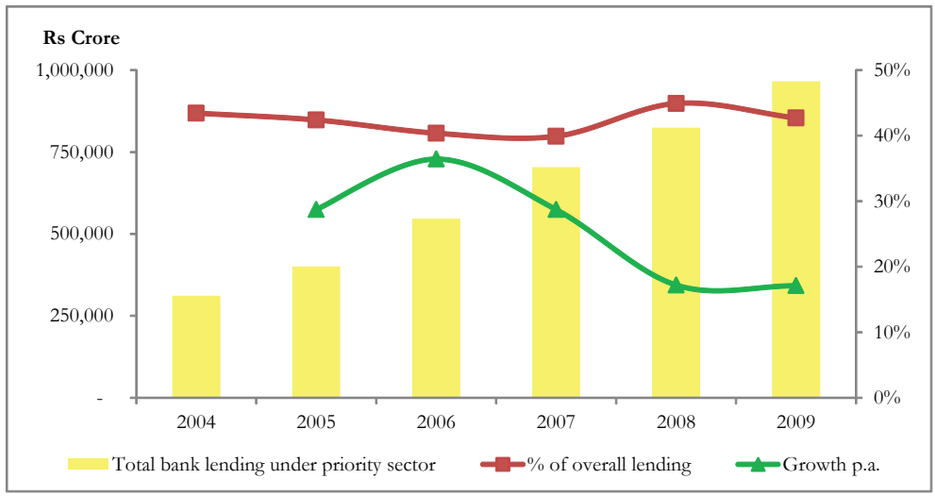
The Priority Sector Lending Scheme Grows and Grows – But is it Good News?

India's 'priority sector' lending has helped in imparting resilience to the agricultural sector. Despite the global financial crisis, this lending requirement has maintained the flow of institutional credit to agriculture. Cumulative lending by the banks (public, private and foreign) increased at a compound annual growth rate of 25.4% p.a. from 2004 to ₹965,773 crore by end-March 2009. Although as groups, different categories of banks had achieved the overall target for priority sector lending in 2008–09, 3 out of 27 public sector banks, 5 out of 22 private sector banks and 4 out of 27 foreign banks had not achieved the overall targets of 40% for Indian and 32% for foreign banks. Overall priority sector lending constituted 42.7% of the total by the banks but since it includes activities such as lending for export and lending to small enterprises this does not necessarily indicate increase in financial inclusion. The growth in priority sector lending is illustrated in **Figure 3.2**.

The Kisan Credit Card has Made Some Contribution

The target of ₹280,000 for credit to the agricultural sector for the year 2008-9 was also exceeded with ₹287,000 crore disbursed by all banks (including RRBs). However, neither public sector banks nor private sector banks, as groups, achieved the agriculture lending target of 18%. The Kisan Credit Card (KCC) scheme, introduced in 1998-99, to enable farmers to purchase agricultural inputs and draw cash for their production needs, had 37.1 million

Figure 3.2 Growth in Priority Sector Lending.



Analysis based on priority sector lending data in RBI Annual Report 2008-9.

accounts with public sector banks with sanction limits aggregating ₹193,250 crore by March 2009. KCC accounts accounted for 33.7% of the total indicating that these make a significant contribution to financial inclusion since a large proportion (80-85%) of farmers tend to be otherwise unbanked. However, it is impossible to quantify the contribution of KCC to financial inclusion since information, disaggregated by size of account, is not available. Evidently those with smaller KCC limits, certainly those with limits less than ₹25,000 are the ones most likely to be otherwise financially excluded.

…But the Share of Small Borrowal Accounts in Priority Sector Lending is Quite Small

The contribution of the priority sector to financial inclusion can be assessed from the information in **Table 3.2**. Of the lending to agriculture, some 8.0% (3.1% of the total for the priority sector) is in loans of less than ₹25,000 whereas another 36.3% (14.1% of priority sector lending) is in loans of up to ₹2 lakhs, making a contribution of 17.2% to the total. Based on data on the size of credit limit of the banks' loan accounts, it is reasonable to assume that 30% of the lending to small enterprises, 10% of the lending for housing and 30% of that for other purposes is to otherwise financially excluded persons. This means that the contribution of the priority sector to financial inclusion is a little over 31% of the total for priority sector loans outstanding (see table). Since the priority sector constitutes 41% of all lending, the contribution of the banking sector to financial inclusion amounts to a little under 13% of all the commercial banks' loan portfolio.

…And Tiny Accounts Now Account for Less Than One-third of the Real Share of Agricultural Lending such Accounts had 15 Years Ago

Yet, while the growth of the priority sector is good news to the extent that it makes a significant (but not substantial) contribution to financial inclusion, the news is still tempered. RBI data shows that over the 15 year period from 1995 to 2010, the contribution of tiny borrowal accounts (<₹25,000) in overall agricultural lending has actually fallen from 59% of the total to just 8% (one-seventh) of the total. While some of this would be attributable to the decline in the value of money, adjusting for inflation by a factor of 2.2 (based on the growth in the wholesale price index) means that the decline in the contribution of agricultural lending to financial inclusion is to the extent of **one-third** (1/3.2) the level of 1995.

Table 3.2

Lending for…	Amount outstanding, ₹ crore	Proportion of total for priority sector	Contribution to financial inclusion	% of priority sector lending
Agriculture	375,593	38.8%		
of which a/cs <₹25,000	24,681	(3.1%)	100%	3.1%
₹25,001-₹2,00,000	112,336	(14.1%)	100%	14.1%
Small enterprises (including artisans, village enterprises, services)	256,128	26.5%	30%	7.9%
Housing	217,300	22.5%	10%	2.2%
All others	118,395	12.2%	30%	3.7%
Total	967,416	100.0%		31.0%

…While Progress Under Other Government-sponsored Credit Schemes is Not so Encouraging

There are various government-sponsored credit schemes intended to achieve poverty reduction and financial inclusion objectives. But while most of these are widely discussed within the government system their achievement is dismal. **Table 3.3** presents the disbursements and outstandings under various schemes during 2008-09. Only the priority sector lending to minorities is significant but proportionately even that is substantially less than the 19.5% minority population in 2001 (and believed to have increased since).

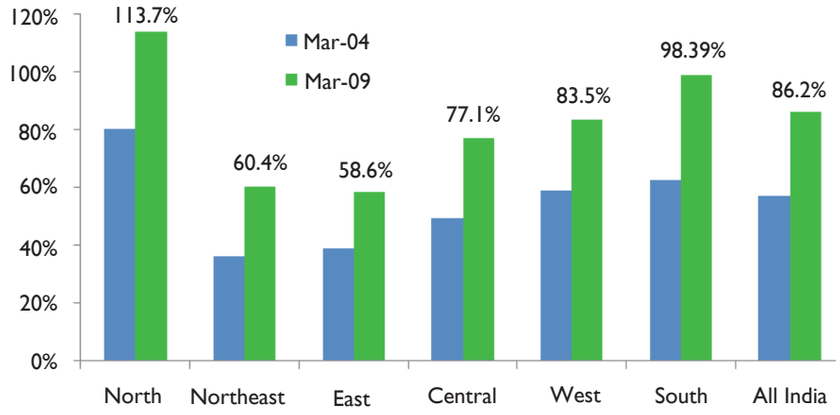
Table 3.3 Contribution of Government-sponsored Credit Schemes.

Scheme	Number of accounts	Amount (₹ crore)	Status
Swarnajayanti Gram Swarozgar Yojana (SGSY)	409,069	333	Disbursed
Swarnajayanti Shahari Rozgar Yojana (SJSRY)	20,002	75	Disbursed
Self-employment scheme for Scavengers (SRMS)	1,409	4.5	Disbursed
Differential rate of interest (DRI)	311,000	753	Outstanding, 0.04% of all advances
Priority sector lending (PSL) for minorities		72,481	9.4% of PSL

3.3 SAVINGS THROUGH DEPOSIT ACCOUNTS – AN ENCOURAGING TREND, PERHAPS…

One of the drivers of growth in India has been the high level of savings. The savings rate was 32.5% of GDP in 2008–09 compared to 22.3% ten years ago in 1998–99. The contribution of the household sector to savings is 70.0%. While the overall savings ratio has increased significantly, financial savings have remained at around 50% of household savings. Within financial savings, the share of bank deposits has increased from 33% in 2000-01 to 55% in 2008-09. Achieving higher rates of growth would call for higher financial savings and this in turn requires much greater penetration of banks and greater involvement of other financial intermediaries like insurance companies,

Figure 3.3 Deposit Accounts: Region Wise Coverage of Adult Population.



RBI, Basic Statistical Return 1; Coverage of adult population estimated by M-CRIL.

Note: Adult population estimate is on the basis of Census 2001 and assuming a growth rate of 1.3% (World Bank, World Development Indicators, 2008).

mutual funds and pension funds. Achieving a higher level of financial savings also requires a benign inflationary environment since high inflation rapidly reduces the value of money and undermines individuals' incentive to save.

The analysis of bank deposit accounts by region in **Figure 3.3** shows a substantial increase in coverage of the adult population in all regions. The coverage through deposit accounts is more than 75% in all regions except the Northeast and East. Though the increase in the all India figure from 57.1% to 86.2% is encouraging, the likelihood of there being multiple accounts for an individual is substantially higher for deposit accounts than it is for credit accounts. This makes it difficult to correlate the level of penetration of banks through deposit accounts to increased financial inclusion.

3.4 COVERAGE THROUGH MICROFINANCE

The microfinance sector in India, is considered to be one of the main contributors to financial inclusion in the country. There are two major models for delivery of microfinance services – the SHG Bank Linkage Programme (SBLP) and the MFI model. Under the SBLP model, NABARD has been refinancing bank loans to SHGs through commercial banks but the credit risk is carried by the banks. The MFI model uses a variety of methodologies ranging from the very popular SHG methodology traditionally pursued in the country to Grameen and joint liability groups, as well as individual banking arrangements. The MFIs use external borrowings from commercial sources (apex financial institutions including NABARD and SIDBI, commercial banks and other financial institutions) and their own equity in on-lending to their micro-borrowers.

Outreach of SBLP

The SBLP in India has emerged as the largest microfinance programme in the world with an apparent coverage of 89 million low income households through 6.81 million SHGs on March 31, 2010. **Table 3.4** below summarizes the progress of SBLP since 2006–7. M-CRIL estimates that the actual outreach (of unique households not covered by the MFI model) of SBLP is around 50 million households on March 31, 2010.

Table 3.4 Progress of SBLP.

Year	Reported – No. of SHGs (million)		Estimated^ (million)		M-CRIL estimate# of
	Savings linked	Bank loan O/s (year-end)	No. of members	No. of Borrowers	No. of households covered (crore)
2006–07	4.16	2.89	58	41	34
2007–08	5.01	3.63	70	51	42
2008–09	6.12	4.22	86	59	47
2009–10	6.81	4.58	89	64	50

NABARD, 2008-9. 'Status of Microfinance in India'.

^ NABARD has assumed an average group size of 14 members; Since all SHGs are required to have a bank savings account and save regularly to become eligible for credit, it is assumed that all SHG members are also savers. It is also assumed that all members of credit linked SHGs are borrowers.

The estimation is based on the no. of borrowers of SBLP. It is assumed that SHG members who are saving but not accessing credit may be accessing credit from MFIs. Srinivasan N., SOS 2010 refers to a CMF study in AP which indicates 13% of the SHG members had loans from MFIs. For estimation, M-CRIL has assumed that there would be around 40% overlap with the MFI model (*meaning that 40% of SHG borrowers also take credit from MFIs*). This analysis assumes that the average number of members per SHG is 13 as indicated by research studies (NCAER, 2008; EDA/APMAS 2006).

The contribution of SBLP to financial inclusion can be gauged from the information in **Table 3.4**. While the programme provides group savings facilities and bank credit facilities to low income families, the average amounts outstanding per member are minuscule in the case of savings and still quite small in the case of credit. Average savings per member of just ₹647 at the end of March 2009 is less than 1.2% of the per capita GNI of India. Average credit outstanding of ₹3,835 is just 7% of the per capita GNI. Even assuming that SHG clients typically have incomes that are less than 50% of per capita GNI, it is apparent that typical borrowing which is less than one-seventh of that number is unlikely to make a significant contribution. Further the savings amount is also minuscule.

The contribution of SBLP to financial inclusion can be gauged from the information in **Table 3.5**. While the programme provides group savings facilities and bank credit facilities to low income families, the average amounts outstanding per member are minuscule in the case of savings and still quite small in the case of credit. Average savings per member of just ₹717 at the end of March 2010 is less than 1.5% of the per capita GNI of India. Average credit outstanding of ₹4,260 is less than 8% of the per capita GNI. Even assuming that SHG clients typically have incomes that are less than 50% of per capita GNI, it is apparent that typical borrowing that is less than one-sixth of that will not make a significant contribution to their lives and the savings amount is so minuscule that it is barely worth mentioning. The average savings amount does not, of course, take into account savings within the group which are lent internally amongst the members. While this amount remains unrecorded beyond the group level it is unlikely to be very substantial for two reasons: (1) repayment rates on internal loans within the groups are reported to be of the order of 35-40% raising concerns about the security of savings in this form, and (2) a large proportion of SHGs distribute the corpus (44% at least once and 26% as many as 3 times within the past 5 years according to an APMAS study of 150 SHGs in AP).

Outreach of MFIs is Now Increasingly Significant in Relation to Credit Provided by Banks

The coverage of the MFI model has grown at a very rapid pace during the last decade. The M-CRIL Microfinance Review 2010 estimates an outreach of around 27 million borrowers (*before allowing for multiple lending*). Of these nearly 22 million (~82%) are covered by Non-Bank Finance Companies (NBFCs). **Table 3.6** shows the outreach of MFIs by different legal types, estimated by M-CRIL based on a sample of 66 leading MFIs. The coverage by all institutions types except NBFCs have declined over the years as they have increasingly transformed into NBFCs to sustain a level of growth of the order of 90-100% per annum over the past ten years.

Table 3.5 Savings and Credit under SBLP.

FY	Savings		Bank loan O/s	
	Amount ₹ crore	Av. /member (₹)	Amount O/s ₹ crore	Av. outstanding/ member(₹)
2006–07	3,512.7	603	12,366	3,052
2007–08	3,785.4	540	17,000	3,349
2008–09	5,545.6	647	22,680	3,835
2009–10	6,358.0	717	27,267	4,260

NABARD, 2009–10. 'Status of Microfinance in India'.

TABLE 3.6 % of Clients Served by Different Types of MFIs in India.

Legal Type	No. of MFIs	Active borrowers million	%
NGO	27	3.1	12.0
NBFC	31	21.8	84.2
Section 25 Company	3	0.6	2.3
Co-Operative	5	0.4	1.5
Sample	66	25.9	100.0

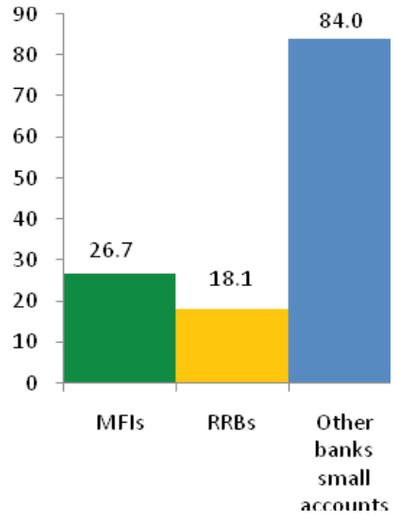
The Sa-Dhan report[6] which uses data of 266 MFIs estimates the outreach at around 27 million. This indicates that around 200 MFIs in the Sa-Dhan sample have very small average client base of 3,700 per MFI. Based on the available data on borrowers of MFIs, M-CRIL estimates a coverage of 20.7 million unique households assuming a lending overlap, amongst MFIs, of 30%.

More importantly, with 26.7 million borrower accounts the size of the MFI sector now more than matches significant parts of the Indian financial system in terms of the number of citizens affected. This number is nearly 1.5 times the total number of borrower accounts serviced by the Regional Rural Banks (as shown by the information in **Figure 3.4**) and is 26% of the total number of small credit accounts (up to ₹2 lakh, $4,400) held by the entire banking sector. If allowed to be seen as part of the mainstream financial system, the microfinance sector would have a 21% share of the total number of small borrower accounts and a 40% share of all micro-accounts (less than ₹25,000, $555).

The operations of MFIs are facilitated by lending to them by banks (MFI-Bank Linkage Programme, MBLP). The total amount of bank finance outstanding to MFIs at the end of March 2010 is estimated by M-CRIL at ₹16,000 crore.

[6] Sa-Dhan, 2010, *A Quick Review, 2010: Financial Performance of Indian MFIs.* Delhi: Sa-Dhan.

FIGURE 3.4 MFI Credit Accounts Compared with Banks (million accounts).



While MFI outreach remains a small proportion of the overall financial system in terms of portfolio size, it is growing much faster: bank credit grew by 17.5% during 2008–09 while microfinance portfolios grew by around 100%. As a result, in terms of portfolio size as well as clients served it is becoming an increasingly significant part of the financial system. As the analysis in **Table 3.7** shows, the end-March 2010 portfolio of the microfinance sector (deflated by the growth in Consumer Price Index numbers for Agricultural Labour) is 0.64% of the total credit outstanding of the banking system and over 40% of all borrower micro-accounts of value less than ₹25,000 ($555), as much as 28% of the credit outstanding of Regional Rural Banks (RRBs) and nearly 20% of the credit outstanding of the district cooperative banks (DCCBs).[7]

The MFIs, except the cooperatives, are currently not allowed to provide deposit services to their clients. The cooperatives can provide deposit services only to their members. Similarly MFIs also cannot

[7] All banking data from RBI, 2010. *Statistical Tables Related to Banks in India, 2008-09.* Mumbai: Reserve Bank of India.

provide remittance services due to regulatory restrictions. However, MFIs have played a significant role in providing micro-insurance services to their clients through collaborations with insurance companies.

TABLE 3.7 Contribution of Lending by MFIs to the Financial System.

Bank type	end-March 2009, ₹ crore	MFIs 2010* as % of total
Scheduled banks	27,75,549	0.64%
a/cs <₹25,000	42,937	41.2%
RRBs	64,011	27.6%
DCCBs	93,201	19.5%

* deflated to 2009 values for the purpose of comparison

By the method of simple accumulation, the overall outreach of microfinance reaches 77 million households at the end of March 2010. This includes around 50 million households covered by SBLP and 27 million by MFIs. However in practice, M-CRIL has estimated above that there are around 39.5 million unique households covered by SBLP and another 20.7 million households covered by MFIs leading to a total of 60 million families covered by microfinance.

3.5 LIMITED COVERAGE UNDER MICRO-INSURANCE – BUT DOES CREDIT-LIFE GIVE REAL LIFE COVER?

Insurance is one of the key services included in the financial inclusion framework. The Insurance Regulatory Development Authority (IRDA) introduced micro-insurance regulations in November 2005 for expanding the outreach of insurance companies to the unreached. As with the banks, insurance companies did not have an intrinsic interest in the bottom of the pyramid market since they expected costs to be high and revenues small.[8]

The micro-insurance regulation defines a micro-insurance policy as one that has been sold under a plan specifically approved by IRDA qualifying as a micro-insurance product. The cover for the micro-insurance life product is a minimum of ₹5,000 and up to ₹50,000 with a maximum term of 15 years. For non-life products the maximum coverage is up to ₹30,000. By end March 2010, there were 48 insurance companies operating in India including 22 in life insurance business, 25 in general (including health) insurance business and 1 national re-insurer. As of March 2010, there were 28 micro-insurance products offered by 14 life insurance companies and a number of other products offered by the general insurance companies.[9]

During the financial year 2009–10, nearly 3 million new policies insuring around 20 million lives were underwritten by the insurance companies. It is also estimated that there were about 79 million renewals of life policies making the overall coverage of around 100 million life policies. It is difficult to estimate unique individuals covered by life and non-life policies because of multiple policies held by a large proportion of individuals. Micro-insurance life accounted for around 28% of the new business during 2008–09. The IRDA annual report indicates that micro-insurance business was procured largely under the group portfolio. This is likely to be mainly due to the group policies of MFI clients, as the MFI sector has emerged as a major contributor to the micro-insurance business. It is estimated that life micro-insurance policies (*individual and group together*) cover around 20 million lives. The difficulty is that over 80% of these policies amount to no more than insurance that guarantees the credit of MFIs and other microfinance providers such as cooperative

[8] M-CRIL, 2008. 'Micro-Insurance regulation in the Indian Financial Landscape', M-CRIL.

[9] *IRDA Annual Report*, 2009-10, www.irda.gov.in.

