# Y V Reddy: Banks and service to the common person

Address by Dr Y V Reddy, Governor of the Reserve Bank of India, on the occasion of the release of the Code of Bank's Commitment to Customers, Reserve Bank of India, Mumbai, 1 July 2006.

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Chairperson of the Board Smt. Udeshi, Chairman of the IBA Shri Shetty, Deputy Governor Smt. Usha Thorat, distinguished bankers and friends,

It gives me immense pleasure and satisfaction to be here to release the "Code of Bank's Commitment to Customers". The Code signifies the first formal collaborative effort by the Reserve Bank of India, the banks and the newly set up Banking Codes and Standards Board of India (BCSBI) to provide a framework for a minimum standard of banking services, which individual customers can legitimately expect. The IBA and members of the BCSBI are to be commended for successfully evolving this Code, which is not only a commitment of banks to their customers but also in a sense a Charter of Rights for the common person. By setting the minimum standards of customer service with reliability, transparency and accountability, it outlines how each bank expects to deal with the customers' day-to-day requirements, and accordingly, what each customer should reasonably expect from his bank. The Board, in a way, helps the banks in terms of providing independent review and feedback on their adherence, in practice, to the self-prescribed standards. We, in the RBI, attach great importance to the work and assessments of the BCSBI, which, in a way places onerous responsibility on the BCSBI in this relatively unexplored area.

### The background

In our context, the issue of services rendered by banks to the common person dates back to the R.K. Talwar Committee (1975) and the Goiporia Committee (1990). The Report of the first Narasimham Committee (1991) ushered in the financial sector reforms, which were expected to spur competition in the banking sector through deregulation and entry of new private sector banks, which, in turn, was to provide high-quality customer service to meet the long pending aspirations of the bank customers. But there is an increasing realisation, both in India and several other countries, that the competitive forces alone do not ensure fair treatment or adequate quality in service to the customers at a justifiable price, in a transparent manner.

There has been an on-going debate on the choice between statutory regulation and self-regulation for oversight of customer service. Statutory regulatory instructions are set out in letter but sometimes, may not be carried out in spirit. Self-regulation may often be more effective in dealing with deficiencies in service but it has been found that in many cases, it has, by itself, not been a fully effective tool for raising standards of customer service. To build on the positive features of both the systems, the Committee on Procedures and Performance Audit on Public Services (CPPAPS, 2004) felt that there was a need to benchmark the extant level of public services in the banking sector. The Committee recommended that a *Banking Codes and Standards Board of India* (BCSBI) be set up to evaluate and oversee the observance of a voluntary code of conduct by the banks. Consequently, the RBI and the banks decided to set up, as a collaborative effort, an autonomous body, which combines the best of self-regulation and statutory regulation. As a part of collaborative arrangements for an independent body, the RBI will fully meet the budgetary requirements for the first five years while the banks would, during this period, contribute to building the corpus of the BCSBI to enable it to eventually become a self-sustaining organisation. I am happy to know that the majority of banks in India are registered with the BCSBI, indicating their willingness to adopt the voluntary Code. Those Banks, which adhere to the BCSBI Code, would provide the RBI necessary supervisory comfort; and I have no doubt that all the banks will join the main stream.

### Standards of service in banks: select country experiences

It may be useful to note recent developments in several countries in regard to services rendered by banks. In the U.K., the Banking Code of the British Bankers' Association (BBA) sets standards of good banking practices for financial institutions to follow when they are dealing with personal or business customers in the UK. As a voluntary code, it allows competition and market forces to work to encourage higher standards of service for the benefit of the customers. The code applies to savings deposits and current accounts, card products and services, loans and overdrafts and payment services including foreign exchange. The BCSBI is, in a way, modeled after the Banking Code and Standards Board of the United Kingdom – which has been promoted by the British bankers' Association, Building Societies' Association and the Association for the Payments and Clearing Services. In addition, the Office of Fair Trading (OFT), established by the Enterprise Act 2002, enforces both consumer protection and competition law, acting as the UK's economic regulator.

In Canada, the issue of bank service charges was the subject of a 1988 investigation conducted by the House of Commons Standing Committee on Finance. The Committee report set out a number of recommendations, which have subsequently been reflected in market practice. The Committee's recommendations resulted in improved disclosure of service charges and the designation of Office of the Superintendent of Financial Institutions (OSFI) for handling and reporting on service charge complaints.

