

## **K C Chakrabarty: Furthering financial inclusion through financial literacy and credit counselling**

Address by Dr K C Chakrabarty, Deputy Governor of the Reserve Bank of India, at the launch of Federal Ashwas Trust, Kochi, 30 November 2009.

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I am happy to be here this morning and feel privileged to launch the Federal Ashwas Trust for running the Financial Literacy and Credit Counselling Centres (FLCC) of Federal Bank. At the outset, let me warmly congratulate my old friend and colleague Shri M. Venugopalan, MD and CEO, Federal Bank, and his team for bringing the FLCC of Federal Bank to fruition. Even though Kerala has the highest literacy rate amongst all States in the country, I am sure that centres such as these have a vital role to play in providing valuable services to the people in the district.

As our Hon'ble Finance Minister emphasized in his Budget speech, our approach to banking and financial sector has been to ensure robust oversight and regulation while expanding financial access and deepening markets. The merit of this balanced approach has been borne out in the recent experience as the turbulence in the world financial markets has left the Indian banking and financial sector relatively unaffected. The recent turmoil which engulfed the western world and its financial sector brought to even sharper focus the pressing need to protect the vulnerable from Ponzi schemes through safety nets of financial education, counselling and timely advice.

The establishment of FLCCs is an important milestone in furthering financial inclusion. As I have emphasised time and again, opening a no frills account is by itself not financial inclusion. That is just the beginning. Financial inclusion is a much broader term which can be construed as the process of ensuring fair, timely and adequate access to financial services, namely, saving, credit, payment and remittance facilities, and insurance services at an affordable cost in a fair and transparent manner by the mainstream institutional players. Educating people and making them financially literate thus becomes integral to achieving financial inclusion, which is why centres such as these are needed.

With the above perspective, I organize the rest of my remarks under the following sections. In Section 1, I propose to talk about the importance of financial education. In Section 2, I would briefly touch upon the need for credit counselling. Section 3 discusses the specific objectives of setting up the FLCCs. Section 4 covers the role of RBI and, finally, I shall share some of my thoughts on issues and challenges that we need to address.

### **I. Financial education**

Financial education can broadly be defined as the capacity to have familiarity with and understanding of the financial market products, especially rewards and risks 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 overall well-being and avoid distress in financial matters.

The financial markets offer a variety of both simple and complex financial products. It is difficult for the common person to grasp the downside risks associated with financial products especially if he or she is confronted by a blitz of clever advertising. Making wrong choices while choosing financial products becomes one of buying in haste and repenting at leisure. The focus of any discussion on financial education is thus primarily on the individual, who usually has limited resources and skills to appreciate the complexities of financial dealings with financial intermediaries on matters relating to personal finances on a day-to-day basis.

Lack of literacy in general and financial literacy in particular, are the main hurdles in expanding the coverage of financial services to the poorer segments of society. Notwithstanding the initiatives taken so far, given the large magnitude of the problem, concerted efforts need to be made in this direction. Banks should, therefore, come forward to set up literacy centres and guide their clients about the features, benefits and risk of various financial products. With no well established banking relationships, the un-banked poor are pushed towards expensive alternatives. These centres can educate the people about proper financial management tools, inculcate saving habits and generate demand for financial products and services which in turn will boost financial inclusion. This process of education could benefit the banks as the centres while interacting with customers would be in a much better position to understand their specific requirements, which could then be a critical input in appropriate product design.

Financial education is also an integral component of customer protection. Despite concerted efforts, the current levels of transparency coupled with the difficulty of consumers in identifying and understanding the fine print from the large volume of information, leads to an information asymmetry between the financial intermediary and the customer. For example, customers are often penalised for minor violations in repayments, although they have limited redressal mechanisms to rectify deficiencies in service by banks. In this context, financial education can greatly help the consumers.

## **II. Credit counselling**

Credit Counselling can be defined as “counselling that explores the possibility of repaying debts outside bankruptcy and educates the debtor about credit, budgeting, and financial management”. It serves three purposes. First, it examines the ways to solve current financial problems. Second, by educating about the costs of misusing a credit, it improves financial management. Third, it encourages the distressed people to access the formal financial system.

As per the All India Debt and Investment Survey, 2003, nearly a fourth of the households were indebted in 2002. The per cent of indebtedness households in rural areas increased sharply from 23 in 1991 to 27 in 2003; the corresponding figures for urban areas during the same period were 19 and 18, respectively. As per the NSSO survey (2003), out of 89.35 million farmer households, 43.42 million (48.6%) were reported to be indebted. Farmer's indebtedness was highest in Andhra Pradesh followed by Tamil Nadu and Punjab. The average outstanding loan per farmer household was highest in Punjab, followed by Kerala, Haryana, Andhra Pradesh and Tamil Nadu.