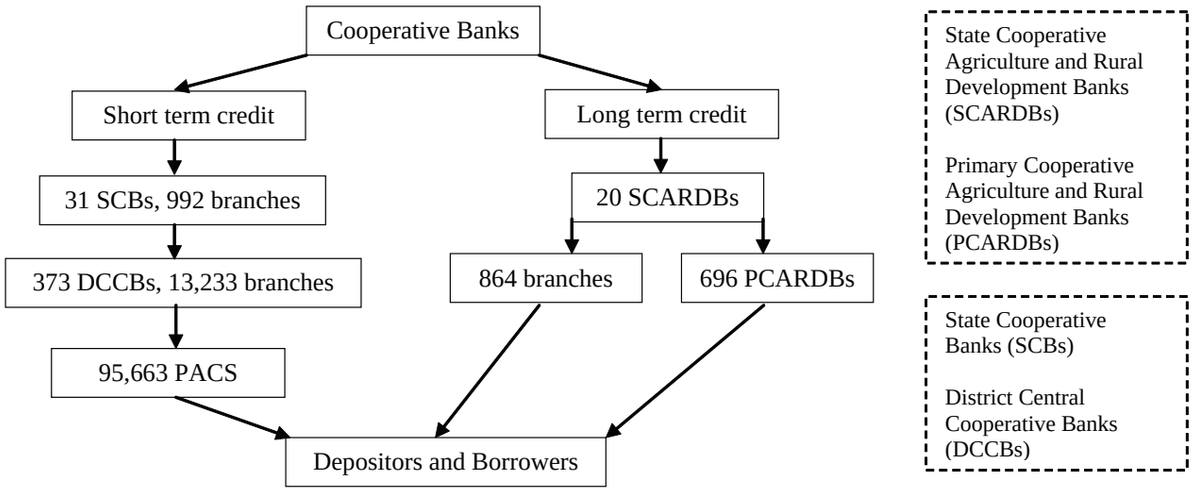
banks and RRBs rather than provide significant support to bereaved families. Even so, the 20 million lives insured in this way provide cover to around 15% of an estimated 140 million financially excluded households.

In addition, the government is increasingly launching safety net programmes through the device of insurance policies, effectively transferring the implementation responsibility to the insurance companies. Thus there are now reported to be some 23.6 million smart cards issued under the Rashtriya Swasthya Bima Yojana, a health insurance scheme for informal sector workers. The scheme has many empanelled hospitals and incorporates hospitalisation benefits up to ₹30,000 per family of five (below the poverty line).

3.6 COVERAGE OF THE COOPERATIVE SYSTEM – EXTENSIVE OUTREACH, INTENSIVE PROBLEMS

The cooperative system consists of Primary Agriculture Cooperative Societies (PACS) at the grass roots level, followed by District Central Cooperative Banks (DCCBs) at the middle and State Cooperative Banks (StCBs) at the apex. The StCBs are federated as the National Federation of State Cooperative Banks (NAFSCOB).[10] The Cooperative Credit Structure (CCS) is depicted in **Figure 3.5** below.

FIGURE 3.5 The Cooperative Credit Structure.



Among these institutions PACS are in direct interface with farmers and low income families (mainly) in rural areas and provide them with short and medium term credit. A large number of PACS also serve as outlets for the public distribution system (PDS) for the supply of food and other essential items. There were 94,647 PACS on March 31, 2010 with a membership base of around 126 million members. **Table 3.8** summarizes the current outreach of PACS.

REGIONAL SPREAD OF PACS

The PACS are spread evenly across most of the regions of the country except the North-Eastern and Western regions. The NE region accounts for just 3.7% of PACS while the Western region has 30.7%. In

[10] NAFSCOB was established on May 19, 1964 with a view to facilitate the operations of State and Central Cooperative Banks in general and Development of Cooperative Credit in particular. www.nafscob.org.

terms of number of borrowers, the Southern region had 41% of the total borrowers while the Eastern region had around 25%; more than two-thirds of the deposits and more than 40% of the loans outstanding were mobilized in the Southern region.

Table 3.8 Outreach of PACS.

Parameters	On March 31, 2010
No. of societies	94,647
Total membership (in '000s)	126,419
Total deposits (in ₹ lakhs)	3,528,608
Total no. of borrowers (in '000s)	59,800
Total loans issued (in ₹ lakhs)	7,493,754
Total loans outstanding (in ₹ lakhs)	7,647,983

NAFSCOB, 2010. 'Performance of PACS, 1 April 2009 to 31 March 2010'.

It is evident that the Central and Northeast regions are way behind the others, while the South and East regions (like in microfinance) contribute the most to the overall outreach of PACS.

The PACS have presence in around 90% of the villages in 33 states/union territories of India with one PACS for roughly every 6 villages in the country. Small and marginal farmers constitute more than 65% of the overall members of PACS. Others include schedule castes, schedule tribes and rural artisans. From a numerical and outreach perspective the PACS clearly have a potentially important role in the financial inclusion framework of the country. However, the PACS are well known to be poorly managed with substantial governance issues and, partly as a result, their overdues are very high at 56% of demand for the agricultural portfolio and 41% overall. More than 55% of the societies are loss making. This undermines the PACS contribution to financial inclusion.

Purpose of Credit from PACS

Though the primary objective of PACS is to provide credit for agricultural purposes, they do lend for non-agricultural purposes as well. Nearly 83% of the loans issued were for short-term and 17% for the medium term during FY 2009–10. About 59% of the loans were issued for agricultural purposes and 41% for non-agricultural purposes as shown in **Table 3.9**.

Table 3.9 Purpose of credit from PACS.

Purpose	Loans outstanding	
	Amount (₹ lakh)	%
Agricultural	3,762,479	50.2%
Non-agricultural	2,547,771	34.0%
Others	1,183,503	15.8%
Total	7,493,753	

NAFSCOB, 2010. 'Performance of PACS, 1 April 2009 to 31 March 2010'.

3.7 …AND THE HALF-FORGOTTEN REGIONAL RURAL BANKS

The Raghuram Rajan Committee was convinced that small (privately owned) banks were the answer to financial inclusion. Such banks would be more likely to regard small customers in remote pockets of the country as their natural market and would, therefore, serve their needs better. It is easy to forget that small banks actually exist in India albeit tucked away in rural areas and half-forgotten on account of their historical inefficiency partly resulting from being in the public sector and, therefore, treated as an instrument of policy: these are the Regional Rural Banks (RRBs).

The Regional Rural Banks were established from 1975 as a major initiative to reinforce the inclusion objectives of bank nationalization and promote the flow of credit to the rural poor. The initiative was based on the recommendations of a Working Group under the chairmanship of a former governor of the RBI, M. Narasimham. The idea of establishing small rural banks was that such institutions would have a 'local feel and familiarity with rural problems', a

feature that was thought to characterize the cooperatives. RRBs, it was expected, would combine this with the professionalism and large resource base of commercial banks.

Starting with just 6 RRBs covering 12 districts in December 1975, the RRBs expanded through the 1980s into a network of 196 such banks covering 525 of the roughly 600 districts in the country through some 14,500 branches. In the event, as the earlier discussion shows, RRBs have been relatively successful at mobilizing deposits but much less so at enhancing the credit flow to the rural poor – at least not in a professional manner. If the poor governance and financial weakness of the cooperative credit system turned it into the subject of official patronage, it was their proximity to the rural poor (not much less than that of the cooperatives), combined with government ownership that turned the RRBs into an instrument of 'policy lending', extending subsidized credit to large numbers of people. As a result, in the words of the latest RBI working group on the RRBs, 'Since their inception the financial health of the RRBs has been indifferent.'[11]

CONCLUSIONS – A LONG WAY TO GO…

While the banks have made some efforts to reach the financially excluded sections of the population, there is still a long way to go before they can achieve their first target of covering 55.8 million excluded households and all villages with >2,000 population by 2012. So far, progress towards achieving this goal has been relatively limited and government efforts to promote financial inclusion in an intensive manner will need an additional impetus in order to help attain the necessary results.

[11] RBI, 2005. 'Report of the Internal Working Group on RRBs', Mumbai: Reserve Bank of India.

4

The Policy Conundrum – Is It Prudential or Simply Restrictive?

The conventional view of the policy conundrum is that financial inclusion cannot be achieved without active support from policy makers and regulators. The Government of India has made several rounds of efforts at several points over the past few decades to promote inclusive financial growth. This process started with the nationalization of the Imperial Bank of India in 1956 to establish the State Bank of India and went on through the nationalization of 17 major private commercial banks in 1969 and another 6 in 1980, the establishment of the Regional Rural Banks (in 1976) and expansion of the RRB system thereafter, recapitalization of the RRBs in the mid-1990s and at least two rounds of reform and recapitalization of the cooperative system.

Keeping in mind the aim to achieve sustainable and equitable growth, the RBI has made numerous policy contributions aimed at increasing access to banking services, credit markets and financial education. These included the lead bank scheme of the commercial banks to encourage a specific bank to take the lead in providing banking services in each district of the country and the promotion of self help groups (SHGs), a programme promoted by NABARD and facilitated by the RBI's acceptance of un-registered groups of low income individuals as an entity for banking purposes.

The current round of initiatives for the promotion of financial inclusion includes

- Promotion of the Business Correspondent (BC)/Business Facilitator (BF) model for outreach to low income families/individuals.
- Establishment of the concept of no-frills accounts and encouraging banks to open such accounts for low income families.
- Encouragement to RRBs/Cooperative banks to sell insurance and other financial products.
- Creation of special funds for financial inclusion.
- Revival of the cooperative credit structure involving PACS, District Central Cooperative Banks (DCCBs) and State Cooperative Banks (StCBs).
- Liberalization of KCC/GCC Guidelines and KYC norms for small accounts.
- Introduction of technology products and services such as prepaid cards, mobile banking.
- Liberalization branch expansion.
- Efforts to promote financial literacy and strengthen consumer protection.

This section discusses the role and scope of these current initiatives to promote financial inclusion.

4.1.1 The First Hesitant Step

Initially, the RBI specified that those who could act as BCs were 'not for profit' entities who could conduct banking business as agents of the banks at places other than the bank's premises. The activities they could conduct were borrower's identification, collections, preliminary processing and submission of loan applications, creating awareness about savings and opening of account (though KYC and AML compliances were the bank's responsibility), promoting SHGs & JLGs, collection of small value deposits, disbursal of small value loans and follow-up on recovery of principal/ interest, sale of micro-insurance and receipt and delivery of small value remittances.

The hesitation of the RBI was indicated not only by its restriction to not-for-profit entities (though later the engagement of some types of individuals was also permitted), not traditionally the most efficient of organizations, but also by the restrictions imposed on pricing. BCs were to be paid from the bank's margin and no charges could be imposed on the customer either by the bank or the BC. This limited the viability of the model since the margins of banks are of the order of 4% and it is well known that any form of micro-banking activity incurs a cost of 6-10% of the money value of the transaction. Soon afterwards, concerned about allowing the links between BCs and bank branches to become too tenuous (leading to a 'lack of supervision'), the RBI limited the distance from the branch within which the BC had to operate to just 15 kilometers in rural, semi-urban and urban areas and to just 5 kilometres in metropolitan cities.

While being widely seen as an unfortunately limited step, these provisions led to some experimentation with leading commercial banks establishing pilot programmes with various not-for-profit entities to determine the feasibility of enabling financial inclusion within the straitjacket then imposed by the rules. Essentially, BCs were employed in opening 'no-frills accounts', providing payment services under government welfare programmes and in mobilizing deposits. While a few, such as FINO, A Little World (ALW) and Eko Aspire Foundation, reached numbers in the tens of thousands over the next three years (see case studies at the end of the report), in a country with perhaps 120 million financially excluded families, these numbers are too small to attract attention. However, FINO has reportedly done better through collaborations with state governments in the facilitation of payments under government welfare programmes, reaching a customer base of 22 million.

In 2009-10, the RBI constituted a Working Group to examine the experience of the BC model under these conditions. The Working Group sought information from banks and other stakeholders on the BC experience and observed:[12]

- Though the regulations on BC model allow a variety of entities/individuals to act as BCs, only a few have actually been engaged. The most common type of entities appointed as BC included Section 25 companies, Trusts and Societies. Further, almost all the Section 25 companies appointed as BCs were floated by technology service providers who had provided smart card or biometric solutions for account openings. The data shows that only 26 out of the 50 public/private sector banks have reported appointing 129

[12] RBI, August 2009. 'Report of the Working Group to Review the Business Correspondent Model'.

BCs. These BCs have been able to open around 8.86 million no-frills accounts which forms just 26.8% of the total number of no-frills accounts opened by banks (by March 31, 2009).

- As most BC transactions are cash based, there is a high potential operational risk of handling large volumes of cash which would lead to security hazards, risk of fraud and also increase the handling cost.
- The clients of BCs are mostly illiterate and susceptible to mis-guidance. Effective utilization of the BC model can happen only with proper financial education of clients.
- The viability of the BC model remains a critical issue and a number of factors have contributed to this including non-operational no-frills accounts, retaining customers after initial transactions, passing of insurance and security (cash-in-transit) costs to BCs by banks, high transport cost for the BCs and inadequate commissions.

4.1.2 A Big Leap Forward or a Step into the Unknown...?

Based on this review, the RBI issued another circular apparently designed to free the model from the shackles that had been imposed upon it earlier.[13] By this circular a wide variety of entities and individuals were allowed to become BCs of the banks. Individuals like retired bank employees, teachers and government employees, owners of *kirana* and medical shops and entities like SHGs, NGOs set up under Societies Act and Section 25 of the Companies Act, cooperative societies (including PACS) and Post Offices could become BCs. The RBI also allowed companies registered under the Companies Act 1956 to become BCs but specifically excluded NBFCs on account of a perceived conflict of interest with their ongoing business. This opened up the possibility of banks choosing from a large range of entities and individuals to provide banking services on a widespread basis. In theory, companies with widespread retail networks in rural areas, like FMCG or cigarette and pan masala marketeers, could be enrolled as BCs leading to substantial outreach.

Equally importantly, the restraints of pricing were removed; the banks (but not the BCs) were permitted to collect reasonable service charges from customers in a transparent manner. The banks were permitted to pay a reasonable commission to BCs based on criteria that include an element of customer satisfaction and not just based on the volumes achieved. Bank managements were held responsible for ensuring that charges were both reasonable and transparent.

In addition to the above features, the banks are also responsible for adopting technology based solutions for managing risks resulting from the use of BCs, regular review of the performance of BCs, and protecting customer interests. The banks are also required to constitute a Grievance Redressal System within the bank for addressing complaints about services rendered by the BCs and give wide publicity about the system through the electronic and print media. The latest guidelines lay strong emphasis on customer education as part of the business strategy of banks.

In the meantime, banks had already been allowed to employ Banking Facilitators (BFs) in activities which did not involve the conduct of banking transactions, including facilitation services like identification of borrowers, preliminary processing of loan applications including verification of primary information/data and submission to banks, creating awareness about savings

[13] RBI, 2009. DBOD No. BL.BC.63/22.01.09/2009-10 dated 30 November 2009.

and other products and education and advice on managing money and debt counselling, promoting and nurturing SHGs/JLGs, post-sanction monitoring and handholding of SHGs/JLGs and follow-up for recovery.

...for lack of a business model

Since the circular of November 2009, there has been increased debate and some impetus to the pilot programmes for BC implementation. Yet, many months after the shackles were removed the Indian government has had to initiate yet another effort to generate some momentum for financial inclusion. As the banks put together their financial inclusion strategies, there is little talk of the centrality of the BC model in their plans. The fact is that the BC model has not been successfully implemented anywhere except Brazil; even there it is used mainly as a bill payment mechanism rather than as a tool to facilitate deposit and credit transactions. Nowhere, therefore, is there a real business model appropriate to the relatively informal functioning of the micro-economy of low income families in India; nowhere is there experience that the Indian banking system can turn to. If the BC model is to succeed, there will need to be an innovative approach to the development of business models. For that bankers will need to see real business in this market. There is presently little evidence that this is the case.

4.2 NO-FRILLS ACCOUNTS – BUT ALSO NO THRILLS, PERHAPS?

In November 2005, RBI instructed banks to offer simple and secure deposit facilities which required minimal or zero balances. The idea behind these no-frills accounts (NFAs) was that unbanked families would be allowed to maintain them without the requirement of a minimum balance but would be permitted only a limited number of transactions per month. Over time, the potential for using such accounts for making government welfare payments such as old age/widow pensions and wage payments under employment guarantee schemes like NREGA became apparent. As a result of the strong thrust placed by the government towards these accounts, the number of NFAs increased from half a million in 2006 to 33 million on March 31, 2009 and is over 50 million today. However, in spite of the large number of such accounts that have been opened, usage behaviour analysis conducted by various studies shows that the initiative has met with limited success since an overwhelming majority of NFAs are inoperative. For example, while the Cuddalore district of Tamil Nadu was declared 100% financially inclusive, a 2008 study by the Institute for Financial Management and Research (IFMR) showed that 85% to 90% of sample accounts were inoperative, households were unaware of banking facilities and most of them opened accounts only to obtain finance from government schemes. A study of accounts opened between April 2007 and March 2009 by the Skoch Development Foundation shows that only 11% of such accounts are operational.

It has been argued that generic financial products are unsuitable for the poor and not much effort has been put towards customizing financial products or services to meet the needs of low income families. Ironically, no-frills accounts were designed keeping in mind the needs of vulnerable groups, but they are still not used by the majority of people. The supply issues that limit the 'thrill' of using no-frills accounts are discussed in **Section 5**.

4.3 MICRO-INSURANCE REGULATIONS[14] – ENABLING IF NOT ADVENTUROUS

The insurance sector in India is regulated under the Insurance Act, 1938 and the IRDA Act, 1999. The Insurance Act, 1938 defines four categories of insurance – life, fire, marine and miscellaneous. In general, two categories of insurers are licensed – life and general (covering the last three product categories). Insurers are not allowed to offer life and general insurance together (although this requirement has been relaxed to some extent for the micro-insurance environment). The evolution of the micro-insurance business in India has occurred through a sequence of measures:

i. The government's concern about the inadequate emphasis on covering the disadvantaged, low income population, especially those living in rural areas that led to the nationalization of life insurance in 1956 and general insurance in 1973.
ii. Post liberalization in the late 1990s, the IRDA regulations declared in 2002 made it necessary for new private insurance companies to procure insurance business on a quota basis from pre-defined rural areas[15] and social sectors,[16] failing which they could be penalized.
iii. Specific regulations for micro-insurance were announced in 2005 to enable the design and easier distribution of products appropriate to the needs of low income families.

[14] Excerpt from M-CRIL, 2008, "Micro insurance regulation in the Indian landscape".

[15] Rural areas are defined by the Census of India as places having a minimum population of 5000, at least 25% of male working population engaged in agricultural economic pursuits and a population density of at least 400 per square kilometre.

[16] The social sectors are defined as "unorganized workers, economically vulnerable or backward classes in urban and rural areas".

The requirements are that new insurance companies must place in rural areas, 5-16% of all life insurance policies from years 1-5 of operations and 18-20% from years 6-10 of operations, and 2-5% of the total gross premium of general insurance underwritten in years 1-5 and 5-7% from years 6-10. The social sector obligation requires each insurer to maintain at least 5,000 policies in the first year rising to 20,000 in the fifth year and up to 25-55,000 in the tenth year , for both life and general insurance, regardless of the size of operations in the social sector. Until recently, it was these , rural and social sector obligations that motivated insurance companies to go down-market and provide services to the financially excluded.

The micro-insurance (MI) regulations promote extensive use of intermediaries (called micro-insurance agents) by the insurers for selling and servicing various micro-insurance products. The regulations clearly defined who could be the micro-insurance agents (NGOs, community organizations, SHGs). Such agents had to undergo compulsory training of 25 hours at the expense of the insurer. Later, in 2008, IRDA also allowed Section 25 companies to act as MI agents. The regulations also attempted to manage the cost of intermediation by fixing commission caps for the MI agents, which seemed to be more liberal than the normal commission rates to encourage participation.

The insurance sector filed 12 micro-insurance products (3 life and 9 non-life) from 6 insurers in 2004–05, which grew to 20 products (12 life and 8 non-life) from 10 in November 2007. However, the sector does not seem to have sustained this growth as by November 2009 there were just 23 micro-insurance products offered by 13 insurance companies. The insurance study [M-CRIL, *2008*] shows that rural and social sector obligations have not been sufficient to ensure outreach to the target

clients as the insurance companies have found different means (like selling to middle and upper income families in rural areas) of meeting their required targets. Some other restraining factors have been: limitations on the definition of MI agents, the capping commissions at levels not commensurate with the responsibilities to be carried out by MI agents, service tax on premiums and commissions that reduced returns for agents and restrictions on partnerships of an agent with not more than one life and one non-life insurance company.

Thus, while the regulatory requirements have been enablers to encourage insurance companies to cast a wider net to include the financially excluded population, in some cases the obligations have been limiting. The insurance regulatory authorities have been cautious in their effort to pre-empt potential difficulties in the functioning of the nascent micro-insurance system. This approach while facilitating financial inclusion on one hand has prevented insurance companies from taking bold steps towards financial inclusion.

4.4 SPECIAL FUNDS FOR FINANCIAL INCLUSION – WHAT'S THE RESULTING IMPETUS?

The apparent success of the Self Help Group (SHG) movement resulted in the Government of India repeatedly co-opting SHGs as its institutional outreach arm for subsidy linked credit schemes such as the Swarna Jayanti Swarojgar Yojana. As part of the effort to strengthen SHGs, the microfinance sector that works with SHGs amongst other types of groups and to promote overall financial inclusion, the government established three funds administered by NABARD. These are:

- Microfinance Development and Equity Fund (MFDEF) to support the growth of the microfinance sector.
- Financial Inclusion Fund (FIF)
- Financial Inclusion Technology Fund (FITF).