In the US, organisations such as Consumers' Union are fighting to create legislation that will help protect vulnerable consumers from price gouging on checking accounts. They are demanding lifeline banking legislation that will give consumers access to basic banking services. Several American States have implemented legislation for minimum no-frills banking services.

Bank Negara Malaysia initiated a nation-wide survey in 2003 to assess the requirements, expectations and the satisfaction level of consumers on the quality of products and services offered by the banking institutions. The quality of interface with bank staff and the efficiency of delivery channels were identified as the key factors that customers look for in their banking relationship. Secondary requirements represented potential leverage factors such as product innovativeness with value-added features, which can be used to substantially improve overall customer relationship.

The central bank of Philippines initiated significant measures geared towards protecting both the industry and the public. In 2002, regulations were issued which tightened the rules on credit card and other lending operations by requiring the banks and their subsidiary credit card companies to ascertain that the cardholders were capable of fulfilling their commitments and setting credit limits based on their net take-home pay. A Consumer Education Committee was subsequently constituted to help improve basic financial literacy.

**Credit card issues: recent measures**

Credit card related payments and charges have been one of the most contentious issues in the recent past. Late payment charges levied by the banks on credit cards have attracted attention worldwide. Recently, the Office of Fair Trade (OFT) in the U.K. undertook a review of prevailing conditions in the UK. The OFT study revealed that the credit card issuers charged consumers excessively for late payment. The OFT came to the conclusion that the default charge should not exceed reasonable pre-estimated administrative cost. In their opinion, such cost should include the cost of postage, stationery, proportionate additional staff, maintenance of premises, etc. On this basis, OFT arrived at the conclusion that any charge exceeding the monetary threshold of £12 may not be fair and tenable. It is estimated that the consumers had paid £300 million more than what was reasonable last year. The industry estimates indicate that with credit card default fees ceiling at £ 15, gross profits of the banks in the UK would be reduced by £ 800 million.

International research has shown that inter-change fee (fee for using ATM of a bank other than that of the account holder) is generally stable or declining in most of the countries. In many of these countries, the decline has been possible because of recent regulatory action or threat of regulatory action. The most common public authority to take such action is normally the Competition Authority. The central banks of Australia, Mexico, Spain, the Netherlands, the United Kingdom and European Union (E.U.) appear to be taking more hands-on regulatory stance on these issues. The Reserve Bank of Australia has instituted a regulation that requires card net works to set inter-change fees at or below the cost-based standards. As a result of this, the inter-change fees have fallen in Australia. The U.K. has also mandated cost-based inter-change fees (inter debit card network). Last year, despite one of the lowest fee structure in Europe, the Dutch Competition Authority fined Interpay and its owner bank for charging excessive fees as compared to cost. Bank de Mexico has used regulatory threat to implement some reforms and has issued regulations requiring the banks to disclose fees.

### Credit counselling: further work in India

A relatively unexplored area in India is credit counseling and we may have to seriously work further on this keeping in view the international experience and our domestic conditions. In this regard, a recent initiative of Bank Negara Malaysia is worth mentioning. The Bank Negara Malaysia has established a Credit Counselling and Debt Management (CCDM) Agency to provide credit counselling and loan restructuring advice to individuals. The arrangement is aimed at assisting individual customers who are encountering difficulties in meeting their financial commitments. In fact, this measure has been introduced to provide a channel for resolving potential credit issues that may be faced by the households. The Agency would provide individuals assistance in restructuring debts relating to household loans, hire purchase, credit card and personal loans from institutions functioning under the purview of the Bank Negara. The arrangement is expected to be a prompt and cost-effective means of debt settlement based on the repayment plan between creditors and the debtor without intervention of courts. The agency will also provide credit counselling and advice on financial management to individual consumers.

In the USA, recent initiatives reportedly imply that, since October last year, debt-trapped consumers seeking bankruptcy protection have been forced to undergo credit counseling and financial training.

In the U.K., in addition to Consumer Credit Counselling Service, Citizens Advice Bureaux and other debt counselling organisations, there is also a National Debt Line through which a bank customer can get free financial advice. In fact, in the U.K., the Banking Code provides that member banks shall discuss financial problems with customers and together evolve a plan for resolving these problems. In general, banks in the U.K. have to be prepared to accept an offer of repayment, which is based on the principle of equitable distribution of available income of the customer, in line with the amount outstanding to each creditor.

