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Regulatory Framework for Financial Inclusion in India

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Abstract

With the progress of the Indian economy, especially when the focus is on the achievement of sustainable development, there must be an attempt to include maximum number of participation from all the sections of the society. Financial inclusion enables improved and better sustainable economic growth and social development of the country. As the majority of the rural population is still not included in the inclusive growth, the concept of financial inclusion becomes a challenge for the Indian economy. Since 2005, many concerted measures are initiated by the Reserve Bank of India and Government of India in favor of financial inclusion. The present paper endeavours to study the regulatory framework and initiatives taken by RBI and Govt. of India to ensure maximum financial inclusion for the underprivileged people of society.

Keywords: Financial Inclusion, RBI Initiatives, Sustainable economic growth, Social Development

Introduction

The penetration of financial services in the rural areas of India is still very low. The factors responsible for this condition can be looked at from both supply side and demand side and the major reason for low penetration of financial services is, probably, lack of supply. The reasons for low demand for financial services could be low income level, lack of financial literacy, other bank accounts in the family, etc. On the other hand, the supply side factors include no bank branch in the vicinity, lack of suitable products meeting the needs of the poor people, complex processes and language barriers.

Government of India has taken several initiatives to provide the benefits of banking to every individual and one of such initiatives was nationalization of banks. After nationalization, Indian banking sector has witnessed an enormous increase in terms of number of branches, deposits and advances. Reserve Bank of India mandated the commercial banks in different regions to start a 100% financial inclusion campaign on a pilot basis. RBI's vision for 2020 is to open nearly 600 million new customers' accounts and service them through a variety of channels by leveraging on Information Technology. This has made the financial inclusion very demanding in view of the policy planning for effective financial development.

The scope of financial inclusion can be expanded in two ways:

a) Through state-driven intervention by way of statutory enactments by the regulatory bodies.

b) Through voluntary effort by the banking community for evolving various strategies for taking the banking sector to large and underprivileged people of society.

Since 2005, the Reserve Bank of India (RBI) and the Government of India (GOI) have been making efforts to increase financial inclusion. Measures such as SHG-bank linkage program, use of business facilitators and correspondents, easing of Know Your Customer (KYC) norms, electronic benefit transfer, separate plan for urban financial inclusion, use of mobile technology, bank branches and ATMs, opening and encouraging 'no-frill-accounts' and emphasis on financial literacy have played a significant role for increasing the use of formal sources for availing loan/ credit. Measures initiated by the government include, opening customer service centers, credit counselling centers, Kisan Credit Card, Mahatma Gandhi National Rural Employment Guarantee Scheme and Aadhar Scheme. These renewed efforts are more focused than the earlier measures which were more general in nature having a much wider scope. Though the measures were initiated earlier, their impact on the rural population needs to be analysed and reframed in order to understand the present scenario in the rural areas.

Initiatives of RBI for Financial Inclusion

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

Initiatives taken during 1960s and1970s

• Focus on increasing credit to the neglected economy and weaker sections of society.

• Development of the rural banking ecosystem including RRBs, rural and semi-urban branches.

• Implementation of the social contract with banks.

• Lead Bank Scheme launched for rural lending.

Initiatives taken during 1980s and 1990s

• Branch licensing policy to focus on expansion of commercial bank branches in rural areas.

• Establishment of National Bank for Agriculture and Rural Development (NABARD) to provide refinance to banks providing credit to agriculture.

• SHG-Bank Linkage Program launched by NABARD.

Initiatives taken during 2000s

• The term ‟Financial Inclusion' was introduced for the first time in RBI‟s Annual Policy Statement for 2005-06 and a policy namely "Financial Inclusion Policy" was framed.

• Restrictions on ATMs deployment removed.

The above mentioned are the various measures undertaken for financial and economic benefit of the vast disadvantaged section. But still more than half of the population remains socially and financially excluded from the formal financial sector.

Hence in the year 2005 a Policy namely „Financial Inclusion Policy‟ was introduced by the Reserve Bank of India according to the instruction of Government of India.

The overall strategy for financial inclusion, especially amongst the poor and disadvantaged segments of the population should comprise :

• Ways and means to effect improvements within the existing formal credit delivery mechanism.

• Suggest measures for improving the credit absorption capacity especially amongst the marginal and sub marginal farmers and poor non-cultivator households.

• Evolve new models for extending outreach.

• Leverage on technology solutions to facilitate large scale inclusion.