4.4.1 Fund for Microfinance Promotion

The Government of India established a ₹100 crore microfinance development fund for the promotion of microfinance in India through the nurturing and capacity building of SHGs, start-up funds for MFIs, development of delivery mechanisms and action research, MIS development and dissemination of best practices in microfinance. Since relatively little progress had been made in the use of these funds, it was re-designated as the Microfinance Development and Equity Fund (MFDEF) in 2005–06. Further, the fund size was enhanced from ₹100 crore to ₹200 crore, with the additional amount as a contribution from RBI, NABARD and commercial banks in a 40:40:20 ratio. The objective of MFDEF is to '*facilitate and support the orderly growth of the microfinance sector through diverse modalities for enlarging the flow of financial services to the poor particularly for women and vulnerable sections of society consistent with sustainability*'.[17]

In the Union Budget of 2010-11 this amount was enhanced to ₹400 crore with the objective of 'further up-scaling the quality and depth of microfinance interventions in the country.' The additional activities to be sponsored by the fund were capital support to MFIs, loans to MFIs for on-lending, self-help promotion initiatives of banks (SHPIs) and rating of MFIs.

A change of name and the injection of additional capital, however, failed to add much adrenalin to the fund. By the end of 2009-10, NABARD had sanctioned an amount of ₹80.91 crore from the fund which included ₹60.42 crore to MFIs as capital support/revolving fund and ₹20.49

[17] NABARD website. www.nabard.org.

crore as grant support for promotional activities.

4.4.2 The Financial Inclusion Funds

Based on the recommendations of the Rangarajan Committee, the central government set up two funds termed the:

- **Financial Inclusion Fund** (FIF) for meeting the cost of development and promotional interventions of financial inclusion, and the
- **Financial Inclusion Technology Fund** for meeting the cost of technology adoption for financial inclusion.

Each of these funds will have an overall corpus of ₹500 crore but on March 31, 2010 each had a size of ₹50 crore with contributions from GoI, RBI and NABARD in the ratio 40:40:20. RBI is contributing to the funds on a reimbursement basis. It is expected that the funds will reach the planned size of ₹500 crore each gradually over a period of five years, depending on utilization.

NABARD reports that on March 31, 2010, two years after establishment, 50,225 villages had been covered under the two funds with a sanction amount of ₹19.47 crore and ₹21.83 crore, respectively. However, it is apparent from **Table 4.1** that the actual expenditure from the funds is far less than the incremental financing made available. It shows that expenditure under FIF was less than 50% of additions to the fund during the year while in FITF it was about 25% of additions. This repeats the lukewarm experience of the MFDEF and is possibly a signal for NABARD to deploy the funds more dynamically in support of financial inclusion initiatives.

From the list of projects sanctioned in 2009–10 (presented in **Annex 3**) it appears that FIF has mainly focused on capacity building, training, financial counselling and account opening. Four out of 14 FIF projects target customer enrolment. FITF, under which 18 projects have been sanctioned, focuses mainly on card-based Information and Communication based Technology (ICT) solutions for RRBs and engagement of BCs to use these applications for account opening. The funds could be used to help institutions experiment with mobile banking, develop a business model for the business correspondent channel, launch no-frills accounts bundled with a modest overdraft facility and so on. The State of the Sector report points out that a clearer articulation of the objectives of both the funds is necessary and there is the need to draw up a timeline for completing investments to enable the funds to provide a real impetus to financial inclusion. The key is to overcome the bureaucratic aversion to risk taking; the funds were intended to enable experimentation, risk is inherent, without it both their utilization and efficacy will be minimal.

4.5 COOPERATIVES AND FINANCIAL INCLUSION – RESUSCITATION YET AGAIN

The age of organized sector finance in India is generally acknowledged to have begun with the Cooperative Credit Societies

Table 4.1 Use of Financial Inclusion Funds.

₹ crore

Fund	Opening balance April 2009	Accretion during 2009–10	Expenditure during 2009–10	Closing balance March 2010
FIF	34.08	19.00	7.98	45.10
FITF	48.36	6.51	1.67	52.20

N. Srinivasan, 2010. 'Microfinance India – State of the sector report'.

Act of 1904 which was introduced with the objective of 'facilitating promotion of cooperative societies, for the promotion of thrift and self-help among agriculturists, artisans and persons of limited means.' Cooperative societies were virtually the only institutions for credit in most rural areas until the nationalization of 14 banks in 1969. PACS have also been involved in distribution of agricultural inputs, subsidised foodgrains and other essential items to low income rural families in addition to credit. Even though the cooperative credit institutions have remained financially weak, operationally inefficient and ineffective, their wide spread in rural areas means that they continue to be seen as a financial system with significant potential for enabling the achievement of financial inclusion.

The government, concerned by the severe financial and institutional impairment of the cooperative credit structure (CCS), set up a task force led by Prof. Vaidyanathan in August 2004. On the basis of recommendations of the task force, it rolled out a revival package aimed at reviving the short-term rural CCS to try to turn it into a well-managed and vibrant medium to serve the credit needs of rural India, especially for small and marginal farmers.

The revival package seeks to [*Ministry of Finance, 2005–06*]:

- Provide financial assistance, specifically recapitalization support, to bring the system to an acceptable level of health;
- Introduce legal and institutional reforms necessary for its democratic, self-reliant and efficient functioning; and
- Take measures to improve the quality of management.

NABARD was designated as the implementing agency for the revival scheme. The main aspects of the revival package are summarized below and details are presented in **Annex 4**.

Financial Assistance

The first aim of the package is to improve the financial health of PACS to acceptable levels and then make interventions with the upper tier institutions (DCCBs and SCBs). The package includes assistance necessary to bring all institutions to a minimum Capital to Risk weighted Assets Ratio (CRAR) of 7%. The share of state governments in the equity of all institutions was to be brought down to 25% with the excess amount of their existing equity holdings converted to grants. However, PACS with a recovery level of less than 30% were deemed to be too weak to justify revival and hence not eligible for financial assistance. Broadly, the package was to provide full capitalization to PACS with recovery levels greater than 50%. The liability for funding the financial package was to be shared by the central and state governments and the CCS based on the origin of loss and existing commitments.

Legal and Institutional Reforms

The financial support was to be reinforced by amendments to various laws including the Banking Regulation Act (BRA) and the respective state level Cooperative Societies Acts to empower the RBI to lay out prudential norms and management processes to ensure the institutions' good financial health in the context of their role as deposit takers. The revival package also suggested some changes in the accounting system of the upper tier institutions to allow recovery adjustments of the principal amount first to cleanse the accounts of any over dues. NABARD was also assigned the responsibility of designing a deposit guarantee scheme for member deposits.

Improving the Quality of Management

The financial package was also to cover the cost of training and capacity building to improve the financial management skills of staff and board members, for installation of uniform accounting and monitoring systems and for their automation.

Implementation

The cooperative reform programme was rolled out in January 2006 but, partly on account of the large number and diversity of institutions ranging from PACS through DCCBs, SCBs, state governments and central government, the pace of implementation has been slow. The status of implementation until mid-2010 has been as below:

- The requisite MoU with the Government of India and NABARD has been signed by 25 of the 30 states for commencing the implementation of the reform agenda.
- It was envisaged that all regulatory actions including compliance to Section 11(1) of the Banking Regulation Act, 1949 (as applicable to Co-operatives) would be kept in abeyance for three years. While this time has now passed; only 14 States out of the 25 that have signed the MoU have been able to amend the Co-operative Societies Act.
- An amount of ₹7,990 crore has been released by NABARD as the central government's share for the recapitalization of 49,830 PACS in 14 States, while the State Governments have released ₹754 crore as their share. All states that have executed the MoU must carry out necessary amendments (as per the legal and institutional reforms) as the release under the package is linked to this. So far, 16 states have made the amendments. Delay in this only delays capitalization and weakens the system further.
- The SCBs and DCCBs have functioned mainly without banking licenses. The Committee on Financial Sector Assessment recommended that no unlicensed co-operative banks should be allowed to function beyond 2012. The RBI took the decision to license those co-operative banks that have a Capital to Risk Weighted Assets Ratio of 4% and above. The revival package also helped in this regard. The RBI issued licenses to 8 SCBs and 105 DCCBs. However, 21 SCBs and 252 DCCBs still remain unlicensed.

The progress in implementing the revival package for short term rural cooperative credit structure is summarized in **Annex 5**.

4.6 AMALGAMATION OF RRBS – UNDERMINING THE MANDATE

Having been established as small banks with limited areas of operation and a focus on small customers precisely for the purpose of enabling financial inclusion, the RRBs (being in the public sector) came to be seen as an instrument of social policy and required to undertake policy lending at low, administered rates to pre-selected customers. Their ills are too numerous to recount in a limited review. By 1991, the RRBs as a banking network were on the brink of collapse with 172 out of 196 recorded as unprofitable. A major recapitalization programme followed along with freeze on recruitment of new staff, revised prudential norms on income recognition, asset classification and provisioning for loan losses and various other measures. However, this resulted in such a focus on commercial viability that the overall RRB C-D ratio fell from 86% in 1990 to just 41% in 2001 with an investment-deposit ratio as high as 72%. Thus, the RRBs largely withdrew from rural lending.

As a result, another working group of the RBI recommended in 2005 that a programme of mergers and amalgamations of RRBs should be launched so that the financially weaker banks could be strengthened, a change in sponsor banks (including private banks) should be allowed, prudential capital requirements should be introduced and various other measures should be taken to ensure professionalization in their functioning. In practice, the amalgamation of RRBs was launched with great enthusiasm and a few other measures were taken up piecemeal but the essential prudential requirements and change of sponsor banks were ignored. Currently the original 196 small RRBs have been amalgamated into 82 larger banks and will be required to reach a capital adequacy ratio (CRAR) of 9% by March 2012; 40 of the 82 banks will need further recapitalization for this purpose. The recent Committee on the Recapitalisation of RRBs (Chaired by Dr K.C. Chakrabarty) has recommended that the authorized capital of the RRBs be increased from the present ₹5 crore to as much as ₹500 crore to facilitate expansion; a clear indication that the concept of RRBs as small, local banks contributing to financial inclusion has been formally abandoned. Far from establishing small banks (with minimum capital of ₹30 crore as recommended by the Raghuram Rajan Committee) the Indian financial system is thus moving firmly in the direction of larger and larger banks.

4.7 THE INFORMAL SECTOR 'CREDIT CARD' SCHEMES—A STEP FORWARD

The important Kisan Credit Card (KCC) scheme referred to in **Section 3** aims to provide financial support to farmers to meet their varied requirements, including the purchase of seeds and inputs for agriculture. Account holders under this scheme are allocated a card and a pass book which contains their credentials and also serves as an authentic identification document. The KCC is a far-reaching credit delivery mechanism since it provides a line of credit for 3 years subject to an annual review, with flexible repayment options and very limited documentation. Additionally, three-year Personal Accident Insurance is given to the KCC holder, which provides cover against death or permanent disability. In 2005, the RBI also introduced a similar General Credit Card (GCC) scheme for non-agricultural clients of banks in rural and semi-urban areas. For the GCC preference is given to women clients and credit up to ₹25,000 is dispensed as indirect finance to agriculture. These schemes have facilitated inclusion of small and marginal farmers in particular by replacing the earlier project-based lending that required expensive appraisal processes.

4.8 KYC AND IDENTIFICATION ISSUES—HELPING COPE WITH PRESENT-DAY CONCERNS

An important impediment to schemes like the 'credit cards' referred to above, are the KYC norms introduced by the RBI for the purpose of customer identification, monitoring of accounts and reporting of suspicious transactions to the appropriate authorities. KYC procedures also enable banks to know and understand their customers and their financial dealings to help them manage their risks prudently. The KYC guidelines define the customer as a *person or entity that maintains an account and/or has a business relationship with the bank*.

Among the key elements of the KYC procedure, customer identification was believed to be a major challenge to achieving financial inclusion. Since most excluded people belong to low income households and do not have identity or address documents it was difficult to insist on these documents as part of the KYC

norms. However, the banks still needed to ensure the integrity of the customer before opening of a bank account for any financial transaction. Considering these issues the latest RBI circular[18] allows flexibility in the requirement of identity and address documents for small deposit accounts. Such accounts are where the balances do not exceed ₹50,000 (for all accounts taken together) and where the total annual credit in all accounts does not exceed ₹100,000. In such cases, if the account holder is not able to produce documents the banks are allowed to open an account subject to introduction by another account holder who has completed the full KYC procedure, has an operational account for at least six months and certifies the photograph and address of the new customer. Alternatively, the banks can accept any other evidence of identity and address of the customer to its satisfaction.

Aadhaar project: The government expects the KYC problem to be addressed in the near future by the ongoing project for providing a Unique Identification Number (UID) for each of the citizens of India. *Aadhaar* is a 12-digit unique number which the Unique Identification Authority of India (UIDAI) will issue for all residents. The number will be stored in a centralized database and linked to the basic demographic and biometric information including a photograph, ten fingerprints and the iris of each individual. The project was launched on September 29, 2010 when the first set of UIDs was distributed among the inhabitants of *Tembhli* village in *Nandurbar* district of Maharashtra. *Aadhaar* is expected to be a powerful instrument for helping the poor by establishing their identities as well as reducing the cash and non-cash transaction costs for banks and their potential customers. The speed with which UIDs are provided to residents will further facilitate banks' penetration and therefore boost financial inclusion. Over a period of five years (*beginning 2010*) the Authority plans to issue 600 million UIDs.

[18] RBI, July 2010. Master Circular – KYC norms/Anti-Money Laundering (AML) standards/ Combating of Financing of Terrorism (CFT)/ Obligation of banks under PMLA, 2002.

4.9 BRANCH LICENSING—POLICY INCENTIVISES INCLUSIVE EXPANSION

Under the current laws of India, every bank requires a licence from the RBI for opening a branch. This legal requirement has been used as a regulatory tool for furthering financial inclusion. Statutory approvals for branch licences in more lucrative centres are linked to the number of branches opened in under-banked districts and states, as also other factors such as the fulfilment of priority sector obligations, offering of no-frills accounts and other parameters to gauge achievements in financial inclusion and customer service. Together with the RBI initiative of the BC model of branchless banking, the availability of licences as an incentive is expected to contribute significantly to the expansion of banks' outreach to unbanked areas leading to greater financial inclusion. Yet, until now, the statistics on bank branches in India show that, out of 600,000 habitations in the country, only about 30,000, or just 5%, have a commercial bank branch. The average population coverage per branch is 13,800, which is significantly higher than the 3,000-5,000 persons per branch common in financially developed economies.

In the last financial year, the RBI totally freed the location of ATMs from prior authorization. More importantly, in the October 2009 Policy Review the RBI took a major step to facilitate inclusion by liberalizing opening of branches in towns and villages with population below 50,000

by domestic scheduled commercial banks (other than RRBs). They are, however, required to ensure that at least one-third of such branch expansion happens in under-banked districts of under-banked states. This is also one of the criteria in the RBI's consideration of proposals by banks to open branches in major cities.

In addition, the RBI has also introduced a pilot project in the North-East Region for encouraging banks to spread their branch networks to untapped locations. It has prepared a list of 35 under-banked areas across five North-Eastern states. The RBI scheme offers viability gap funding in the form of one time capital for branch opening and a subsidy for operational cost for the first five years, provided the state governments are willing to make land available for setting-up the branch and providing for its security. However, this scheme has not taken off as no branch has yet been established under it. The scheme is apparently difficult to operate in far flung areas without local government support in providing security and basic infrastructure like electricity and water.

4.10 PAYMENT SYSTEMS—FACILITATING INCLUSION WITH A FEW SMALL STEPS

Payment systems/remittance services form a very important aspect of financial inclusion. The role of technology in providing access to such services is crucial. The efforts in developing an effective payment system are highlighted below:

- The National Rural Employment Guarantee Act (NREGA) was introduced to enhance livelihood security by providing at least 100 days of guaranteed wage employment in a financial year to every household whose adult members volunteer to do unskilled manual work. NREGA wage payments are now made through bank/post office accounts with job cards serving as the document of identity. The BC Model is expected to play a big role in ensuring access to bank accounts to NREGA workers in regions with limited banking facilities. By end-March 2009, there were some 16 million NREGA accounts at post offices.
- The National Payments Corporation of India is currently engaged in a project that will allow a recipient of a remittance up to ₹5,000 to use any BC outlet anywhere, even if he/she has no bank account, irrespective of the bank from where the remittance has emanated. It will also allow seamless transfers across banks using the new technology-driven payment products.
- The growth of mobile phone users in India (*more than 700 million in August 2010, TRAI report*) has been recognized by the RBI as a major facilitator for providing banking services. In this context, the RBI issued guidelines for Mobile Banking Transactions in October 2008. The guidelines permit banks to provide mobile banking transactions and mandate that all transactions must originate from one bank account and terminate in another bank account.
- The broad regulatory approach of RBI towards non-banks has been to permit these entities to provide payment services which are fee-based without access to funds of the customers. However, telecommunication operators as service providers have been permitted to enable 'm-wallet' facilities up to ₹5,000 in the interest of small retail payments.

4.11 INTEREST RATE DEREGULATION—ANOTHER SMALL STEP FORWARD

Until recently, interest rates on loans up to ₹200,000 in the priority sector were capped

at the prime lending rates of banks. RBI freed these interest rates from July 1, 2010 on condition that the banks ensure that the rates charged by them are reasonable and transparent. This change in policy was based on the view that financial inclusion can be viable and sustainable only if pricing is adequate to cover costs albeit with some cross-subsidization.

Since the base rate will now be the minimum rate for all loans, the credit flow to small borrowers can be expected to increase with direct bank finance at reasonable rates providing effective competition to other forms of high cost credit. Thus, the deregulation of interest rates is expected to promote financial inclusion with greater credit flow to agriculture and small business. It could also, together with other specific measures taken by the RBI for financial inclusion, draw borrowers away from the informal financial sector to the formal financial sector thus reducing the cost of credit for low income borrowers.

4.12 CONSUMER EDUCATION AND PROTECTION—VALUABLE EFFORTS...

Financial Literacy... Facilitates Inclusion in the Long Term

Financial education has been defined as the capacity to understand the rewards and risks of financial market products in order to make informed choices. Viewed from this standpoint, financial education primarily relates to personal financial education to enable individuals to take effective actions to improve well-being and avoid distress in financial matters. Financial literacy, therefore, is crucial for ensuring responsible borrowing by clients and responsible lending by financial institutions. It is, thus, essential for customer protection.

The following initiatives have been taken by the RBI to promote financial literacy:

- RBI has initiated 'Project Financial Literacy' with the objective of disseminating information regarding the central bank and general banking concepts to various target groups. One important instrument in this is the RBI website which is available in 13 languages. The financial education website link introduces the basics of banking, finance and central banking to children of all ages. Further, to generate interest, the complexities of banking, finance and central banking have been presented in a simplified comic book format.
- The RBI is furthering the financial literacy drive by collaborating with state governments across the country to include financial literacy in the school syllabus. It has launched a pilot in Karnataka in which materials on banking, personal finance as well as on the RBI are provided to the State Government. The Karnataka Government has adapted, translated and included much of this material in the curriculum for high school classes and this was slated to be used from the academic year starting June 2010. Based on this pilot experience, the RBI plans to mainstream this initiative across the country.
- The RBI has also advised the convenor-bank of each State Level Bankers' Committee to set up a financial literacy-cum-counselling centre (FLCC) on a pilot basis in one district and extend the facility to other districts based on their experience. These centres are expected to provide free financial education to people in rural and urban areas on various financial products and services, while maintaining an arm's-length relationship with the parent bank. FLCCs are not expected to act as investment advice centres /marketing centres for products of any particular bank. So far, 154 credit

counselling centres have been set up in various states of the country.

Consumer Protection Measures... have a More Immediate Impact

Issues related to consumer protection have been an important discussion point in the microfinance sector over the last few years. An issue which directly impacts microfinance customers is the provision of multiple loans to a single client by various MFIs leading to over-indebtedness. Lack of transparency in the pricing of products (interest rates) and harsh recovery practices are other issues. The RBI believes that better transparency, improved customer awareness of financial products and the development of effective grievance redressal systems are the way forward in ensuring consumer protection.

Acknowledging these concerns, the RBI issued a circular in May 2007 [RBI/2006-07/414] instructing the NBFCs to lay out appropriate internal principles and procedures in determining interest rates, processing and other charges and to share their actual costs (interest rates and other charges) with clients on a compulsory basis in keeping with the Fair Practices Code. The following are the main features of the code:

- The loan application forms of NBFCs should be transparent in disclosing the rate of interest and should also provide a comparison with terms and conditions of other competitor NBFCs to allow consumers to make informed decisions. The NBFCs should also devise a system of acknowledging receipt of all loan applications.
- The NBFCs should convey in writing to the borrower through a sanction letter, the amount of loan sanctioned and terms and conditions of the loan including the annualized interest rate. They should keep a record of acceptance of the terms and conditions of the loan by borrowers.
- The NBFCs should give notice to the borrower of any change in the terms and conditions including disbursement schedule, interest rates, service charges and prepayment charges. Such changes should only be effected prospectively. A suitable condition in this regard should be incorporated in the loan agreement. NBFCs should also release all securities on repayment of all dues or on realization of the outstanding amount of loan subject to any legitimate right or lien for any other claim NBFCs have against the borrower.
- The Board of Directors of NBFCs should also lay down an appropriate grievance redressal mechanism within the organization to resolve disputes arising in this regard.

A code of conduct has also been developed for the banking sector.[19] This has resulted from the RBI initiative in 2005 of setting up of the Banking Codes and Standards Board of India (BCSBI) in order to ensure that a comprehensive code of conduct for fair treatment of customers was evolved and adhered to. The BSCBI is registered as a separate society and functions as an independent and autonomous body. The BCSBI has evolved two voluntary codes; the first is a code of commitment setting out minimum standards of banking practices in dealing with individual customers, and the other is a code of commitment to micro and small enterprises.