### Financial education: need for study

It has been said, particularly in the context of developed economies that the young do not save enough and do not fully understand the need for investments for future. The middle-aged tend to regret that they did not save when they could afford to. Many of the elderly tend to feel the pinch of poverty. In this background, priority is accorded to financial education. For example, in the U.K, the Financial Services Authority is reported to have launched the biggest campaign ever to improve the financial skills of the population. According to a recent report in the U.S, the Congress formed a bipartisan Financial and Economic Literacy Caucus last year that has, among other things, passed a bill to designate April as the financial literacy month. Singapore, Hong Kong and Hungary also have schemes to boost financial training levels, as does Finland, where a theatre group puts on plays in high schools about financial education issues. In New Zealand there is an official financial-information website with an online game "money island" – while the Australian Securities and Investments Commission organises money expos to help investors avoid scams and improve investment choices.

It must be admitted that the effectiveness of the literacy programmes has been questioned, partly attributed to the manner in which literacy campaigns are conducted by the regulators. However, the subject needs to be explored further in our country since there is a spurt of new financial products and financial intermediaries, and often, the savers are bewildered by them. The skills for assessing risks and rewards have to be acquired anew as administered interest rate regime and public sector guarantees are diminishing. It may be desirable to encourage research and study on financial literacy in India, which would help customers use transparent information provided by banks in a monitorable manner.

### Business Banking Code: for SMEs

An area, which needs special attention in India, is related to lending to Small & Medium Enterprises (SMEs) and here, there may be a pointer for further attention. In the U.K., the Banking Code Standards Board has evolved a separate Business Banking Code which covers traders, partnerships, companies with a turnover of under £ 1 million and clubs, charities and associations with income of less than £ 1 million. Small business customers are, therefore, covered by this Business Banking Code. The SME Sector in India needs to be nurtured and I would urge the BCSBI to consider encouraging a Code for the SMEs somewhat on the lines of the U.K. Business Banking Code.

## Fine print and undue enrichment

In India it is said that people are reluctant to change their doctor, lawyer and banker. In some cases, the consumer adherence to particular service provider can be attributed to lack of information. Many a times, even with alternate services available, clearly at lower price, including the switching cost, customers tend to stay with the same service provider. Therefore, customer staying with any specific service provider should not be construed by the service provider as a certificate of good customer service. Consumer choice to a great extent depends on the availability of complete information about the product or service being sold. The main issue is whether the bank is genuinely providing information or merely satisfying the requirement of doing so by getting a plethora of signatures over a volume of documents with fine print. Often, the customers trust a banker, especially with a standard printed form, assuming rightly that there are no choices to be made and also presuming, unrealistically, that fair treatment is assured. I trust that fairness and ethical conduct to ensure genuine transparency will be ensured by all concerned.

Banks all over the world have been very active to provide a multitude of products and services by way of value addition. This is no doubt necessary in a competitive market. But earning fee-based income through exorbitant charge, which are not revealed upfront, points to, in some ways, what may be described as ‘undue enrichment’.

## Dilution of reputation risk

Generally, it is assumed that a penalty imposed by regulators would be a source of major reputation risk for the bank concerned, due to adverse public perception of such penalty and would thus be a deterrent. However, it is noticed in recent years that the regulatory penalties do not appear to be a material cause for reputation risk for the penalised bank. Perhaps, as far as banks are concerned, a penalty is now being viewed more from the perspective of affordability of its monetary value rather than the cause for its imposition. This warrants that supplementary efforts are made on several fronts to ensure the quality of service while the sense of regulatory comfort is kept in view for according various regulatory approvals in respect of each bank.

## Unequal parties: validity of contracts

Banking is a trust-based relationship and the banking licence from the regulator provides an assurance of trust to the public at large. To the banks, the banking licence provides the privilege of accepting uncollateralised deposits from the public. However, the acts of stealth banking, negative option marketing, misleading advertisements, information gathering from customers for cross selling of products and services, and tie-up arrangements are inconsistent with the concept of a trust-based relationship. The lack of transparency, coupled with the difficulty of consumers in identifying key information from the large volume of material and communication in fine print, leads to an information asymmetry, which renders the banker-customer relationship one of unequals. In this context, banks would do well to keep in mind a Supreme Court’s judgement regarding the non-enforceability of a contract entered into between two unequal parties.