Developments on RBI Policy Framework for Financial Inclusion

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

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

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

i) Opening of No-Frills accounts

In November 2005, a new concept of banking was introduced, known as 'no-frills' account with 'nil' or very low minimum balance to make such accounts accessible to vast sections of the population. In 2012, the nomenclature was changed to Basic Savings Bank Deposit Accounts (BSBDAs) for all individuals with zero minimum balance and facility of ATM card/ Debit card. There is no charge on deposits and up to four withdrawals in a month are allowed. By doing this, every person has the right to open a bank account. Banks have been advised to provide small overdrafts in such accounts to meet emergency credit requirement in hassle free manner.

ii) Bouquet of Financial services

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

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

iii) Engaging Business Correspondents

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

iv) Use of Information and Communication Technology

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

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v) Relaxation of KYC Norms

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

vi) Simplified Branch Authorization

To address the issue of uneven spread of bank branches, in December 2009, domestic scheduled commercial banks were permitted to freely open branches in Tier 3 to Tier 6 centres with population of less than 50,000 under general permission, subject to reporting. .In the second quarter review of Monetary Policy, Branch Authorisation has been relaxed to the extent that banks do not require prior permission to open branches even in tier I centres with population less than 1 lakh, which is subject to reporting.

vii) Opening of branches in unbanked rural centres

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

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

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

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

ix) Direct Benefit Transfer

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

x) Financial Literacy

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

xi) Financial Inclusion Plan of Banks

Banks are encouraged to adopt a structured and planned approach to financial inclusion with commitment at the highest levels, through preparation of Board approved Financial Inclusion Plans (FIPs). The first phase of FIPs was implemented over the period 2010-2013. The Reserve Bank has used the FIPs to gauge the performance of banks under their FI initiatives. Thus a structured and comprehensive monitoring mechanism is put in place for evaluating banks‟ performance vis-à-vis their targets. To ensure support of the Top Management of the Bank to the Financial Inclusion process and to ensure accountability of the senior functionaries of the bank, one on one annual review meetings, chaired by Deputy Governor, Dr. Chakrabarty are held with CMDs/CEOs of banks.

xii) Robust Institutional Mechanism

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

Approaches to Financial Inclusion

(a) A Bank led Model

A bank- led model have adopted for financial inclusion, which seeks to leverage on technology. Our belief has been that in view of the population and geographic area of our country, the success of Financial Inclusion initiatives would depend on the solution being ICT- enabled, with the market participants developing new delivery models to best suit their individual requirements.

(b) An Integrated approach – Financial Inclusion & Financial Literacy

We have adopted a structured, planned and integrated approach towards Financial Inclusion which is focusing on improving access to financial services and also encouraging demand for financial services through Financial Literacy initiatives. We recognize that the success of the financial inclusion efforts depend not just on the extent to which the reach of the formal financial sector is improved, but also on whether the target population is aware about the benefits of moving on to the formal financial system and is inclined to make this transition.

(c) Building a Robust Institutional mechanism for Financial Inclusion

The institutional mechanism that has been built for ensuring success of financial inclusion across the country comprises of following:

i.) The Financial Stability and Development Council (FSDC) headed by the Finance Minister is at the apex. Under the aegis of the FSDC, we have a Sub-Group of FSDC headed by the Governor, RBI and within that is a Technical Group, headed by a Deputy Governor, RBI exclusively mandated to focus on financial inclusion and financial literacy. The membership of these groups comprises of representatives of all financial sector regulators, which makes the structure of the group very strong.

ii.) In order to gauge the performance of banks and to continuously review the various models adopted under Financial Inclusion, RBI has constituted a Financial Inclusion Advisory Committee (FIAC), headed by a Deputy Governor from RBI, which has members comprising of few Directors from the Central Board of RBI as also experts drawn from various NGOs/other civil society representatives, etc. The collective expertise and experience of these members is expected to be leveraged towards developing viable and sustainable banking services delivery models for meeting the objective of total financial inclusion.

iii.) Further, we also leverage upon the infrastructure created at the state level, wherein we have the State Level Bankers Committee (SLBC) at the Apex which is ably supported by the Lead District Managers (LDMs) at the District level.

iv. In order to ensure that the initiatives on the supply side are ably supported by initiatives on the demand side, we have around 896 financial literacy centres set up by banks. Banks have been advised to educate, train and counsel people in the rural areas regarding the benefits of getting linked to the mainstream financial system and also to take all out efforts to ensure that such people get converted into long term customers of the banks.

Conclusion

Financial inclusion is a 'safe' way to invest, a 'reliable' way to send and receive money, a 'quick' way to borrow in times of need, and 'easy to understand' insurance products. Certainly, savings is the ultimate investment in the economy. The savings system has to be fair to the domestic savers; with inflation well into double digits and deposit interest rates way below the inflation rate, the domestic savers are virtually being robbed of their hard earned savings. The success of financial inclusion is breaking the link between poor public service, patronage, and corruption. This study found that branches in the country should provide banking facilities in a physical form and therefore new technologies are being used to provide banking facilities to the vulnerable and poor sections of the unorganized sector.

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