The codes are applicable to all products and services offered by banks or their branches/subsidiaries including savings services, payment services, demat accounts, equity and government bonds, currency

[19] BCSBI, August 2009. 'Code of Bank's Commitment to Customers'.

exchange, loan products and card products. Individual complaints about non- adherence to the code are within the jurisdiction of the Banking Ombudsmen who also investigate individual complaints of non-adherence to RBI guidelines on customer service.

4.12 CONCLUSIONS—INCLUSION CONSTRAINED BY REGULATORY PRUDENCE

Indian policy makers and regulatory institutions (Government of India, RBI, IRDA) have laid out guidelines and developed regulations to promote and strengthen financial inclusion in the country. However, this facilitating regulatory framework has not yet gone far enough to overcome the extensive costs involved in the outreach to large numbers of people, often in dispersed locations with small value accounts. As a result, financial services institutions do not yet perceive financial inclusion as a viable business strategy. While a number of experiments and pilot projects have been launched for testing various business models and potential delivery mechanisms, the rolling out of inclusive financial services on a large scale will require the development of significant experience in this area.

More specifically, an analysis of the regulatory framework shows that:

There has been a significant set of regulatory and promotional efforts which, taken together, could be expected to have a substantive impact on financial inclusion. In sum, these are:

- The boost provided to the business correspondent model
- Introducing the concept of a no-frills account for small value transactions
- Enabling the provision of micro-insurance services through facilitating regulation
- Establishment of funds to finance promotional activities that support the above measures and reinforce the work of microfinance institutions
- Impetus to the cooperative credit system

along with a number of small steps that facilitate inclusion within the existing financial system

- Simplified KYC norms and interest rate deregulation for small value accounts
- An increased emphasis on devising payment systems that address the needs of low income families
- An investment in financial literacy and increased emphasis on consumer protection.

While these measures have served as facilitators and motivators for financial inclusion, they have also had some inbuilt limitations:

- The BC model met with limited success for four years before the decision to liberalize it was taken. Even today, its future success is yet to be determined given the non-existence of an established replicable business model. Use of the no-frills account is minimal despite its linkage to government welfare payments.
- Micro-insurance is yet to be rolled out in a big way outside the limited confines of micro-credit cover.
- The funds allocated to promote financial inclusion are administered within the traditional framework and do not sufficiently emphasize innovation The cooperative credit system has undergone several rounds of revival and yet its true potential remains to be tapped.

The challenges that need to be addressed to give a real impetus to financial inclusion are discussed in the next section.

5

Challenges to Achieving Financial Inclusion

The effectiveness of the regulatory and promotional measures for financial inclusion set out in the previous section is affected by a wide set of challenges. Some of these have to do specifically with poverty and the small size of transactions required by low income individuals while others are related to the cautious approach taken by policy makers and regulators.

5.1 BROAD CHALLENGES TO FINANCIAL INCLUSION

The broad challenges involved in financial access to low income families are set out below.

Socio-economic factors: Financial exclusion is closely related to the social exclusion of low income households, who are not able to access the available financial products and services due to constraints such as illiteracy, low income, low savings, unavailability of identification documents, and generally low levels of awareness.

Geographical factors: A review by the Rangarajan Committee shows that financial exclusion is highest among households in the Eastern, North-Eastern and Central areas of the country partly due to poor infrastructure coupled with remoteness and sparse population in some areas resulting in problems with access.

High operational costs: Most financial service providers are wary of providing products and services appropriate to low income families on account of the high transaction costs intrinsic to small value accounts with limited numbers of transactions. In the perception of bank managements this reduces financially inclusive services to corporate social responsibility rather than real business.

Limited availability of appropriate technology: The key driver of widespread financial inclusion is the proliferation of e-financial inclusion or the application of innovative, stable and reliable Information and Communication Technology (ICT). The challenge is to integrate the daily transactions done through hand held devices with the bank's main server. Furthermore, the devices should be capable of handling transactions related to at least four main types of banking products: savings cum overdraft accounts, pure savings products, remittance products and entrepreneurial credit such as KCC and GCC.

Inadequate banking products: Studies of no frills accounts show that poor people

prefer to transact with banks only if the latter provide overdraft facilities to meet emergency needs. Their needs are more often met by remittances and entrepreneurial credit such as KCC, GCC.

Financial inclusion and banks' business plans: Since banks have a tendency to view financial inclusion as a part of corporate social responsibility rather than serious business, financial inclusion is rarely core to the bank's business strategy. The lack of infrastructure and cost effective technology for facilitating small volume transactions at the doorstep of the account holder compounds the perception of high costs and thus discourages banks from providing financial services to low income individuals.

Greater emphasis is required on financial inclusion for the aged: The need for financially inclusive services has actually increased in recent years as the cost of social commitments such as health, safety and security has risen along with improved life expectancy. While people retire relatively young they need adequate funds to maintain their standards of living. The need for financial services such as insurance, remittances, reverse mortgage loans, facilities for pensioners and deposit schemes for the older population has grown over time.

5.2 PRODUCT SPECIFIC CHALLENGES

At the same time, there are challenges specific to financial products and services introduced/promoted by RBI for the dissemination of inclusive financial systems. Analysis of these challenges is crucial to an understanding of the issues that need to be addressed to improve the efficacy of financial inclusion initiatives.

5.2.1 No Frills Accounts

Ironically, though no frills accounts (NFA) have been designed keeping in mind the needs of vulnerable groups, but they are still not used by most of the NFA account holders. Some of the reasons identified for this are:

- *Distance from banks:* One of the main constraints to the operation of NFAs is physical access to banks. The costs of conveyance and the opportunity cost of the time required to reach the bank consumes a significant proportion of the savings of low income households and thus becomes an economically unviable option for them. Keeping this in mind, the committee on financial inclusion stressed the provision of banking services physically close to the account holders through channels such as mobile banking, formation of SHGs and provision of banking services through BCs.
- *Lack of information:* Information about NFAs is publicized either through the print media or websites. Mostly illiterate or semi-literate individuals living in remote areas are unable to obtain the information necessary to take advantage of the facility. Though the RBI has introduced the concept of financial literacy centres for providing counselling to the target clients it is yet to take off on a large scale. The efficacy of such centres in reaching the target clients is still untested.
- *Irregular flow of income:* The low income households for whom the NFAs are designed tend to have an irregular and uncertain flow of income; the frequency and amount of savings undertaken by such account holders is low and infrequent as well.

Challenge Faced by Banks

- *Reluctance on the part of banks:* Studies show that banks are also reluctant to open NFAs due to high account opening costs. A cost-benefit analysis of NFAs shows that banks are able to recover their maintenance costs but not their account opening costs.

5.2.2 Banking Correspondent/ Banking Facilitator Model

The BC model aims at developing and strengthening the relationship between the poor/excluded people and the organized financial system. The BC model has become necessary since it is not economically feasible to establish brick and mortar branches in all areas. Some of challenges faced by the BC model are given below.

Challenges Faced by Banks

- *Limited use by banks of the entities/ individuals eligible for BCs:* The RBI has widened the scope for appointing BCs by allowing banks to use the services of individual owners of fair price shops, PCO operators, authorized functionaries of well-run SHGs connected to banks. Interestingly, even though RBI permitted variety of individuals to work as BCs, very few have actually been engaged by banks. Indeed most of the banks have just taken the services of Section 25 companies promoted by technology service providers which make use of smart cards, biometric measures of account openings and other such measures.
- *Operational Risks:* The working group formed for assessing the progress of BCs identified cash handling by BCs as the biggest issue. The handling of a large volume of cash leads to logistical problems and added operational risks, particularly in the North East due to higher security risks, vast and difficult terrain and poor connectivity. Since BC staff often operates in isolation, there are high chances of fraud and misappropriation. There have been cases of miscommunication and failure to account for cash observed by the banks.
- *Cash settlement:* The regulations mandate BCs to complete accounting and undertake cash settlements within 24 hours of a transaction. It becomes difficult for BCs working in areas with accessibility issues to adhere to this.
- *Distance criteria:* The distance criterion of 5-30 km (depending on area of operation) is often restrictive. Banks find it difficult to get the necessary waivers from District Consultative Committees limiting their flexibility when operating in certain areas.
- *Reputational risks:* Banks are fully responsible for all actions of BCs and their retail outlets/sub agents. Hence they are required to carry out due diligence of individuals/entities prior to their appointment, as well as undertake systematic internal monitoring and control of transactions undertaken through BCs. Partly because of this the majority of banks have not been able to scale up their BC model beyond the pilot stage. Banks find it hard to assess the integrity, reputation, and cash handling ability of individuals acting as BCs. It is apparent that banks consider BC operations as fundamentally unprofitable. They focus on opening just no frills accounts through BCs due to a distrust of third party agents for credit evaluation. In other words the work of BCs has been curtailed essentially to that of business facilitators.
- *High costs of IT enabled financial inclusion:* Banks have been encouraged by the RBI to adopt IT enabled solutions to promote remittance systems and make

use of smart cards, mobile technology for the purpose. Such methods not only enable integrity but also prevent fraud by ensuring that transactions are documented on a real time basis. However the lack of robust technology (in terms of cost effectiveness), high costs of implementation, lack of suitable training to BCs and doubts among customers regarding the protection of confidential information stymie the proliferation of Information and Communication Technology (ICT) based solutions.

Challenges Faced by Business Correspondents

- *Lack of training:* Individuals working as business correspondents are allowed to service clients within a radius of 30 km. However many individual BCs face financial constraints that lead to low coverage by them. BCs tend to lack professional orientation, are irregular in the maintenance of records, delay the processing of loans and subsequently generate a low volume of business for banks. Such problems increase the costs associated with small value transactions and render the BC model unviable.
- *Low Commission:* Independent research (and the experience of M-CRIL's associated Section 25 companies) has shown that the commission structure (based on fees per transaction) available to BCs is not sufficient to cover their costs. Since the majority of NFAs opened by BCs remain inoperative, the transaction fees are also remain limited. Some BCs have also started functioning on balance-based fee model which ties the earnings of BCs to client account balances. This requires a long investment horizon for the BC as account balances take time to increase to levels at which the BC's revenue becomes significant.
- *High costs borne by BCs:* Banks charge interest from BCs for bank overdrafts or temporary accommodation provided to their staffand also the BC must bear the cost of transit insurance, security and transport. Hence the overall cost of operation is quite high for BCs.

Viability

The viability of BC operations is one of the major challenges of the model. Though sufficient data is not available to critically analyse this, a study of five Bank-BCs relationships (Eko Aspire Foundation/ SBI, IGS/Axis Bank, IGS/KBS LAB, KAS Foundation/ICICI Bank and Swadhaar Finances/ICICI Bank)[20] with data from 58,000 clients acquired by BCs over a period of 73 months, shows that out of the total per client revenue generated of ₹154.65, the credit revenue contributed the most with around 83% in comparison with revenues from deposit and payment services. However, for every rupee of revenue the cost of operations was ₹2.23 making the business highly unviable. The costing of the BC operation is illustrated in **Table 5.1**.

TABLE 5.1 Costing of BC Operations (per client).

Cost of	Amount (₹)	Revenue from	Amount (₹)
Staff	191.49	Credit	128.61
Operations	147.96	Savings	22.45
Capital expenditure	13.69	Payments	3.02
Others	10.96		
Total	346.09	Total	154.65

Hence it becomes apparent that banks need to allow BCs to offer a mix of transactions (in fact more credit related services along with deposits and remittances)

[20] Bansal Yeshu & Srinivasan N., June 2009. Article in CAB Calling "Business Correspondents and Facilitators: The story so far"

rather than simply concentrating on the opening of accounts. The key to the viability of the BC operations however, will be in achieving volumes.

Other Challenges

- *Restrictions on NBFCs to act as BCs:* The Rangarajan Committee suggested that NBFCs engaged in microfinance could actually be engaged as BCs for the provision of deposit and remittance services. The committee opined that the provision of such services would not lead to any conflict of interest as NBFCs are not permitted to undertake such activities. Furthermore NBFCs have the necessary, manpower, knowledge, skills and accessibility. It is in the case of deposit taking NBFCs that there is likely to be a conflict of interest and the risk of the mingling of funds. However, so far even microfinance NBFCs continue to be excluded from providing BC services along with other NBFCs.
- *Inappropriate targeting of clients:* The BC model has also been found to have been floated in areas which have easy access to banks and where clients already have bank accounts. Here the BC model functioned mainly as a provider of additional/convenient services for financially included people.

5.2.3 Financial Literacy and Credit Counselling Centres

One of the main impediments to the achievement of financial inclusion is limited literacy in general and financial literacy in particular. Some of the challenges faced by FLCCs as documented in the Mid Term Review of 2007-08 revealed that FLCCs were not functioning as envisaged by the RBI. Some of the main challenges identified are:

- *FLCCs as marketing centres:* Under the FLCC guidelines, counsellors must refrain from marketing and advertising their own products. However, the review revealed that the majority of FLCCs were operating as marketing centres and were simply promoting the banks' own products to the detriment of generic financial literacy.
- *Lack of training:* The FLCC staff should ideally assist and guide people to manage their finances most effectively. Hence, they should have sound knowledge of banking, law and finance and need to be equipped with social skills such as team work and effective communication. Upgrading of knowledge is also required to keep credit counsellors abreast of the latest developments in the banking sector. The review however showed that no formal training on financial management or social-attitudinal skills was provided to counsellors, and this hindered the provision of useful counselling.
- *Arms-length distance:* The banks are allowed to set up trusts/societies for running FLCCs; but the centres are required to maintain an arm length's relationship with the parent bank. Such steps are indispensable to prevent FLCCs from being viewed as marketing or recovery agents of banks. Since bank branches face monetary challenges and aim to minimize their costs, they tend to set up FLCCs in their own premises, inadvertently creating the impression that the centres are part of the bank.
- *Limited sensitization of banks:* According to the model scheme FLCCs are allowed to call joint meetings with banks to discuss their concerns and/or debt restructuring plans for distressed individuals. However, banks are yet to give due consideration to debt management plans prepared by FLCCs before they embark on recovery measures.

- *Limited number of FLCCs:* One of the key challenges for banks is to set up an adequate number of FLCCs within easy accessibility of vulnerable sections. According to the RBI monthly bulletin, banks had reportedly set up 154 FLCCs by June 2009 which is obviously inadequate in relation to the numerous districtsthat are yet to be covered.
- *Lack of awareness:* Lack of awareness among households also poses a problem since people can only use the FLCC if they are aware of the free availability of credit counselling services.

5.2.4 Kisan Credit Cards

A study on KCCs by NABARD reveals that 42.4million KCCs were issued by the end of March 2009. However, the scheme continues to face some challenges.

- *MIS related issues:* A NABARD commissioned study on KCCs revealed operational problems in the issue of KCCs. Some of these include the issuance of KCCs to more than one family member for the same operational holding, provision of multiple KCCs to the same person by different banks and renewed KCCs being shown as freshly issued ones. These miscalculations and incorrect information has led to inflation of the number of KCCs issued by as much as 50%.
- *Operational inflexibilities:* The KCC scheme intends to ensure flexibility in credit sanctioning operations such as issuance of ATM cards and cheque books. However, the study of KCCs showed that no banks or cooperatives provided any flexibility on the credit limit.
- *Inadequate credit limit:* Impact studies assessing the utility of KCCs shows that credit limits set under the KCC scheme are considered inadequate by a majority of farmers.
- *Elaborate documentation process:* The current application process is quite lengthy and requires farmers to make numerous visits to the concerned officers. Such conditions lead to delays in sanctioning of KCCs thereby forcing farmers to obtain credit from informal sources.
- *Lack of awareness:* Many farmers are not fully aware of the revolving cash credit facility available under the terms of the KCC scheme and end up using it mainly as a one shot loan facility.

5.2.5 Mobile Banking

Acknowledging the presence of over 700 million mobile phone connections in India, the RBI has permitted 32 banks to engage in mobile banking. However, the volumes of transactions undertaken through mobile banking have been slow to build up on account of various challenges faced by banks.

- *Difficulties in establishing partnerships with mobile service providers:* The banks have to enter into partnerships with various technology and service providers for facilitation of mobile banking services. However banks find it difficult to engage in such partnerships since mobile service providers (MSPs) do not open up channels for provision of mobile banking services by banks.
- *Security issues:* The operative guidelines issued by the RBI for banks state that the technology used for mobile payments should be secure and must maintain high standards of confidentiality, integrity and authenticity. In this regard mobile operators are also responsible for the security infrastructure, which is embedded in mobile instruments. One of the major challenges in this regard is also the natural resistance and apprehension about security amongst most of the mobile customers.

- *Lack of support for all handsets:* Mobile services faces insecure conditions such as low-end handsets with limited or no internet connectivity. At present there are various handset models and Mobile Operating System (MOS) variants.

5.3 CHALLENGES IN OFFERING MICRO-INSURANCE

As part of the initiative to expand micro-insurance services, many insurance companies are now tapping previously unexplored semi-urban and rural areas. The spread of insurance however, has been slow. At present, the penetration of life and non-life insurance is very low at 10% and 0.6% respectively. The following are some of the key challenges

Challenges Faced by Insurance Companies

- *Suitable products*: One of the biggest challenges for insurance companies is to design suitable and affordable insurance products. An analysis by Consultative Group to Assist the Poor (CGAP) states that actuarial/mathematical analysis to determine the likelihood of risk is difficult due to the high degree of volatility and lack of reliable data about the economic lives of low income clients
- *Distribution channel*: The distribution channels for micro-insurance have not been efficient enough to handle small value financial transactions. Further, majority of the institutions distributing micro-insurance have not been able to garner trust among low income customers with respect to the claims procedure.
- *Marketing:* Studies of the requirement for and viability of micro-insurance show that poor people are not able to comprehend the meaning or importance of insurance and are inherently biased against it. Low-income families are not able to plan for the future due to extreme income volatility and, as a result, are sceptical about the payment of premium for future risks. The insurance companies face problems specific to insurance types as well; for example health insurance is difficult to sell in remote areas due to the lack of availability of basic health infrastructure.

5.4 CHALLENGES FACED BY THE COOPERATIVE SYSTEM

- *Supersession of boards*: The SCBs and DCCBs face major managerial and governance issues, which leads to their frequent supersession. On March 31, 2009, nearly a third (32%) of the reporting SCBs and around 45% of DCCBs were facing supersession of their respective elected boards. The supersession of the board takes place on the occurrence of any or all of the following conditions:
  (i) If the societies incur losses for three consecutive periods, or
  (ii) If serious financial irregularities or fraud have been identified, or
  (iii) If there are judicial directives to this effect or there is a perpetual lack of quorum.

Challenges Faced by Primary Agriculture Credit Societies (PACS)

- *Low mobilization of savings*: PACS were formed as rural credit and thrift societies, which were supposed to depend primarily upon member savings forthe provision of credit to rural borrowers. However their members see PACS solely as a means of obtaining credit and limit their savings with such societies. Recently PACS themselves have also not made substantial efforts to mobilize

savings, and this has ultimately affected their sustainability and profitability. Recent information on PACS shows that the borrowings of PACS were almost double their deposits.

- *High risk portfolio*: The high number non-performing assets (NPA) of PACS has accentuated the inadequacy of the cash flow (coupled with low savings mobilization) to fulfil the credit needs of members. The cause of NPAs has been weak governance and management of these institutions. The NPA of PACS have been increasing over the years - from 26.9% in March 2007 to 36.6% in March 2008 and 59.2% in March 2009 [*NAFSCOB 2009*].
- *Decreasing diversity of members*: The absolute number of members of PACS has seen a continuous rise over the years; however the share of rural artisans, SC/STs as a percentage of members has declined. In 2002–03, 6.1% of the members were rural artisans, whereas in 2007–08, the proportion dwindled to 3.6%. Also the members who receive credit are mainly farmers. This suggests that many members of other communities (SC/ST) and rural artisans are not able to obtain credit from PACS.

Finally, the RRBs have been specifically discouraged from functioning as small banks with a local interest, in the belief that imitating the processes of large banks will somehow make them professional and viable whereas what is really required are reforms in governance and management and changes in their operational structure by returning them to the small regional level banks they once were – perhaps not limited to 3 districts but likely to be viable in a 10-15 district operational area. A historical opportunity to turn them into the small banks recommended by the Raguram Rajan Committee appears to have been foregone.

5.5 CONCLUSIONS—WHAT ARE THE CHALLENGES AND HOW CAN THEY BE OVERCOME?

It is apparent from the discussion in this section that the task of increasing and maximising financial inclusion faces major challenges. These cover a range of issues including:

- The social exclusion of low income families which results in the barriers of illiteracy, inhibition and poor physical access; it limits awareness, ability to overcome prejudice about their bank-worthiness and enhances the transaction costs incurred by them in using the financial services available in the country.
- The small value of accounts and transactions expected by the banking system from financially excluded families which results in high cost of operations and limits the incentive to serve them.
- The lack of understanding of products and services appropriate to the needs of low income families resulting in static approaches like the no frills account where it has become apparent that mere availability is not the issue.
- Limited experience with business models suitable for small value accounts and doorstep service delivery resulting in the slow adoption of mechanisms such as the business correspondent model.
- Historical problems such as the governance issues facing the cooperative credit system and RRBs which need a substantial effort to discipline and reorient thinking, an effort that requires political will in short supply in a system that is geared to populist thinking on account of frequent elections at various levels of government.

It is apparent that there is a huge task ahead in overcoming these challenges to financial inclusion. Most efforts are

concerned with augmenting the supply side without adequate recognition of the long term potential of demand side measures such as effective financial literacy programmes. Initial pilots have amply demonstrated the significant difference that an aware client can make in the manner in which financial products and services are delivered to and used by her.