In the case of *LIC of India vs. Consumer Education & Research Centre (AIR 1995 SC-1811)*, while considering the validity of LIC policy under table 58 restricted only to salaried persons in government / semi-government or reputed commercial firms, the Supreme Court observed:

> *“It is well settled law that if a contract or a clause in a contract is found unreasonable or unfair or irrational, one must look to the relative bargaining power of the contracting parties.”*

## Symmetrical compensation: case for

In the Reserve Bank, we have been trying to enhance quality of our customer service and in the process, it was noticed that interest was not being paid to customers if there had been delay on our part. For example, in the case of Savings Bond Scheme, the RBI commits that in case of any delay in payment of interest warrants or redemption, the holder is compensated at savings bank rate. Such a commitment is also binding upon its agency banks. More important, I feel, that we need to accept that compensation has to be necessarily symmetrical and banks have to put in place procedures that ensure it. Instances have been reported where the interest rate or penalty charged by the banks is higher than what banks pay for any delay or default on their part. I hope that this Code will provide an unequivocal commitment to customers on the principle of symmetry in compensations in regard to delay or default in payment between the bank and its customers.

**Status in India: regulatory initiatives**

The Reserve Bank has taken several regulatory initiatives including issuance of guidelines to banks on various customer-related issues, such as matters relating to opening & maintenance of the deposit accounts and other banking services including credit cards. The banks are required to form Board-level committees to focus on customer service and to constitute a Standing Committee of Executives. Besides, they are also required to appoint and notify nodal / specific officers for redressal of customer complaints at their controlling offices and critical branches. Enlarging the scope of the Banking Ombudsmen Scheme to also look into deficiencies in customer service and credit card-related complaints is an initiative that has been welcomed by consumer groups. A recent initiative has been the setting up of a Working Group to look into the reasonableness of bank charges and fees. At the level of commercial banks, they have been advised to display and update, on their websites, in a format prescribed by the RBI, the details of service charges apart from displaying the prescribed minimum information on such charges in all their branches. This wide spectrum of measures, together with the efforts of the BCSBI and the IBA in evolving the Code of Bank's Commitment to Customers will hopefully bring about improvement in the quality of customer service. An exclusive department, namely, the Customer Service Department is being set up in the RBI to attend to the matters relating to customer service and grievance redressal for the customers of the banks and the RBI.

**Linking the content with the title**

Let me conclude by explaining the title of my speech, namely, Banks and Service to the Common Person. Though the Code is for customers as a whole, our major concern is with the common person. As the Nobel Laureate Professsor Amartya Sen has been articulating recently, there are different identities to each person; whether to attach greater importance to one over another depends on us. I feel that for the limited purpose of customer service, banks' customers may be divided into two categories – privileged clients like other financial intermediaries or corporates, and the common person. We, in the RBI, whenever considering customer service, tend to focus on the common person, particularly in the context of our country.

When I joined the Indian Administrative Service (IAS) in 1964, a Professor at the Academy imparting training to us said this: "You are among the best and the brightest of the youth in the country. You have chosen to join IAS and your basic duty is to serve the public. Please remember that public are those who are not in the IAS". That is one of the lessons worth remembering.

**Appreciation**

I want to place on record my deep appreciation of the enormous cooperation extended by all banks and in particular, Indian Banks' Association in bringing to fruition this important institutional venture, under the overall guidance of my colleague Shri V. Leeladhar.

I am grateful to our Finance Minister, Shri P. Chidambaram who supported and encouraged us in the RBI for pursuing this work in conjunction with revisions in the Ombudsman Scheme.

Finally, I am thankful to Smt. Udeshi for agreeing to chair the Board and build the institution. I am also grateful to Sarvashi MG Bhide, MM Chitale, S Divakara and Krishna Kumar for graciously allowing themselves to be persuaded by me to work for the Board, as a matter of public service, inspite of their otherwise busy schedule. In house, but spared to work on this worthy cause, are Sarvashri Kolarkar and Baijal who will serve the common person through this forum.

I have great pleasure in releasing the Code of Bank's Commitment to Customers and assuring the Board and the banks of continued support and understanding from the RBI in all their endeavours to discharge their mandate.

Thank you.