6

The Way Forward

The Government of India is committed to ensuring financial inclusion for the entire population and this intention has been reflected in the policy initiatives taken over the last few years. Various policies have been stimulated by the recommendations of the committees set up for suggesting strategies to promote financial inclusion and improve the health of rural financial structures.

Over the past 4-5 years, as financially inclusive policies have been put in place, financial institutions have also started experimenting with different models for reaching the excluded and offering them various services. With the overall framework in place, it is now time to focus on large scale implementation of the suggested policies. As discussed in the previous section, and based on the collective experience so far, it is apparent that a few issues continue to decelerate the progress towards financial inclusion.

6.1 DO BANKS SEE THE BUSINESS POTENTIAL OF FINANCIAL INCLUSION?

As part of the renewed emphasis on financial inclusion, the six lakh villages (including 72,825 unbanked villages with population >2,000) have been allocated to various banks for coverage by 2012-15. The banks have also been advised by the RBI to submit their financial inclusion plans, integrated with their normal business plans, and approved by their Board. While this measure undoubtedly encourages the banks to give the activity some impetus, the question remains whether banks see true business potential in the delivery of financially inclusive services or whether they view it as a regulatory requirement that they need to adhere to in order to continue to do business in the more profitable segments. Over the decades since the first wave of bank nationalization in 1969, the regulations have required the financial institutions to go down-market and to financially excluded areas.

While much has been achieved under the regulatory framework, what has been done by the banks seems to have been the minimum necessary to allow them to gain approval. Thus, while significant areas of the rural hinterland of the major states are now reasonably served with banking services; parts of central India, the hill regions and the northeast as well as many of the poorest areas of eastern India continue to be sparsely banked. Even where banking services are available in these regions they cater to the

needs of the creamy layer of large farmers, traders and, where relevant, production activities. The engagement of banks with low income families has been essentially in response to directed programmes such as Integrated Rural Development Programme (IRDP) and, more recently, KCC and no frills accounts along with a plethora of schemes for marginal farmers, youth, and micro-enterprises. All of these are high cost activities and are often seen as obligations upon the normal business of the bank. In some cases, in order to boost their priority sector lending; banks also enter into buyouts of MFI portfolios.

Thus, as the discussion in this report illustrates schemes to promote financial inclusion have had limited impact. When there is some traction, as in the case of the KCC, it is the upper band of the target clientele that has reaped benefits. The banks' lukewarm response to these schemes has also affected the momentum of their roll-out to some extent. However, if bankers saw significant business potential in these activities a more dynamic rollout with real momentum would be possible. Thus, even the untested and unproven business correspondent model remains limited to technology service providers opening no-frills accounts that are mostly dormant.

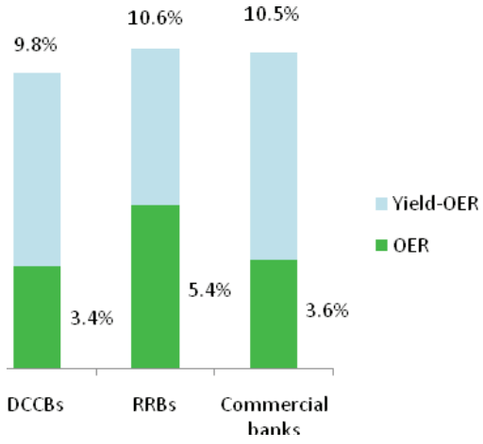
In this context, as an institution whose promoters have been engaged with issues of microfinance and financial inclusion for more than three decades, M-CRIL has a deep understanding of the issues. The two key problems emerging from this report and M-CRIL's overall experience are set out in the following sub-sections.

6.2 THE IMPACT OF INTEREST RATE DE-REGULATION

It has been repeatedly observed in this report that low transaction volumes in small value accounts entail very high proportionate costs for the banks. For many years bankers were required to cross-subsidize financial inclusion activities. They had to offer small value services to low income families at the lowest interest rates in the system. The well-known differential rate of interest scheme (requiring banks to lend at 4% interest, well below their cost of funds) still exists, although it now accounts for a minuscule proportion of their total portfolio. Even after general interest rate deregulation in the late 1990s, interest ceilings (defined as the prime lending rate, the minimum, 'risk free rate' to be charged by the bank) continued to exist for small value accounts. As a result it has become ingrained in the public mind that 'loans for the poor' should be subsidized. The reality of credit rationing resulting from such subsidies is however lost on the average observer.

In the past months, all interest rate regulation has been abandoned. This change must be welcomed in that it constitutes official recognition that bankers must be allowed to determine the parameters of their own business. However, all circulars from the RBI and the government continue to retain the underlying message of reasonableness. While there is no case for profiteering from those affected by poverty, it most likely implies some element of cross-subsidization must continue. This would inevitably result in a higher than optimal

FIGURE 6.1 Yields in the Banking System.



price for those provided services on a viable basis and a lower than optimal volume for those receiving subsidized services.

It is notable that the rural banking system (consisting of the DCCBs and RRBs) has not had to follow interest rate regulation for around a decade now. Yet, at no point has it felt free to charge much more than the commercial banks for the apparently more inclusive services it provides. A study by M-CRIL in 2008-09 showed that the average yields of DCCBs and RRBs were not significantly more than the 10.5% average yields of commercial banks (in 2007-08) despite the RRBs operating expense ratios that were significantly higher (see **Figure 6.1**). While DCCB operating expense ratios were lower this was largely on account of most origination expenses being borne by the loss making PACS. Hence as it turns out the lower yields of the cooperative banks actually come at the expense of the target population that they are trying to protect as it is ultimately members who must bear the losses of the PACS.

There is no evidence so far of bank managements charging higher interest on financial inclusion products despite the higher costs of such services. This limits the business potential of financial inclusion. Thus, the services available remain limited in volume (small value SHG loans and non-functional no-frills accounts) and lacking in innovation. Ultimately, as a result, low income families continue to remain excluded and the legendary, rapacious moneylender flourishes in providing the only real financial services available to low income families.

6.3 PRUDENCE IN REGULATION AND PROMOTION IS PERHAPS A CASE OF 'NO RISK, NO RETURN'

The discussion in the earlier sections has shown extensively how financial regulators and the government in India have opted for prudence in relation to financial inclusion rather than bold, even adventurous, experimentation. While the easing of KYC norms and the launching of an extensive financial literacy programme are excellent long term measures, some examples of the limitations of a cautious approach are discussed below.

1. The prevailing environment of low cost, cross-subsidized inclusive finance products to improve the availability of financial services to low income families have proved to be a detriment to volumes as well as to experimentation and innovation.
2. In an effort to regulate the business relationship between financial service providers and clients, the business correspondent model was constrained for four years on pricing and by stipulations on who could and could not be a correspondent. The prevention of microfinance NBFCs from playing the role of BCs continues to be a limitation on outreach, since it is these institutions that have a financial relationship with the largest number of low income families, as well as on the functioning of MFIs since they continue to have a uni-dimensional 'credit only' relationship with their clients. A more holistic relationship would not only protect such families as borrowers) but would also create a more secure savings environment for them.
3. Similarly, in the case of the micro-insurance regulation there are significant rules governing the relationship between the insurance company, their agent and the client. Again microfinance NBFCs are allowed to be distributors of insurance but not agents resulting in significant, and unproductive, attempts at regulatory arbitrage rather than a direct concentration on the rolling out of products to large numbers of clients.

Reducing some of these constraints would provide the much needed impetus to financial inclusion in a market that remains minuscule.

4. The KCC, an excellent idea from the perspective of the user, is constrained and ill-administered on account of the limited interest rate (just 9% on crop loans) earned by the banks. The margin between the cost of funds and the lending rate is insufficient to cover both the administrative cost and the high risk associated with agricultural lending. Hence, this has led to problems in the KCC which has low credit limits and tedious documentation procedures.
5. There have been repeated attempts to revive the cooperatives with cash injections to wipe out losses, provide training to managers, and recently also to improve the information technology environment. However, the real issue is the governance of these institutions. In order to effectively address this concern, it will probably be more suitable to revitalize the RRBs through privatization thereby promoting financial inclusion.

In the context of most of the issues discussed above, both regulators and the government have sought to protect the poor and adopted a restrained approach to minimize risk. While this may be seen as a prudential approach, embracing a more adventurous and bold line of action is more likely to maximize welfare implications of the various financial inclusion strategies. Some questions that need dwelling on are:

- Does the lack of deposit services for the poor result in more loss of savings through theft from their homes than what would result from any institutional misappropriation?
- Does the lack of cover due to an inefficient claims management system for microinsurance cause more welfare losses for the poor through variable incomes and insecurity than any claims misappropriation by local institutions would cause?
- Do low priced products necessarily mean low volume availability?
- Do 120 million low income families deserve to be financially excluded?

Perhaps the price of prudence in the regulation and promotion of financial services for low income families is substantial welfare foregone. Perhaps this price is substantially higher than the risk associated with a bolder, more experimental approach. It is a matter of consideration for all stakeholders involved.

Case Studies of Financial Inclusion Initiatives

Over the last couple of years, a number of new initiatives have been started by various stakeholders to contribute to the financial inclusion drive. The following annexes set out the effects of some of the individual efforts to extend financial services to the excluded population in rural as well as urban areas.

C.1 EKO MODEL—BANK ACCOUNTS FOR EVERYONE (by Orlanda Ruthven)

State Bank of India (SBI) appointed Eko Aspire Foundation (EKO) as its BC and on February 23, 2009, they launched SBI Mini Savings Bank Account at Uttam Nagar, New Delhi. The account holders can do a host of financial transactions including deposit and withdrawal from their accounts at SBI-Eko CSPs. The EKO model works on the fundamental premise of giving everyone a bank account.[21] The attempt of EKO is to build a scalable model using mobile technology. EKO expects that technology will bring down the cost of operations and effective use of existing distribution networks will make the model viable.

[21] EKO Website. http://eko.co.in/about_us.

Model

The key to EKO-SBI BC's 'no frills account' model is that small savings are paid to the bank up front by 'super agents' partnered with EKO, so that there is no cash risk to the bank (i.e., the bank gets the deposit capital it wants upfront, placed in non-interest-bearing accounts) nor to EKO (since controlling for this would be the single most significant cost for such a programme and the risks would multiply with such an outsourced model). Here's how it works:

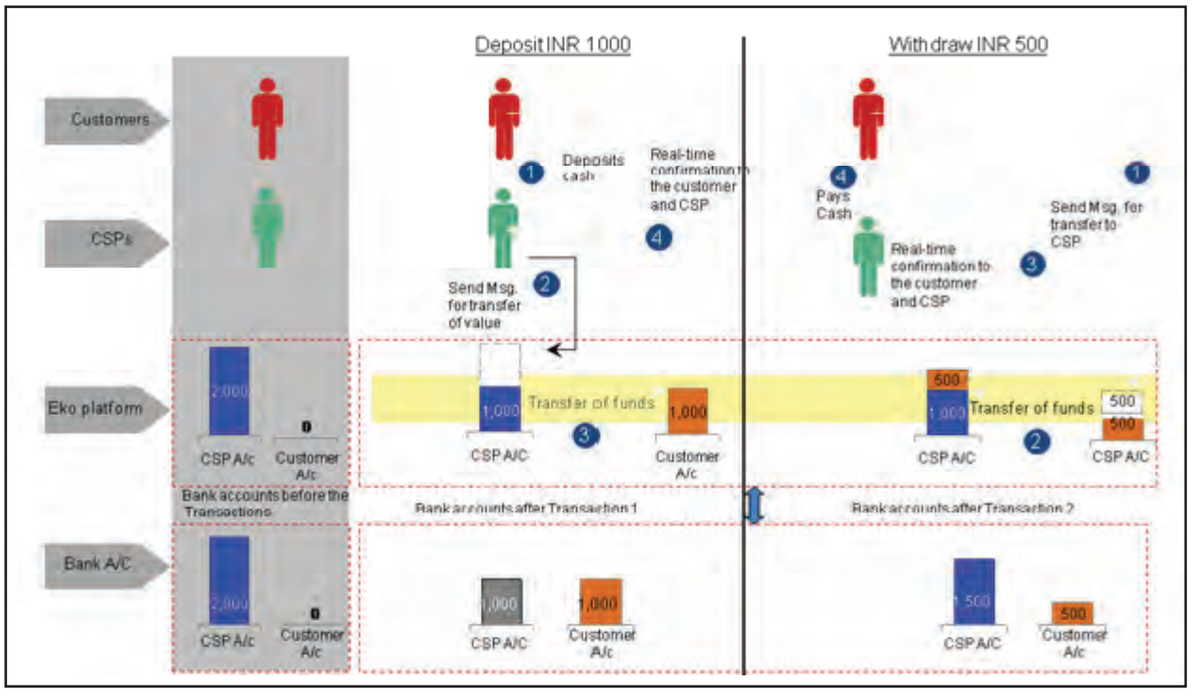
- Super Customer Service Points (SCSP) deposit lump sums in their SBI accounts. They are traders/ distributors operating in a range of FMCGs, with existing relationships to retail shops in the market.
- The CSPs, retail shops working under SCSPs, pay smaller lump sums and have their accounts credited accordingly.
- CSPs take small deposits from clients, to the value of the credit in their account, in the process crediting the clients' accounts and debiting their own. Conversely when CSPs cash out customers, they debit their accounts and credit their own.

- CSPs pass this cash to SCSP, who then replenish CSP's credit with the sum of cash collected.

If a CSP has too much electronic balance as a result of servicing withdrawals, they have the option of doing a similar withdrawal in lieu of cash with their SCSP to bring down their electronic balances to optimal levels.

EKO follows the principle of a pre-paid distribution pyramid, e.g. for fast moving consumer goods (FMCG) and mobile telecom. The retail points (CSPs) are effectively recovering investment already made by 'distributors' at higher levels of the supply chain. As retail shops, CSPs are familiar with this approach and can understand their role in this way. The model is illustrated in **Box C.1**.

Box C.1: EKO's Cash Management System



Note: CSP can accept only to the extent of float he has with EKO, CSP replenishes electronic and physical cash with super CSP
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Outsourced structure

EKO has 45 staff, 15 of whom are in Bihar, 30 in Delhi. Till August 2010, 75,000 accounts had been opened. The structure is lean because the bulk of functions are outsourced, leaving EKO staff to play only a small number of critical roles, which include: selection, training and ongoing mentoring of CSPs; identification of and liaison with SCSPs; liaising with the bank to agree sequencing and rollout of their products; awareness & package material development; development of the technology to support products; management of outsourced activities, and model and business development. The daily functioning of the 'distribution channel' is wholly outsourced to a combination of the SCSP and his supervisors, and the CSP retailers.

Each CSP handles as many accounts as his capacity and some are now up to 200,

each located at least 1-2 km apart from the next (depending on geography). Delhi currently has 60 CSPs (east, west, south) and 8 SCSPs. Each CSP is visited daily, not by EKO staff, but by a 'field sales executive' (FSE) who is an employee of the SCSP. As well as assisting the CSP in his role, the FSE collects or provides cash based on the net-position of the CSP, provides account opening forms and kits, places product communication material and resolves issues that arise for customers that the CSP is unable to address. FSEs are themselves trained and monitored by EKO's junior-most tier of staff, Territory Sales Managers (TSM), and one TSM might have a team of 7-8 FSEs to handle across 1-2 SCSPs that serve up to 300 CSPs.

As well as outsourcing the core 'distribution channel', other functions are outsourced and carried out through tight strategic partnerships, e.g., form processing and document management; the call centre which assists clients with any range of questions; technology partners who handle the servers and back-end processes, and the printers who issue marketing materials, booklets, etc. The majority of EKO's staff have no desk in their single south Delhi office but are permanently on the road/ in the market.

The biggest constraint on growth is finding the resources to build the capacity required at CSP level (since the brand, more than deposits per se, is constantly 'at risk' if messages are poorly communicated). SBI has recently started charging for products to its 'no frills' customers in response to new RBI guidelines (December 2009). SBI will pay Eko a portion of the fees collected from the customer, thus making Eko sustainable.

Products and charges

EKO is offering two variants of SBI's no frills savings account:

(i) Account opening fee of ₹100 and cash-in/ cash-out transactions charged at ₹2 on each transaction.

(ii) Account opening fee of ₹100 and ₹100 per year for unlimited cash-in/ cash-out transactions (levied in advance).

For both, transfers are charged at 3% up to ₹2,500 and 2%, above.

All transactions are done by simply dialling into a mobile phone. The dialled 'string' consists of a series of 4 numbers separated by star key and terminated by hash, e.g., *543*recipients mobile number*amount*signature#. The first number (543) indicates to telecom switch that this 'string' needs to be delivered to EKO's platform; the second number (phone number) doubles as account number; the fourth number (signature) is a key provided in the personalized 'okeykey' booklet given by EKO, combined with the 4-number pin which each client is required to remember. This means clients don't have to go to the CSP unless they wish to deposit or withdraw cash. They can transfer from their own to another account, or between their EKO accounts, without going to the CSP, unless they need to take his help.

Transfer facility, crucially, is not limited to account holders (at either end): anyone can go to a CSP and deposit cash into an EKO-SBI account (whether or not he has an EKO account at another CSP), charged at ₹25 per transaction. Even more surprising, the recipient doesn't have to have an EKO account but can be a regular SBI account holder. This opens up huge potential for a new transfer service. 98% of accounts so far opened, however, have only used deposit and withdrawal facility though transfer facility is available and catching on fast.

Eko is also in a partnership with Bharti Axa Life Insurance, retailing low cost life insurance policies (Bharti Axa Bachat Bima). These are savings-linked policies starting at ₹499 per year and offering the flexibility of

top-up premiums, with the sum assured at death 5 times the account balance.

Future plans

EKO-SBI accounts are technologically integrated, with the core banking systems operating for 'no frills accounts'. However, while 'no frills accounts' offer customers an overdraft facility (4 times the minimum balance successfully maintained over several months), these are not yet available through the BC but will be shortly. Eko is also in discussions with SBI to allow customers to deposit cheques into their accounts.

EKO will explore opportunities to engage with employers to access payroll salaries directly in to accounts, thereby offering a reduction in paperwork and supervision during payment process and fuelling improved access to banking by the waged poor. The only experience with this so far is a temporary desk which EKO sets up in the ESIC office (East Delhi) to open accounts for recipients of disability pension (previously these individuals were not able to receive the money since they had no bank account).

In the next one year, EKO aims to engage around 8,000 CSPs in Delhi and Bihar in order to provide convenient access to the unbanked population.

C.2 IIBF—CAPACITY BUILDING OF BCs FOR EFFECTIVE SERVICES

Reserve Bank of India permitted banks to use the services of intermediaries in the form of business correspondents (BCs) and business facilitators (BFs) to increase their outreach in the country. Banks can thus engage in having more manpower but without investing in brick and mortar infrastructure. For this to happen in large numbers, banks have to outsource services through BC/BF across the country who are not employees of the bank but act as their agent. Banks are required to conduct due diligence of the entities providing the services of BC/BF.

One of the challenges faced by the individuals employed as BC/BF is the lack of training. They lack professionalism and guidance. A large number of people outsourced as BC/BF agents need professional training and technical knowledge of banking services. To cater to this demand (though somewhat latent) of both banks as well as BC/BF agents Indian Institute of Banking and Finance (IIBF) offers certificates course for BC/BFs.

About IIBF

Established in 1928 as a Company, IIBF, formerly known as The Indian Institute of Bankers (IIB), is a professional body of banks, financial institutions and their employees in India. During its 80 years of existence, IIBF has emerged as a premier institute in banking and finance education for those employed in the sector, aiming for professional excellence. Since inception, the institute has serviced over 8 lakh members and awarded over 5 lakh banking and finance qualifications, viz., JAIIB, CAIIB, Diploma and certificates in specialized areas.

With its membership of over 662 institutional members and over 3.45 lakh individual members, IIBF is the largest Institute of its kind in the world and is working with a mission 'to develop professionally qualified and competent bankers and finance professionals primarily through a process of education, training, examination consultancy/counselling and continuing professional development programs.'

The Institute is managed by a Governing Council comprising eminent persons from the banking and finance sector, academics and professionals. The day-to-day management of the institute is the responsibility of the Chief Executive

Officer (CEO) with support from the Deputy CEO.

IIBF is a 'Distance Learning' institute. In order that the candidates who appear for the examinations get adequate knowledge inputs, the institute offers various educational services. The pedagogy of distance learning offered by the institute is (i) publishing specific courseware for each paper/examination; (ii) publishing work books; (iii) tutorials through accredited institutions; (iv) contact classes; (v) virtual classes; (vi) e-learning through portal; and (vii) campus training for selected courses.

Course for BC/BFs

Genesis: The genesis of the idea for launching a course for BC/BFs stemmed from Mr R. Bhaskaran's (CEO, IIBF) initiative of educating the farmers through *Krishi Vigyan Kendras* (KVKs) and Farmer Training Centres (FTCs) using DVDs. He believes that financial inclusion cannot happen without financial literacy and as CEO of IIBF he endeavours to contribute to this cause.

Mr Bhaskaran had written a book 'Inclusive Growth—thro' Business Correspondent/Facilitator' which is currently used as the textbook for the training of BC/BFs. The course was launched on April 23, 2009. In the first year 241 candidates enrolled for the programme.

Course objectives: The main objective of the course is to provide basic knowledge in banking operations and help the candidates in developing an overall understanding of the following aspects:

- Role/functions of banks
- Basics of banking operations & procedures
- Role and function of BC/BFs
- Financial advising and counselling
- Various forms/documents used in banks

The aim is to expose the individual BF/BCs to current developments in the field and upgrade skill-sets to enable them to relate better with the rural people.

Courseware: It is expected that BC/BF person should be equipped with adequate knowledge of banking and banking operations, bank-specific rules, norms and procedures related to acceptance of deposits and lending to the public. In addition, they should possess the skills for communication, interviewing, marketing and cross-selling. These are essential and necessary to enhance their effectiveness in information-gathering and customer-profiling. BC/BF aspirants need to learn the basics of banking, banking products and debt counselling.

This course is intended to further the cause of rollout of services to people of those areas where there are no bank branches and to those who have so far remained 'financially excluded.' The courseware book gives an overview of the basics of banking, the structure of banking system and the functions performed by banks. It also exposes the reader to various types of deposits and different relationships that banks forge with customers while extending banking and other services. While opening a customer's account, banks need to follow KYC norms, with permitted relaxation to rural customers, details of which are covered.

The training process: IIBF has accredited 14 institutions to provide BC/BF training after completing due diligence. These institutes are recognized for-profit institutions that specialize in training like Rudseti's. The training is of 5 days conducted at a place which is easily accessible to the BCs. To ensure that the quality and standard of training across the country is maintained, the institute offers a training of trainers (ToT) programme to the faculty of accredited institutions who handle the training to BC/

Business Correspondent/Business Facilitators Course

Target Group

- Persons working as Business Correspondents /Business Facilitators
- Employees of BC/BFs providing banking and finance related services
- Persons aspiring to make a career in this field.

Eligibility: Candidates with SSC/SSLC/Matriculation or equivalent qualification will be eligible

Application process: Application forms to be downloaded from the website www.iibf.org.in.

Examination Fees: Total fee per candidate is ₹4,000 which include ₹1,000 for certification. In case a candidate is not able to pass the examination in first attempt, fee for each of the subsequent attempt is ₹750.

Medium of examination: English, Hindi, Bengali, Kannada, Marathi, & Telugu

Course stages: Six stages as outlined below

(i) Self paced study of correspondence training material
(ii) Training for 5 days with accredited institutions
(iii) Obtain Training Completion Certificate from the training institute
(iv) Apply for Examination of the Institute enclosing the training completion
(v) Appear and pass the Examination
(vi) Get Pass Certificate from the Institute

Periodicity of examination: Normally once a month. IIBF announces from time to time.

Examination Pattern of IIBF: 60 multiple choice questions of 75 minutes duration

Courseware: Book published by the institute 'Inclusive Growth- thro' Business Correspondent/ Facilitator'

BFs. The accredited institutes coordinate with the banks and ensure that exam is conducted as and when the training is complete.

In view of the fact that candidates taking up BC/BF examination may not be matriculates and may lack proficiency in English the Institute has conducted the examination in 6 languages—Bengali, English, Hindi, Kannada, Marathi and Telugu in 2009–10. Recently (November 2010), the textbook has also been published in Malayalam (in addition to Hindi and English) and it is expected that the BCs may be soon able to write exams in Malayalam as well. IIBF plans to bring out the courseware book in other vernaculars also. Books in Marathi and Bengali are ready for release and in another month's time books in Tamil, Kannada and Telugu are also expected to be published. All books are released in SLBCs to ensure that the banks know about it.

Outreach: About 398 BC/BFs have been trained by IIBF till now. SBI and PNB have mainly taken a lead in identifying the BCs and sending them for training to IIBF. IIBF has also trained a large pool of 300 master trainers at PNB to enable them to directly train their BCs/BFs.

NABARD support to IIBF course

NABARD extends support to the course by way of partial/full reimbursement of the

course fee to successful candidates through the Financial Inclusion Fund. The support is 100% of course fee for 256 districts identified by the committee on financial inclusion and 75% for rest of the districts banks have to IIBF forwards the claim received from banks to NABARD. Out of total course fee of ₹4,000 (including certification), ₹3,000 is reimbursable from NABARD while ₹1,000 is contributed by the participating banks. IIBF consolidates the claims received from banks and Section 25 companies and submits to NABARD on quarterly basis for reimbursement.

Challenges

NABARD is also providing support to FINO for a similar programme on providing training to BC/BF. There is a need to develop knowledge collaboration among them to ensure standardization and quality assurance.

A number of BC/BF agents in the field operate without any formal training. As of now RBI has not made training for BC/BF mandatory which also limits the interests of individuals in getting certified. Mr Bhaskaran feels that the certification cost can come down to ₹1,000 per person if there are 20,000–30,000 BCs available every year for training and training/certification is made mandatory by banks.

C.3 DRISHTEE MODEL OF BC

This case study is of a three year old project, which is currently going on in selected districts of Uttar Pradesh, Bihar, Assam and Mizoram, wherein BC services were provided by Drishtee after entering into a tri partite agreement with for-profit Technology Company, A Little World and leading public sector and private sector banks.

The BC: Drishtee is a Noida (Uttar Pradesh) based social enterprise focused exclusively in rural areas and aims at employing Bottom of Pyramid (BoP) approaches/technologies for upliftment of rural poor. It commenced its BC/BF services three years back and partnered with State Bank of India (SBI) and Housing Development Finance Corporation (HDFC) for its operations. Currently Drishtee works as a BC in selected districts of Uttar Pradesh, Bihar, Assam and in some areas of Mizoram. The reasons for becoming business correspondents of SBI and HDFC as stated by Drishtee were the wide coverage of SBI and localized presence of HDFC in above mentioned districts.

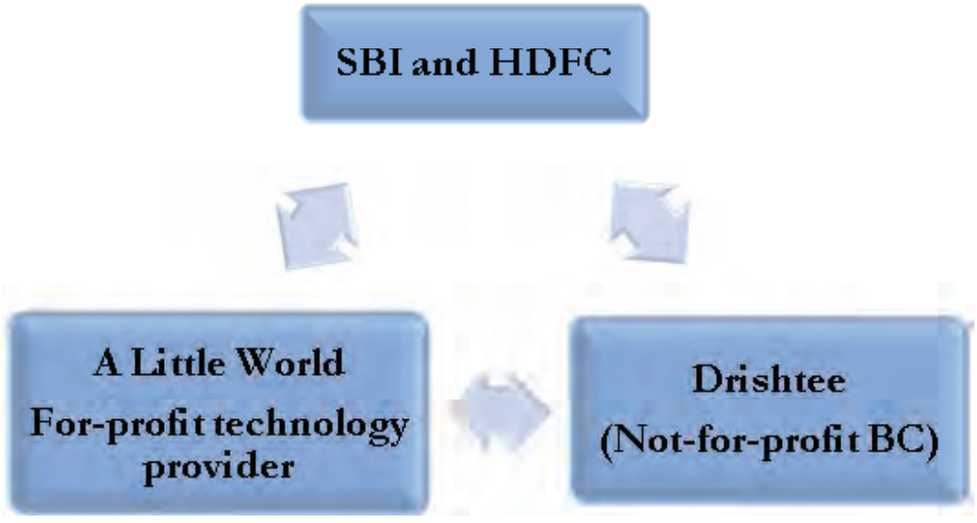
The technology provider: The technology provider for Drishtee is A Little World (ALW), a for-profit technology company, which develops low cost technology solutions for carrying out financial transactions. ALW is one of the country's major technology providers and endeavours to provide financial services through innovative technology solutions to those at BoP. Presently ALW provides RFID[22] smart card enabled technology to undertake banking activities.

The operational model

SBI has two core systems for provision of technology and business correspondents have a choice to select any one of the alternatives. Under the first alternative, BCs develop and use their own core technology after getting it verified from SBI. Alternately, SBI can get its technology developed from various technology providers and BCs can choose any one suitable vendor. Keeping this in mind, Drishtee entered into a tri

[22] Radio Frequency Identification (RFID) is a technology that works by a means of a small data storage device.RFID allows the user to track, monitor, report and manage products, documents, assets and people more effectively and efficiently as they move between locations anywhere at any time. [http://rfid.bemrosebooth.com].

Box C.2 BC Arrangement



partite agreement with State Bank of India and technology provider ALW. The arrangement among the three parties is depicted in **Box C.2**.

- *Operations*: Drishtee operates as a business correspondent through its kiosks, which are run by village level entrepreneurs, who work as BC agents. The BC agents are responsible for acquiring new business, taking care of daily bank related operations, whereas Drishtee takes care of administrative functions such as business flows, release of agent's commission. Additionally, Drishtee has also appointed its local teams in rural areas and each team is responsible for over viewing the functions of 5 to 10 BCs. The BC agents work as a local cashier to banks and are responsible for deposit making, withdrawal from bank accounts of individuals. Drishtee maintains its accounts with partner banks so that transactions get reflected in bank's accounts on a real time basis. In this regard it takes refundable security deposit of ₹10,000 from each BC agent and sets a maximum limit of same amount.
- *Process of selection of agents*: Currently Drishtee has 500 BC agents spread across the country. The selection of agents is done by Drishtee wherein it undertakes due diligence and checks the social standing, residential status of applicants and gives franchise only if it is satisfied with background check. Once the agents are selected, they are required to pay a refundable security deposit of ₹10,000 and franchise fee of ₹375,000. Subsequently BC agents also receive a BC code, which is generated by SBI.
- *Training of BC agents*: The training to BC agents is provided by both SBI and Drishtee, wherein SBI informs BC agents about bank's various products, application procedure, documents required and Drishtee provides one day organizational training by instructing BC agents on areas such as running kiosks, troubleshooting. Furthermore, Drishtee also organizes customized refresher trainings as per the requirement.
- *Functions of BC agents*: The BC agents are responsible for acquisition of new bank accounts. Presently Drishtee's BC agents offer services for opening of SBI's savings accounts and NFAs.

- *Commission structure*: The BC agents do not receive any minimum remuneration and their pay structure is completely commission based. BCs receive ₹10 per NFA and ₹50 per bank's savings accounts. Furthermore, they are also entitled to receive 1% of loan amount and FD facilitated by them through bank. However, it should be noted that currently BCs do not work upon loan applications and 3% of Drishtee's BCs are also engaged in Drishtee's microfinance. As per rough estimates, the activities of BCs are not lucrative since they earn on an average ₹700 to ₹1,200 per month.

Problems Faced by Drishtee in Implementation

The study tried to assess some main problems in this model in order to judge the viability and sustainability of the model. Some of the issues are specified below:

(i) *Problems with existing technology*: The study team was informed that Drishtee is planning to change its technology partners due to problems with the existing technology, such as:
   - The mobile phone set has GPRS activated in it but it does not operate in certain villages due to network problems.
   - The card is provided directly by ALW to BC agents and to final customer. As a result, there are many variables in the service provider chain and probability of delays increases.

(ii) *Attrition rate*: Drishtee faces the problem of high attrition rate since majority of BCs work on a part time basis and are demotivated by low income earned as BC agent.

(iii) *Changes in strategy*: Drishtee has been using card based technology provided by ALW for the past three years of its operations. However, recently it has decided to change technology provider and select kiosk banking model development by Tata Consultancy Services (TCS). Under this model biometric devices instead of smart card devices are used and integrated with core banking tools. Currently SBI is striving to undertake phase wise migration of clients by tagging card based clients with kiosk based clients. Resultantly Drishtee has temporarily suspended its operations and is not engaged in customer acquisition.

(iv) *Problems faced by BCs in their daily operations*: Drishtee reviews work of BCs at timely intervals, hence they were asked to specify some of the main problems faced by BCs in their operations. Some of the issues are
   - The BCs find it difficult to sell savings products since people are more interested in obtaining credit and procuring remittance services
   - BCs have to face resistance from local bank's branch managers, who are sometimes not forthcoming and willing to use services of BC agents.

Progress So Far

As per the estimates, approximately 50,000 SBI savings accounts and 10,000 NFAs have been opened by Drishtee's BC agents in the last three years. However, just 20% to 30% of these accounts are currently active due to various reasons such as propensity to save and differences in client behaviour. A discussion on viability and long term growth proposition of BC model indicated that the model can be undertaken only if banks provide a host of services and a proper follow up on use of such services is undertaken. Furthermore, BCs find it expensive to deploy an outside technology provider due to high costs of machines and

other equipment. Hence it is necessary to develop in house low cost technology, which can be used by BCs themselves without engaging separate technology provider.

It was also found that the Drishtee team lays greater emphasis upon financial literacy of its clients since majority of clients are mostly unwilling to purchase financial products or even use NFAs.

C.4 FINO—TECHNOLOGY ENABLED INNOVATIVE APPROACH TO FINANCIAL INCLUSION

Financial Inclusion Network & Operations Ltd. (FINO), promoted by various players (indicated in **Box C.3**) in 2006, represents bank led model of financial inclusion. FINO provides an enabling environment for financial inclusion to banks, government entities, insurance companies, MFIs. FINO has an objective of building technologies to enable financial institutions (FIs) to serve the under-served and the unbanked sector. FINO has set up a not-for-profit Section 25 company, FINO Fintech Foundation (FFF) in 2007 as the initial RBI guidelines did now to not allow for-profit companies to become BCs. While FINO works as a technology service provider (TSP), FFF works as BC for banks through its nationwide network of *bandhus* (BC agents) in the field. The operational structure of its BC operations is depicted below.

Box C.3 Shareholding Pattern of FINO

Investors	% share
International Investors	40% (IFC 15%, Intel 15%, HAV 3 Holdings Mauritius 10%)
Public Sector	30% (UBI, Indian & Corporation Bank 22%, LIC 8%)
Private Equity	28% (ICICI 19%, ICICI Lombard 9%)
IFMR Trust	2%

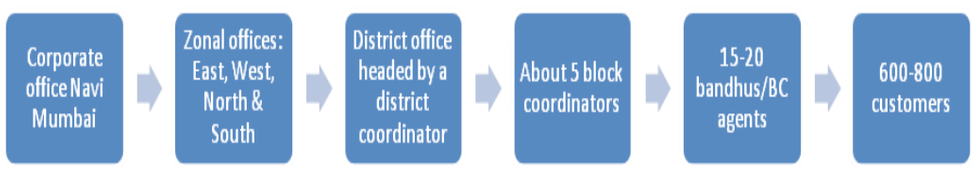
FINO with its head office in Mumbai has four zonal offices in north, south, west and east. The district office is headed by a district coordinator which is served by about 5 block coordinators. Each block coordinator is in charge of 15-20 *bandhus*. Each *bandhu* on an average serves 600-700 customers.

Technology Platform[23]

The FINO platform has been sized for 12-50 million customers at the moment but can be expanded if the needs are larger. FINO's solution encompasses three key components:

i. Core banking system component which is built as a shared back end banking engine that provides accounting, MIS, reporting and monitoring facility for all asset and liability products.
ii. Distribution component that enables 'offline' data capture from end user specific unique, biometric enabled hybrid multi-application Smart Cards. These smart cards can hold upto 15 different types of end consumer financial and non-financial relationships

Box C.4: Operational Structure



[23] Based on an article hosted on www.cab.org, in website 'ICICI Bank's strategy for Promotion of Financial Inclusion'.

on a single card. In the field, these cards can interact with various offline and online channel enablers like FINO's biometric enabled Point of Transaction devices (POT), Mobile POS/PDAs, etc., and existing mag-stripe based on-line networks of ATMs, PCs, POS and Kiosks. Captured end-consumer data is periodically transferred to a centralized location using connectivity options like PSTN (GSM/CDMA options are being planned). Authentic identification and non-repudiation of transactions is achieved through the biometric fingerprint templates stored in the card of the end user. The fingerprint verification is done at the device level where a live fingerprint of the end user is captured and verified using against the stored fingerprint template on the card. The fingerprint technology ensures that there will be no duplicate identity created for the same customer.

iii. Credit Bureau/scoring component (Sayana Ravi) which enables creation of knowledge base and financial credit worthiness, credit rating profile of the end user.

Numbering Logic

Box C.5: Technology Enablers

Customer	Biometric Enabled multi application smart card
Business Correspondent	Biometric Enabled handheld device, i.e., Point of transaction (POT) machine, Mobile phone with camera, PC, Menu based Application; PSTN line, USB
Bank / MFI	Middleware, Core Banking System

FINO system relies on multiple-number logic. There are two types of numbering logics that FINO system uses:

URN: *Unique relationship number* is a banking pin based number that is unique to a card chip (also called FINO chip number). This number is used for transaction identification over the FINO network.

FID: *FINO ID number* is a unique geographical locater printed on the facia of the card. This 17 digit number among other data sources is based on census data of India and is structured to capture details like year of birth, gender, state and village codes besides a serial number. Thus FID uniquely identifies the individual belonging to a village.

Besides the above internal numbering logic, FINO systems have a provision of mapping account ID belonging to back-end of a third party entity, like account ID in core banking solutions of banks. Such a provision ensures that there is a seamless flow of information specific to a consumer not only internal to FINO system but also in third party back ends.

FINO Operations

FINO is working in 4 different spaces:

(i) Government to Person Payments (G2P)/Electronic Benefits transfer (EBT) in partnership with banks
(ii) With banks as TSP for banking services and/or BC for banks for account opening, person to person payments (P2P) - Remittances
(iii) Insurance
(iv) Microfinance Institutions (MFI) services as MIS and credit scoring

- *Government Payments*:

This foray into the Government sector is most common through National Rural Employment Guarantee Act (NREGA), which involves convergence of the banking segment with the government domain. The disbursement of NREGA payments and social security pensions to beneficiaries, pension in remote locations is done through the BCs.

The concerned government department communicates the list of social security benefits to ensure that all intended beneficiaries in a specific locality are brought under inclusive banking. The BC gets data about the NREGA beneficiaries from National Informatics Centre (NIC). The BC then organizes enrolment camps at village level and collects information of the 'would be account holders' as also their biometric identification. After due diligence of 'no-frills accounts' (NFA), banks open the accounts in their books. The government decides the fee for delivery (2%) and mandates that it must go through a bank, which takes a cut (0.25%). Every account holder is issued a smart card, which contains the basic data of the account holder along with the biometric data and photograph.

The BCs have hand held devices which facilitates connecting to bank's database and carry out cash-in and cash-out function on behalf of the bank. A day or two before the due date of payment, government gives an invoice to the bank along with the details of the beneficiaries. The bank credits the accounts of the beneficiaries enabling the BC to access the account balance through a mobile access device and disburse cash at *gram panchayat* level. The Bank/BC receives advance payment of the services that it provides in respect of G2P from the government department.

G2P payments of FINO are in operation with the tie up of state governments of Andhra Pradesh (AP), Haryana, Gujarat, Chhattisgarh, Jharkhand, Karnataka, Maharashtra, Madhya Pradesh (MP) and Uttar Pradesh (UP). The highest numbers of FINO *bandhus*, about 3,000 of them are in AP, which accounts for the highest number of beneficiaries for G2P payments.

- *Banking Services: NFA accounts, Deposits, P2P payments/Remittance*

FINO works as a TSP to banks in providing technology solutions for remote banking. This could be both back end and front end. The relationship with banks can be in two ways:

a. As a TSP to banks and this technology is then provided to a BC.
b. FINO as a TSP and FFF as a BC.

Box C.6: Scale achieved by FINO (Oct 2010)

Total customers served	22 million
FINO network of bandhus	10,000
No. of villages touched	50,000
Gram panchayats covered	5,884
Districts	278
States	22
Partner banks	22
Insurance companies	4
Government entities	10

Banks invite requests for proposals from various TSP for branchless banking. FINO can then be chosen as a technology partner for the bank. In addition FINO's sister concern FFF can act as a BC using the technology provided by FINO. The *bandhus* are recruited by FFF as commission agents of banks. On an average a *bandhu* is able to earn ₹750-3,500 per month.

The most common banking service provided by FINO is opening of NFA. NFA has a simple one page application form with requirement of a simplified KYC document of residence proof. A new account can be opened by the *bandhu* immediately after receiving the completed application form and the smart card can be issued to the customer on the spot. FINO's communication with its *bandhus* is in the form of an SMS-driven web-based tracking system called *Samvaad*. As soon as a *bandhu* touches bases with a customer, she sends a *samvaad (SMS)* to the block coordinator – this *samvaad* is linked to the central server and his activity is daily updated.

Enrolment of new NFA accounts is also outsourced by FINO to registered

Box C.7 Field Visit Observations from Visit to FINO's Dharavi Branch in Mumbai

Started in December 2007, *Dharavi* branch in Mumbai has 21 *bandhus* associated with it. FINO is working as a BC for Union Bank of India (UBI) in *Dharavi* and has a tie up with HDFC Ergo for offering insurance products.

The Dharavi branch has a good flow of customers all through the day, comprising of mainly migrant population in Mumbai. The customers feel that FINO smart cards serve the most useful purpose of remittances. Some enrolments of new customers also take place over the counter in the Dharavi branch. The customers have to wait in queue and it takes 10-15 minutes for completing the entire transaction. The business model is designed as a doorstep delivery model. Large presence of migrant population in Mumbai gives FINO a high customer base in the city. However, due to the large volume of transactions each day, *bandhus* are unable to cater personally at doorstep of each customer in this branch. Doorstep delivery also increases the cost of transaction for BC. Banks are also constrained to charge the customers on any increased cost of transaction. Most of the customers therefore have to come to the branch to perform their transactions in this branch.

FINO *bandhus* face the constraint of physical operational space. The banks do not allow them to operate from their premises. In such cases *bandhus* have a tie up with a nearby merchant entity which offers them the space to operate.

At the field level *bandhus* are FINO's interface with customers. They work on the basis of commissions. They get a fixed base salary from FINO. The training is provided by FINO and banks on technology, financial literacy, banking services and products. *Bandhu* is issued a POT machine by FINO. *Bandhu* is required to put a security deposit of ₹5,000 as a risk mitigant for security of cash on field. FINO as a BC has a pool account with the partnering bank. Its account gets hit each time a transaction is made by a customer. The BC also has an overdraft limit from the bank. The *bandhu* also maintains an account with the bank. While the card has an overdraft limit of ₹3 lakh, the POT limit is ₹20,000. Once transactions with *bandhu* hit ₹3 lakh, the POT is locked and it has to be settled by the block coordinator. *Bandhu* can also call up the branch and his account can then be replenished. This acts as a risk mitigation and cash management check for BC. The POT machine has a cap of maximum 200 transactions thereafter which it needs to be settled.

Loan product: UBI through FINO also started providing small ticket loans *Saubhagaya* and *Bhagya* of ₹3000 to –25,000 (savings linked) to its clients in Dharavi area, Mumbai. The rate of interest charged was 11.25%–11.75% with weekly instalments. The bandhu commission charge was ₹5 per loan. The loan was offered to vegetables and fruits hawkers and small entrepreneurs, usually a person with an existing savings account with the bank and mandatory deposit amount equal to half of the credit amount offered. The loan product in this branch was started in 2009; was offered for 6-7 months and is currently not in operation.

A profile of two bandhus who were interviewed by the study team is presented below.

Name	Gnana Sundari Nadar	Prakash Shinde
Tenure as *bandhu*	3 years	2 years
Other income source	PAN card facilitator	Electrician
Bank associated with	UBI	UBI
Products catered	NFA, Remittances, Insurance, loans	
Daily routine	8-10 am : cash deposits 12-2pm: New enrolment, Insurance 3-5pm: report to FINO branch for end of day settlement	8:30 a.m.–2 p.m. Remittance, Insurance 12:30–2 p.m. New enrolment 3-5 p.m.: report to FINO branch for end of day settlement
Point of operation	UBI branch (Mulund) allocated corner/window Doorstep of customers	UBI branch (Borivli East) allocated corner/window Doorstep of customers

Cost to *bandhu*	Travel costs: ₹1,000/month	Travel costs: ₹400-500/month
Fixed base salary from FINO	₹1,000/month	
Commission details	NFA opening: nil Deposit/withdrawal: ₹2/transaction P2P : ₹4/transaction HDFC Insurance: ₹10/20	
No. of transactions/day	New enrolments: 5-10 Remittance: 40-50	New enrolments: 5-6 Remittance: 40-50
Average income/month	₹6,000-7,000	
Feedback on association with FINO	Future seems bright as this is a banking service and possibility of catering to more products and higher income. Unable to focus on other supplementary economic activity as bank work leaves little time.	Improvement in self-image and personality as now involved with bank and catering to knowledge based sector Unable to focus on other supplementary economic activity as bank work leaves little time

companies through a due diligence process. Jatinder Handoo, Manager Strategy at FINO says that 'about 65-70% of FINO NFAs are active accounts.'

The study team had visited the *Dharavi* branch of FINO to observe the on-field operations. A case let on *Dharavi* branch is presented in **Box C.7**.

- *Insurance Services*

FINO is working with three insurance companies: ICICI Lombard, Max New York and HDFC Ergo. *Rashtriya Swasthya Bima Yojana* (RSBY) through ICICI Lombard is in operation in the states of Haryana, UP, Bihar and Chhattisgarh. In RSBY government pays an average annual premium of ₹600 per BPL household. RSBY beneficiaries are enrolled at the designated RSBY enrolment stations by FINO staff. The family is given a biometric smart card with an annual cashless limit of ₹30,000 per family.

The POT machines are installed across the designated network hospitals for carrying out transactions and the back end database is maintained for claim and scheme management.

The insurance policies of Max New York and HDFC are offered by *bandhus* to the customers on commission basis as insurance agents.

- *MFI services as MIS and credit scoring*

FINO provides both backend and frontend technology solutions for MFIs to facilitate

Box C.8 FINO's Approach to Financial Literacy

FINO has launched a new division, the Channel Empowerment Group (CEMG) with 3 sub-verticals; knowledge management and training, protocol and monitoring and resource raising & new initiative. CEMG recently formed Financial Inclusion Education Academy (FIEA) which will be set up at a central location in the country. FIEA will implement Microfinance Opportunity's financial education for branchless banking program, based on a sponsorship by the MasterCard Foundation. The academy aim is to empower BCs through training & capacity enhancement programmes through the Financial Literacy Program (FLP) launched by it. The FIEA curriculum on financial literacy includes: financial planning, planning personal needs and budgeting, saving & investment, borrowing & loan management, mitigating risk & insurance and formal financial services knowhow. The Academy recently also received support from NABARD from Financial Inclusion Fund (FIF) for its training programme for BCs.

operations management and portfolio control. Its product 'Sayana Ravi' is a credit scoring solution for MFIs serving the micro credit customer. It involves tailored credit scoring, third party verification and risk management services.

Approximately the product mix of FINO is NREGA 40%, EBT 30% and NFA 30%. In addition to the above discussed services, FINO is also actively involved in promoting financial literacy among its clients. Its approach to financial literacy is outlined in **Box C.8**.

Viability of FINO Business Model

On the viability of FINO business model, a senior professional from CEMG comments that 'the business model is not unviable in the long run and is profitable. FINO has already reached break-even. It is important to achieve scale of operations in this model to make it viable. Cross selling of products is the key to achieve profitability. FINO aims to offer a whole bouquet of products and services to the customers like: EBT, NFA, insurance, remittances, utility bill payments, and micro-loans.' He feels that 'if the policy support from government continues, FINO will be able to build a successful model of financial inclusion.'

C.5 FINO TATKAAL—A REMITTANCE SERVICE FOR MIGRANT WORKERS

FINO through its subsidiary FFF and network of 10,000 *bandhus* aims to provide a host of financial services to its customers. One such service which is in high demand is remittance facility for the people who have migrated from rural areas to metropolitan cities/urban areas. Recognizing this demand, FINO launched the FINO *Tatkaal* services in collaboration with Union Bank of India (UBI).

The remittance services provided by FINO are becoming immensely popular due to a vast unmet demand for transfer of money by migrant workers to far flung areas of the country. This scheme was started in Dharavi, Mumbai and is currently offered in Mumbai and Delhi for remittances to remote parts of the country. As per the company's social responsibility report, FINO plans to extend this service to other parts of the country as well. As per 2009-10 data, approximately 3,000 transactions are conducted on a daily basis.

Target Population

FINO's target clients are migrant citizens who come to cities in search for livelihood and need to send money to their dependents living in far off rural, sometimes inaccessible areas. In this regard, FINO *Tatkaal* provides a safe, secure, fast and easily available remittance opportunity, which works even outside banking hours.

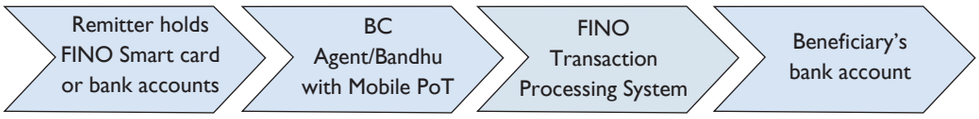
Technology Employed

FINO provides remittance services through formal remittance delivery mechanism using biometric enabled smart cards, which are held by end customers. This chip embedded card comprises of all basic information about the customers such as biometric identification, demographic details, product relationships, their status and transaction and also bears a photograph. Such smart cards ensure correct identification of members, without the need for any PIN/password. Each card has a Unique Relationship Number (URN)/ FINO chip number imprinted upon it, which is used for identification of transactions. The card can maintain up to 8 relationships with financial or non-financial institutions along with their individual transaction history of up to 10 transactions.

Transactions

The BC agents are also equipped with a kit, which comprises of hand held devices

Box C.9 Method of Conducting Remittance Transactions



such as PoT machines, mobile phones with camera and USB device. The three ways of conducting remittance transactions are as follows (illustrated in **Box C.9**):

- Cash to Card: Remitter gives cash or debits his bank account and sends the remittance to a beneficiary with a FINO smart card.
- Card to Bank: Remitter holds a smart card and remits money into the normal banking account of the beneficiary.
- Card to Card: Both remitter and beneficiary hold FINO cards.

Some of the benefits of FINO Tatkaal as stated by FINO Fintech Foundation are as follows:

- It is a manual agent-based collection and disbursal system; hence the timings can be adjusted to suit the convenience of both remitters and beneficiaries.
- The remitter can deposit even small amounts of money in a cost-effective way.
- The customers can access services from different parts of the country. This service is particularly important since majority of the remitters are migrants and might have to change locations frequently.

Field Interaction with the BC Agents and Customers

The study team interacted with some BC agents and their customers during the field visits to Dharavi branch of FINO in order to understand the process, use and scope of remittance services. The observations are discussed below.

Interviews with BC agents:

A brief profile of two agents interviewed is shown in **Box C.10**.

Training: Two day training was provided to them at FINO Mumbai office. Under this training, they were informed about the bank's financial products, use of hand held devices such as PoT, nature of carrying out transactions, method of carrying out enrolments and appropriate behaviour to be maintained. However, no official certificate was given after successful completion of training. Additionally, one day training on mobile registration was also imparted.

Products offered: They are allowed to offer products such as enrolments, remittances, savings and withdrawal and insurance. However, their customers approach them mainly for the remittance services. It is also their responsibility to

Box C.10: Profile of BC Agents Involved in Providing Remittance Services

Categories	Aslam Khan	Dharmendra
Highest Educational Qualification	Senior Secondary	Senior Secondary
Employment tenure	9 months	5 months
Security deposit	₹5,000	₹5,000
Area of operation	Andheri	Malaad East
Average monthly income	₹6,500	₹8,500
Remittance transactions per day	50	75
Enrolments per day	8-10 accounts	15 accounts

convince new account openers to obtain life insurance services, which are provided by FINO in collaboration with HDFC ERGO. On an average, they are able to undertake 50 remittances in a day and open 8-10 NFAs.

Mode of functioning: Initially, they were allowed to operate from the bank premises for about a month, but after that they had to make their own arrangements. The RBI circular on BC does not allow them to operate from a bank's premises, but in this case FINO has an arrangement with the bank for temporary use (up to one month) of their premises by the agents. The remitters can approach BC agents in a pre-determined location and pay in either cash or get their account debited to transfer money to the beneficiary.

Box C.11: Commission Structure for BC Agents

Services	Commission per transaction
Remittance	₹4
Transaction	₹2
Enrolment	₹8
Insurance	20% of annual premium
Mobile recharge (FINO Suvidha)	1.25% of amount recharged

Commission structure: They work six days a week (Monday to Saturday) on a fixed cum variable pay structure. The full time BC agents working in Mumbai earn anywhere between ₹7,000 to ₹9,000 out of which they receive ₹1,000 p.m. as fixed income. The commission on various financial products and services are mentioned in **Box C.11** alongside.

Security Deposit and transaction limits: They were required to pay a one-time refundable ₹5,000 as security deposit for PoT machines. They were also provided with a smart card, which has a limit of ₹300,000 per day and an additional limit of ₹20,000 per day on the PoT device. Once the limit of ₹300,000 is crossed, the PoT is automatically locked and they have to contact a Block Coordinator to get it unblocked. They can also get the smart card recharged by sending a message to head office.

Interviews with Customers

The study team interviewed the customers present at the Dharavi branch during their visit. Almost all the interviewees were mainly using remittance facilities and were depositing around ₹2,000 each on a fortnightly basis. A fee of ₹25 is charged on every ₹5,000 remitted by a customer. The maximum remittance limit per card for a customer is ₹25,000. In a single transaction

Advantages	*Problems*
• Cost-effective and easy accessibility. • Small amount of cash (lower ticket size) can be directly deposited with BC agent. • FINO's offices are easily accessible in comparison to bank branches. • The remittance is channelled through a savings A/c linked to the FINO card. • The smart card can be obtained easily with relatively simpler KYC norms compared to stringent KYC norms followed by banks.	• The branch has high customer footfall due to which the remitters have to wait for at least 10-15 minutes in a queue for depositing their money with BC agent. • The money gets remitted to the beneficiary in two to three days. Hence the immediate and urgent needs of customers for money are not addressed. • Some customers complained that BC agents do not have enough time for doorstep collection of money. • Interoperability of accounts is not present; hence remitters (and/or beneficiaries) are required to have savings accounts with same bank. Some customers complained that they were forced to send money indirectly to their beneficiaries, since their beneficiaries did not have same bank's savings account.

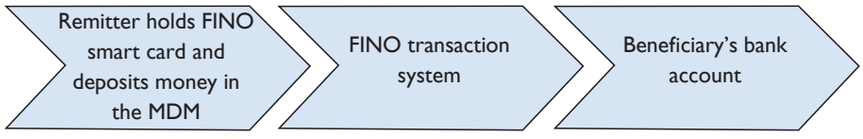
the maximum amount a customer can transfer is ₹10,000. The beneficiaries of FINO were not necessarily un-banked and maintained savings accounts with other banks also.

The customer had the following feedback to offer:

New initiatives

Remittance services through FINO Timor: FINO Timor is a biometric smart card based NFA product designed for provision of financial services to people living in remote areas. The smart card works as a passbook, ATM card and the machine can perform the functions of authentication of customers, deposit making, withdrawal, mini statement, request for loans and balance enquiry. From October 2010 onwards, FINO has also started a new initiative of providing additional remittance services through its 'micro deposit machines (MDM)' or FINO Timor. These stand alone MDMs have been deployed at BC points and enable customer to remit money even in odd hours, depicted in **Box C.12** below:

Box C.12: Method of Conducting Remittance through MDM



Annexes

ANNEX 1: PRINCIPLES OF CLIENT PROTECTION

(adapted from: Accion/Campaign for Client Protection www.campaignforclientprotection.org)

Principle 1: Prevent Over-indebtedness
A financial institution measures up to this principle by carefully establishing the borrower's ability to afford the loan and repay it. Clients should be able to handle debt service payments without sacrificing their basic quality of life.
• MFI's written credit policies give decision makers (loan officers, supervisors, etc.) explicit guidance regarding borrower debt thresholds. • The loan approval process includes an evaluation of clients' ability to repay the loan. The loan approval process does not rely solely on guarantees (whether peer guarantees, co-signers or collateral) as a substitute for sound risk management. • Clients receive training/guidance on evaluating their own debt capacity. • The credit decision making procedure and supervision function promote sales force or loan officer accountability for the quality of the loan. • Incentives and productivity targets reward risk management. Productivity targets and incentive systems value portfolio quality at least as highly as other factors, such as disbursement or customer growth. Growth is rewarded only if portfolio quality is high. • The organization ensures product suitability through careful product design and testing with the target market. • Internal audits check household debt exposure, lending practices that violate procedures including unauthorized re-financing, multiple borrowers or co-signers per household, and other practices that could increase indebtedness.
Principle 2: Transparent Pricing
A financial institution measures up to this principle by ensuring that complete information is made available to customers in clear language that is not misleading and that the customer is able to understand.
• Senior management creates a culture of transparency within the organization and develops systems, controls and incentives to support it. • Prices, terms and conditions of financial products are fully disclosed to the customer, including interest charges, insurance premiums, minimum balances required on savings and transaction accounts, all fees, penalties, and whether those can change over time. • Reasonable efforts are made to ensure customers with low levels of financial literacy understand the product, the terms of the contract, and their rights and responsibilities. (Communication addresses client literacy limitations (reading contract out loud, material in local languages)

- ***Prior to sale:*** Customers are given adequate time (at least 1 week) to review the terms and conditions of the product and have an opportunity to ask questions and receive information prior to signing contracts.
- ***At the point of sale:*** Loan contracts show the repayment schedule that separates principal, interest, fees and define the amount, and number and due dates of instalment payments.
- ***After the point of sale:*** The client regularly receives clear and accurate information regarding the account.

Principle 3: Appropriate Collections Practices

A financial institution measures up to this principle by maintaining high standards of ethical behaviour even when clients fail to meet their contractual commitments.

- The code of ethics requires all clients to be treated with dignity and respect, even when they fail to meet their contractual commitments. The code forbids subjecting a borrower to abusive language or threats by collection agents.
- Loan contracts include clauses on late repayment and default, and what the borrower should expect in these cases.
- Debt collection practices and procedures are clearly outlined in a staff book of rules or credit procedure manual.
- Specific step-by-step procedures and time frames are outlined for late payment recovery and how to proceed when borrowers are in default.
- If the institution uses 3 party debt collectors, these agents are expected to follow the institutional codes of ethical practices.
- There is recognition that accurate analysis of a borrower's repayment capacity is a first step to preventing delinquency, and the organization may hold some responsibility for borrowers' failure.
- Collections staff receive training in acceptable debt collections practices and loan recovery procedures.
- Practices and procedures are followed widely in the organization and monitored by the internal audit department. Violations are sanctioned.
- Rescheduling policies prevent automatic debt extensions. Re-scheduling procedures follow written protocol through official negotiations.

Principle 4: Ethical Staff Behaviour

A financial institution measures up to this principle by creating a corporate culture that values high ethical standards among staff and ensuring safeguards are in place to prevent, detect, and correct corruption or mistreatment of clients.

- A code of business ethics, code of conduct, or other guidelines spell out organizational values and the standards of professional ethics expected of all staff. The code of ethics has been reviewed and approved by the Board and is included in staff rule books or administrative policies.
- Staff rules include provisions on what is considered acceptable and unacceptable behaviour. Provisions describe reprimands and actions that can result in termination of employment.
- Anti-corruption policies and procedures are in place, provided to each staff member and enforced by decision-makers.
- Hiring procedures assess new employees for compatibility with organizational values and ethics.
- New staff receives orientation on the practicalities of following codes of conduct and refresher courses include customer service standards.
- Managers and supervisors are tasked with detecting corruption and client mistreatment in the normal course of business.
- Managers and supervisors review ethical behaviour, professional conduct and the quality of interaction with customers as part of staff performance evaluations.

Principle 5: Mechanisms for Complaints Handling and Resolution.

A financial institution measures up to this principle by having a mechanism for collecting, responding in a timely manner, and resolving problems for their clients.

- A written policy requires customer complaints to be taken seriously, investigated and resolved in a timely manner.
- A ready mechanism to handle customer complaints, problems, and feedback is in place and accessible to customers.

- Customers are informed of their right to complain and know how to submit a complaint to the appropriate person.
- Staff is trained to handle complaints and refer them to the appropriate person for investigation and resolution.
- Specialized personnel are designated to handle customer complaints and problem solving.
- Complaints are fully investigated and decisions are made consistently and without bias.
- Internal audit or other monitoring systems check that complaints are resolved satisfactorily.
- Customers have the opportunity to seek independent third party recourse in the event that they cannot resolve the problem with a financial institution, such as an ombudsman or mediator with the power to make binding decisions.

Principle 6: Privacy of client data

A financial institution measures up to this principle by respecting the privacy of client data, ensuring the integrity and security of client information, and seeking the client's permission to share information with outside parties prior to doing so.

- A written privacy policy is in place which governs the gathering, processing, use, and distribution of client information.
- Systems are in place and staff trained to protect the confidentially, security, accuracy, and integrity of customers' personal and financial information.
- The IT system is secure and password protected with various levels of authorized access to information and access to data modification adjusted to the tasks and needs of the user.
- Internal audit reviews security of locations and electronic systems where client data is stored.
- Customers know how their information will be used.
- Staff explains how client data will be used and seeks client permission for use.
- Clients have the option of not having their information shared.
- The organization ensures the accuracy of information shared and requests customer consent for use of data in a Credit Registry or Bureau.
- Customer consent is required for use of information in promotions, marketing material and other public information. Clients are asked to express their written agreement for use of their personal information, such as pictures and business and personal stories in the organization's publications, promotional material, and any information shared with external audience.
- The organization offers information, orientation, or educational sessions to clients on how to safeguard access codes or PIN numbers.

ANNEX 2: SALIENT FEATURES OF BC MODEL

	Guidelines for engaging BCs
Applicable to	The scheduled commercial banks including RRBs and Local Area Banks (LABs). The banks may formulate a policy for engaging BCs with their Board's approval and due diligence.
Eligible individual/ entities as BC	• Individuals like retired bank employees, retired teachers, retired government employees and ex-servicemen, individual owners of *kirana*/medical /fair price shops, individual PCO operators, agents of small savings schemes of GoI/Insurance Companies, individuals who own petrol pumps, authorized functionaries of well run SHGs which are linked to banks, any other individual including those operating Common Service Centres (CSCs) • NGOs/ MFIs set up under Societies/ Trust Acts and Section 25 Companies • Cooperative Societies registered under Mutually Aided Cooperative Societies Acts/ Cooperative Societies Acts of States/Multi State Cooperative Societies Act; • Post Offices; and • Companies registered under the Indian Companies Act, 1956 with large and widespread retail outlets, excluding NBFCs. While a BC can be a BC for more than one bank, at the point of customer interface, a retail outlet or a sub-agent of a BC shall represent and provide banking services of only one bank. The banks will be fully responsible for the actions of the BCs and their retail outlets / sub agents.
Scope of activities may include	• Identification of borrowers; • Collection and preliminary processing of loan applications including verification of primary information/data; • Creating awareness about savings and other products and education and advice on managing money and debt counselling; • Processing and submission of applications to banks; • Promoting, nurturing and monitoring of Self Help Groups/ Joint Liability Groups/Credit Groups/others; • Post-sanction monitoring; • Follow-up for recovery, • Disbursal of small value credit, • Recovery of principal/collection of interest • Collection of small value deposits • Sale of micro insurance/ mutual fund products/ pension products/ other third party products and • Receipt and delivery of small value remittances/ other payment instruments. The above activities can be conducted by BCs at places other than bank's premises/ ATM.
KYC norms	Banks may use the services of BC for preliminary work relating to account opening formalities. However, ensuring compliance with KYC and AML norms under the BC model continues to be the responsibility of banks.
Customer confidentiality	The banks should ensure the preservation and protection of the security and confidentiality of customer information in the custody or possession of BC.
Information technology standards	The banks should ensure that equipment and technology used by the BC are of high standards.

	Guidelines for engaging BCs
Distance criterion	For ensuring adequate supervision, the distance between the place of business of a retail outlet/sub-agent of BC and the base branch should ordinarily not exceed 30 km in rural, semi-urban and urban areas and 5 km in metropolitan centres. In case there is a need to relax the distance criterion, the District Consultative Committee (DCC)/State level Bankers Committee (SLBC) could consider and approve relaxation on merits in respect of under-banked areas.
Payment of commission/ fee	The banks may pay reasonable commission/ fee to the BC but the BCs cannot charge any fee to the customers directly for services rendered by them on behalf of the bank. The commission structure should be devised in a manner that mere increase in the number of clients served or the transaction volume does not drive the commission. It should include some element of customer satisfaction. The banks (and not BCs) are permitted to collect reasonable service charges from the customers in a transparent manner.

RBI Circular, 28 September 2010. RBI/2010–11/217 DBOD.No.BL.BC.43 /22.01.009/2010–11.

ANNEX 3: PROJECTS SANCTIONED UNDER FIF AND FITF

Financial Inclusion Fund	Financial Inclusion Technology Fund
Capacity building and financial literacy Indian Institute of Banking and Finance (IIBF) has been involved to provide training to candidates to get engaged as BC/BF. The training cost of candidates who successfully complete the certification course on BC/BF will be met from FIF. The project plans to cover 20,000 candidates over a period of 2 years (2009-11). Financial literacy training in Vidarbha. Ten training of trainers (ToT) will be conducted covering 300 resource persons drawn from SHG leaders, FCs and retired bank personnel. Pilot project to establish Farmers' Service Centres/ Village Knowledge Centres (VKCs), mobile credit counselling centres for promotion of financial literacy and farmer education through mass media in South Malabar district of Kerala. Plans for setting up 8 such centres in 8 districts. Support to Kozhikode DCCB for setting up of Credit Counselling and Livelihood Promotion Centre. Support to Thrissur DCCB for setting up of Information Dissemination-cum-Human Resource Development Centre. Capacity building programme for RRB and post office for using Post office as BC of RRB through five training programmes in Uttarakhand. Financial Resource Centre at RRB to cater to the capacity building and research needs for up-scaling financial inclusion in four districtsof West Bengal - Murshidabad, Nadia, North and South 24 Parganas. Four training programmes for around 100 members of 11 FCs identified by the bank to act as BFs in Morigaon district, Assam. Financial literacy by RRB in Assam in Nalbari district. Capacity Building Programme for LDMs of banks conducted by BIRD, Lucknow.	Card based ICT solutions implemented by RRBs for strengthening of BC model • Engaging 30 BCs in Papum Pare, West Siang and Upper Subansiri districts of Arunachal Pradesh for opening 30,000 card-based accounts in two years. • Engaging 104 BCs in Sonitpur & Sibsagar districts in Assam to open minimum 104,000 card-based accounts. • Gulbarga and Bidar districts in Karnataka to cover 450,000 accounts. • Engaging 100 BCs in the two hilly tribal districts of Karbi Anglong and North Cachar Hills in Assam to open minimum 100,000 card-based accounts through 50 branches. • Bahraich and Shrawasti districts in Uttar Pradesh to cover 150,000 new accounts. • Opening 40,000 new accounts in four blocks of Aizawal and Kolasib districts in Mizoram. • Bellary and Chitradurga districts in Karnataka covering 706,000 beneficiaries. • Opening 120,000 accounts in West Tripura and Dhalai districts of Tripura. • Covering 64,420 beneficiaries in Hamirpur district of Uttar Pradesh. • Covering 190,000 new accounts in Gopalganj district of Bihar. • Covering 1,25,000 rural households across 569 villages of Kanpur Dehat district of Uttar Pradesh. • Covering 5,000 new customers through BC in Chamba district of Himachal Pradesh and enabling contactless smart card and biometric finger print scanning technology. • Covering 5,000 customers in Nainital and Almora districts of Uttaranchal and introduction of Gramin Bank smart card. Other initiatives for strengthening BC model • Engaging BCs in 10 bank branches (1 CSP per branch) and enabling technology in 74 RRB branches in Pali district of Rajasthan to cover 120,512 households. • Providing banking services through one lakh new accounts using BC model and bio-metric enabled mobile services by a commercial bank for transaction at Village CSPs in 194 villages in five blocks of Kutch, Banaskantha and UT of Dadra & Nagar Haveli.

Financial Inclusion Fund	Financial Inclusion Technology Fund
Promotion of savings/credit services Micro-credit programme in Nagaland with Village Development Boards (VDBs) as intermediaries for augmenting the corpus of 107 VDBs in Longleng and Kiphire districts of Nagaland. A one day DCCB camp for opening of bank accounts/ KCC & GCC accounts in five zones - Arambagh, Tarakeswar, Chanditala, Sreerampore and Chinsurah of Hooghly district of West Bengal resulting in opening of at least 150 account per camp. Viability gap funding for the Biometric card project through BC/BF model in NER for Smart card based accounts.	Expansion of branch network Installation of four ATMs in Andaman and Nicobar Islands by a co-operative bank where the services of banks have not penetrated thereby providing banking facilities at their doorsteps to local populace. Extending banking services in remote rural areas through 43 bank branches in West Singhbhum and Gumla districts in Jharkhand to open 100,000 accounts. Provide financial transaction facility in villages by establishing Point of Transaction with infrastructure and technical support to cover 60,000 beneficiaries in Latehar district by RRB in Jharkhand. Implementing Core Banking Solution through usage of COIN software developed by National Informatics Centre (NIC) in Sikkim by a Co-operative Bank, six branches and 10 Multi Purpose Credit Societies (MPCS) in the first phase and five MPCS in the immediate second phase.

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ANNEX 4: KEY FEATURES – CCS REVIVAL PACKAGE*

Package	Key features
Financial Assistance	Restructuring to start with PACS to improve their financial health to acceptable levels and then move to upper tiers. This will enable PACS to clear DCCB dues to reduce their accumulated losses. Assistance to be provided to DCCBs to clear balance accumulated losses. The same process will be applied to State Cooperative Banks. The package will include assistance necessary to bring all cooperatives, including PACS, to a minimum Capital to Risk weighted Assets Ratio (CRAR) of 7%. While this ratio will be raised within three years to 9% by PACS, DCCBs and SCBs shall raise their CRAR as prescribed by the RBI. This increase in CRAR shall be met by the CCS from its own resources. The share of the state government in the equity of each institution in the three tiers shall be brought down below 25% of the total subscribed share capital within a period of three years, subject to the condition that there will be only one government representative on the Board of a DCCB or SCB to represent the equity of the state government. The amount in excess of 25% shall be converted into a grant by the State Government to the concerned CCS entity. The quantum of financial assistance will cover accumulated losses as of 31 March 2004. For this purpose, a special audit of accounts will be carried out for all the PACS, DCCBs and SCBs based on uniform accounting criteria. All PACS with a recovery level of at least 30% of the demand as on 30 June 2004 will qualify for receiving financial assistance under the revival package. Capitalization will be full for the PACS with recovery levels of >50%. The PACS with recovery levels between 30-50% will receive financial assistance in three annual back-ended instalments at the beginning of each succeeding year subject to their achieving an incremental increase in their recovery rate by at least 10 percentage points on 30 June 2006 against the benchmark recovery achieved on 30 June 2004, and an annual increase of 10 percentage points thereafter. As and when a PACS achieves 50% recovery, the entire assistance will be released without waiting for the year to year recovery benchmarks. For the North Eastern States, scheduled areas and tribal districts, the Central Government may consider relaxing the eligibility levels for PACS and DCCBs. The liability for funding the financial package will be shared by the Central Government, State governments, and the CCS based on origin of loss and existing commitments.
Legal and institutional reforms	Since cooperative banks accept deposits, RBI should have the authority not only to lay out prudential norms but also in regard to those aspects of management which have a bearing on the financial health of the institution. The Banking Regulation Act and the respective Cooperative Societies Acts would accordingly be suitably amended to empower the RBI. Unless the management and governance of the cooperative societies are improved, there is every chance of capitalization amount going waste. This requires amendments of all relevant Acts – like Cooperative Societies Acts of the States, BR Act, NABARD Act, DICGC Act – as suggested by the Task Force.

Package	Key features
	Reforms in the Cooperative Societies Act • Ensuring full voting membership rights on all users of financial services • Removing state intervention in all financial and internal administrative matters in cooperatives • Cap of 25% equity contribution of state in cooperatives and limiting participation in the Board to one nominee • Allowing transition of cooperatives registered under the State Cooperative Societies Act to migrate to the Parallel Act (wherever enacted) • Withdrawing restrictive orders on financial matters • Permitting cooperatives in all the three tiers freedom to take loans and place deposits in any regulated financial institution of their choice, beyond certain thresholds • Permitting cooperatives under the Parallel Act (wherever enacted) to be members of upper tiers under the existing Cooperative Societies Acts and vice versa • Limiting powers of State governments to supersede the Boards • Ensuring timely elections before the expiry of the term of the existing Boards • Facilitating regulatory powers for RBI in the case of cooperative banks • Prudential norms including CRAR, for all financial cooperatives including PACS, as per the directions of RBI Reforms in the BR Act 1949 • All cooperative banks would be on par with the commercial banks as far as regulatory norms are concerned • RBI will prescribe fit and proper criteria for election to Boards of cooperative banks. • RBI will prescribe criteria for professionals to be on the Boards of cooperative banks. • The CEOs of the cooperative banks would be appointed by the respective banks themselves and not by the State government. RBI will prescribe minimum qualifications for a CEO • Cooperatives other than cooperative banks as approved by the RBI shall not accept non-voting member deposits. Such institutions cannot use the words such as "bank, banking, banker" in their registered names The accounting system presently used in the CCS (adjusting first the interest due and then the principal) is the one universally used by all banks including cooperative banks with multiple tiers in other countries. As per suggestion of some states, a portion of the interest presently collected by upper tiers will be credited to the principal amount due – expert group may be constituted to examine the issue. Deposit guarantee scheme may be designed by NABARD to ensure safety of member deposits. Such a scheme will be applicable only to the PACS.
Improving quality of management	The financial package will also cover the costs of training and capacity building to improve the financial management skills of staff and board members; for installation of uniform accounting and monitoring systems; as well as for computerisation. This grant assistance from the Central Government will be phased over a period of two to three years based on necessity and will culminate with the completion of implementation in each State.

* Ministry of Finance, 2005-6. "Package for revival of short-term rural CCS"

ANNEX 5: CURRENT STATUS OF IMPLEMENTATION OF THE CCS REVIVAL PACKAGE*

Activities	Status
Execution of MoUs	25 states[24] have signed MoUs with GoI and NABARD. This covers more than 96% of the short term CCS units in the country.
Special audit of PACS	Guidelines and formats for conduct of Special Audit circulated to all participating States. Training for Master Trainers and Departmental Auditors for conduct of special audit of PACS has been completed in all 25 implementing States. Special Audit has been taken up in 81,778 PACS and completed in 81,613 PACS. Approval by District Level Implementing Committees (DLIC) and State Level Implementing Committee (SLIC) in 16 states. Special Audit of 217 CCBs has been taken up and completed in nine States. SLIC has approved 196 CCBs. Audit in progress in 5 states.
Release of recapitalisation assistance to PACS	₹7,990.29 crore released by NABARD as GoI share for recapitalisation of 49,830 PACS in 14 States. State Governments have released ₹754.27 crore as their share. The PACS share will be ₹1,453.06 crore and they have been give 2 years to bring in their share.
Amendment of Cooperatives Act	16 States[25] have amended their respective State Cooperative Societies Act through Legislative Process viz. The amended Act of Govt. of Meghalaya has been examined by NABARD and forwarded to the State Govt. for further amendment. The State Govt. of Chhattisgarh has taken a cabinet decision approving the amendments in respect to the reform measures, as their earlier State Cooperative Societies Act has been submitted to Hon'ble President for assent. The earlier Assam Cooperative Societies Amendment Bill is awaiting Presidential Assent. West Bengal State Cooperative Societies Bill, 2006 has received the Presidential assent and the State is to get the amendment passed by the Legislature. Earlier, the State Cabinet had decided to pass the draft amendment. Draft amendments to Jharkhand, Mizoram, Manipur, Nagaland, Punjab and Uttarakhand CSAs have been vetted by NABARD and are under consideration of the respective State Govts.

[24] Andhra Pradesh, Arunachal Pradesh, Assam, Bihar, Chhattisgarh, Gujarat, Haryana, Jammu & Kashmir, Jharkhand, Karnataka, Madhya Pradesh, Maharashtra, Manipur, Meghalaya, Mizoram, Nagaland, Rajasthan, Orissa, Punjab, Sikkim, Tamil Nadu, Tripura, Uttarakhand, Uttar Pradesh and West Bengal

[25] Andhra Pradesh, Arunachal Pradesh, Bihar, Gujarat, Haryana, Karnataka, Jammu & Kashmir, Madhya Pradesh, Maharashtra, Meghalaya, Orissa, Rajasthan, Sikkim, Tamil Nadu, Tripura and Uttar Pradesh

Activities	Status
Amendments of rules and adoption of bye-laws	Bihar, Karnataka and Orissa have amended the respective State Cooperative Societies Rules in tune with the amended Acts. In Maharashtra, Rules have been framed and likely to be notified after clearance from Law & Judiciary Department of Govt. of Maharashtra. Draft of Tripura Coop Societies Rules is being examined by NABARD. The bye-laws of SCB has been amended in Madhya Pradesh and is in progress in Andhra Pradesh, Karnataka, Orissa, Maharashtra and Tamil Nadu. The bye laws of all 18 CCBs have been amended in Gujarat; 29 out of 30 CCBs in Maharashtra. Amendment is in progress in Andhra Pradesh, Karnataka, Madhya Pradesh and Tamil Nadu. The bye laws of PACS have been amended in Bihar and in Tripura. It is partially complete in Gujarat (in 6,743 out of 7,174 PACS) and Maharashtra (20,813 out of 20,791 PACS) and is in progress in Andhra Pradesh, Karnataka, Madhya Pradesh and Tamil Nadu. In Haryana, a committee has been constituted to suggest necessary amendments to the Rules/ Bye laws. The committee has submitted its report. In UP, the committee has prepared the revised rules/bye-laws and sent to Legal Dept. of the State Govt. for vetting.
Status of conduct of Statutory Audit by CAs in CCBs/SCB	Statutory Audit by CA panel (valid upto March 2010) as on 31 March 2008 has been completed in the SCB and CCBs of seven states - Andhra Pradesh, Gujarat, Haryana, Madhya Pradesh, Maharashtra, Orissa and Uttar Pradesh. The Audit process as on 31 March 2009 is completed in the SCB and CCBs of twelve states viz., Andhra Pradesh, Bihar, Chhattisgarh, Gujarat, Haryana, Madhya Pradesh, Maharashtra, Meghalaya, Orissa, Punjab, Uttar Pradesh and Tamil Nadu. (CA panel valid upto March 2010). Statutory Audit by CAs as on 31 March 2010 is completed in the SCBs in Andhra Pradesh, Chhattisgarh, Gujarat & Tripura SCBs and is in progress in Meghalaya & Sikkim. The Statutory Audit of CCBs as on 31 March 2010 is completed in Andhra Pradesh.
Status of elected Board in CCS structure	Across 20 states - 15 StCBs, 257 out of 332 CCBs, 71,438 out of 77,906 PACS now have elected Boards. Election process is on in 1,032 PACS in Maharashtra. Elections are yet to be held in Arunachal Pradesh, Jammu & Kashmir, Manipur, Nagaland and Tamil Nadu.
Status of Professional Directors as per fit & proper criteria	In place in Maharashtra StCBs. 17 of the 22 CCBs in Andhra Pradesh, 14 out of 18 CCBs in Gujarat, 3 out of 19 CCBs in Haryana, 5 out of 21 CCBs in Karnataka, 23 of the 30 CCBs in Maharashtra, 5 out of 17 CCBs in Orissa and 45 out of 50 CCBs in Uttar Pradesh.
Status of CEOs as per fit & proper criteria	In place in Andhra Pradesh, Gujarat, Haryana, Maharashtra, Meghalaya, Nagaland, Orissa and Tripura SCBs. 17 out of 22 CCBs in Andhra Pradesh, 14 out of 18 CCBs in Gujarat, 30 of the 38 CCBs in Madhya Pradesh, 26 of the 30 CCBs in Maharashtra and 8 out 17 CCBs in Orissa. Underway in Haryana and Tamil Nadu.

Activities	Status
HRD-Training	At PACS level Training to 245 Master Trainers from 21 states for training of staff & Board members. Master Trainers have trained 1,896 District Level Trainers to conduct field level Phase I training programme for PACS. 76,862 PACS secretaries have been trained in fourteen States and 100,107 elected members of PACS have been trained in eleven States. 3,908 auditors/supervisors have been trained on Common Accounting System (CAS). 65,855 PACS functionaries have been provided training on CAS/MIS. 76 Master Trainers from 12 implementing States trained at BIRD for training PACS secretaries on Business Development and Profitability. These trainers have trained trained 160 DLTs from 2 implementing States. At StCB and CCB level 1,778 board members of CCBs have been trained from fourteen States. Training of identified 368 CEOs of CCBs from 16 States and CEOs of 6 SCBs in NER States at BIRD, Lucknow to enable them to recognize the increased business opportunities in the changed scenario. 319 Branch Managers/Senior Officers of CCBs/SCB trained for business development/diversification.
CAS and MIS for PACS	CAS for PACS designed and circulated to RCS of all implementing states. Process of adoption underway in 16 states. CAS/MIS has been introduced from 01 April 2009 in almost all PACS in 10 states - Andhra Pradesh, Chhattisgarh, Gujarat, Haryana, Madhya Pradesh, Maharashtra, Orissa, Tamil Nadu, Uttar Pradesh and West Bengal. CAS/MIS partially introduced in Assam. In Karnataka instructions given to CCBs on implementation from 2009-10. In MP 3,995 PACS affiliated to 35 CCBs have implemented CAS. In UP 5,816 PACS have introduced CAS by April 2009 of which 2,141 prepared their financial statements (FY 2008-9) as per CAS. Of the eleven States mentioned above, ten (except MP) have printed the necessary registers for implementing CAS/MIS. Printing of registers completed in Arunachal Pradesh and Sikkim and in progress in Bihar, Karnataka, and Rajasthan. A standardised set of MIS for PACS has been designed and circulated among RCS of implementing States to aid decision making at all levels. A Handbook on MIS has also been issued. In Uttar Pradesh, 854 PACS have generated MIS. Cooperative Auditors, Inspectors and Supervisors are also being trained to support the PACS functionaries to adopt the new system.

Activities	Status
Computerisation	Guidelines on computerization of CAS and MIS for PACS were issued in two separate modules: (i) development, procurement & deployment of software including training on software and (ii) procurement and installation of hardware. In Haryana, pilot testing of software in 2 PACS. On-site User Acceptance Test of the modified software has been completed and SLIC plans for roll out in 325 PACS. In Tamil Nadu, pilot testing in 2 PACS. In Andhra Pradesh, MIS has been generated in the 139 PACS which were computerized in the first phase. Data digitization has begun in 504 PACS. AP State Govt. proposed to computerize all PACS by 2012. NABARD has formed a committee for development of Core software for PACS at the National level. Eighteen States[26] have opted for the national level core software. Gujarat has decided to develop software suiting its need.
Monitoring	For guiding and monitoring the implementation of the package at national level, National Implementation and Monitoring Committee (NIMC) has been constituted. So far eight meetings of the NIMC have been held. The last meeting was held on 02 June 2010. At State level, the progress is being monitored by SLIC and at district levels by DLICs. At NABARD level, review meetings of Regional Offices of Implementing States are held periodically.
Expenditure incurred under package	An expenditure (other than recapitalisation assistance) of ₹155.60 crore has been incurred as on 31 July 2010 towards Special Audit, HRD, Technical Assistance and Implementation Costs.
Status regarding Task Force report on LTCCS	A Revival Package for LTCCS has been worked out by GoI and discussed with State Governments. The Task Force constituted by GoI to review the need for the Revival Package for LTCCS has since submitted its report to GoI on 25 February 2010.
Special package for NER States	GoI has, on 25 November 2008, approved special dispensation and relaxations under the Revival Package for STCCS in NER States.

* Department for Cooperative Revival and Reforms, NABARD, 2010. Status as on 31 July 2010.

[26] Arunachal Pradesh, Assam, Bihar, Chhattisgarh, Jharkhand, Karnataka, Madhya Pradesh, Maharashtra, Manipur, Meghalaya, Mizoram, Nagaland, Orissa, Rajasthan, Sikkim, Tripura, Uttar Pradesh and West Bengal

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