The report on the Situational Assessment of Farmers (NSS 59th round-2003) estimated that 64.4% farmer households are indebted in Kerala as against the national average of 48.6%. The major reasons for arrears in repayment reported include high cost of cultivation, fall in prices of agricultural produce and crop failures. Opening of credit counselling centres such as these can certainly benefit the people.

Earlier, there were reports of farmers committing suicides in some parts of the country due to their financial liabilities. Through the provision of timely and professional advice, common people can be helped to manage their debt, improve money management skills and gain access to the structured financial system. Counselling can help solve current financial problems, create awareness about the costs of misusing a credit, can improve financial management and help develop realistic spending plans. Debt counselling/credit counselling can be both preventive and curative. In case of preventive counselling, the centres could provide awareness regarding cost of credit, availability of backward and forward linkages, where warranted, etc. The clients could be encouraged to avail of credit on the basis of their repaying capacity. Preventive counselling can be through the media, workshops and seminars. In the case of curative counselling, the clients may approach the counselling centres to work out individual debt management plans for resolving their unmanageable debt

portfolio. Here, the centres could work out effective debt restructuring plans that could include repayment of debt to informal sources, if necessary, in consultation with the bank branch.

### **III. Specific objectives of FLCCs**

With the above background, let me remark on the specific objectives of setting up FLCC. As you are aware, while the broad objective of the FLCCs will be to provide free financial literacy/education and credit counselling, the specific objectives of the FLCCs would be:

- i. To provide financial counselling services through face-to-face interaction as well as through other available media like e-mail, fax, mobile, etc. as per convenience of the interested persons, including education on responsible borrowing, proactive and early savings, and offering debt counselling to individuals who are indebted to formal and/or informal financial sectors;
- ii. To educate the people in rural and urban areas with regard to various financial products and services available from the formal financial sector;
- iii. To make the people aware of the advantages of being connected with the formal financial sector;
- iv. To formulate debt restructuring plans for borrowers in distress and recommend the same to formal financial institutions, including cooperatives, for consideration;
- v. To take up any such activity that promotes financial literacy, awareness of the banking services, financial planning and amelioration of debt-related distress of an individual;

FLCCs are not expected to act as investment advice centres /marketing centres for products of any particular bank/banks. Counsellors may refrain from marketing/providing advice regarding investment in insurance policies, investment in securities, value of securities, purchase/ sale of securities, etc., or promoting investments only in bank's own products.

### **IV. Role of the RBI**

We, at the RBI, actively encourage these initiatives and one of the main reasons for my coming here to launch the trust is to demonstrate our commitment to this cause. RBI has completed 75 years and in our platinum jubilee year, we are making concerted efforts to expand the reach of formal finance through outreach initiatives. All the stakeholders are being encouraged to push aggressively for greater financial inclusion. The Banking Codes and Standards Board of India (BCSBI) has recently brought out an updated code to ensure that the banks formulate and adhere to their own comprehensive code of conduct for minimum standards of banking services, which individual customers can legitimately expect. And finally, the Banking Ombudsman Scheme has been instituted for redressal of grievances against deficient banking services, covering all the States and Union Territories.

### **V. Issues and challenges**

Since promoting awareness is one of the primary objectives, the FLCCs should give due emphasis to customers' rights under fair practices code and act as watch dogs. Our institutions must provide high quality public services to all citizens with transparency and accountability. To achieve this, there are several issues and challenges that come to my mind:

- i. The first issue is that of treating the customers fairly. Transparent pricing, terms and conditions of financial products including interest charges, premia, fees and user

friendly products made available in a form which is intelligible to borrowers would go a long way in reducing the need for having financial education centres in the first place. There is a need to sensitise the bank staff to engineer an attitudinal shift with empathy for the poor, strengthen and streamline systems to improve the efficiency of our distribution and delivery mechanisms.

- ii. The second issue for banks is to expand the range and reach of counselling and advisory services to vulnerable sections. For this a large number of such centres would be required. Up to end June 2009, banks have reported setting up 154 credit counselling centres in various States of the country. Obviously, there are many districts which still do not have such centres and we need to strive towards setting up more centres.
- iii. Third, banks need to facilitate the empowerment of credit counselling centres for them to be effectively liaising and negotiating on behalf of their customers. It must be understood that FLCCs are to facilitate responsible behaviour among financial institutions serving customers at the base-of-pyramid as part of their focus on equity and efficiency.
- iv. The fourth issue is that of enlisting committed and well trained personnel to man these centres. As quality of service is an important aspect, it is desirable to have appropriately bench-marked quality standards for credit counsellors and counselling agencies. A related issue is that whether there should be accreditation of credit counselors? If so, who should do it, industry associations or individual banks? These could be considered in due course.
- v. The fifth issue that faces agencies is that of following a segmented approach vis-à-vis a broad-based generalized one. It is clear that banks may have to adopt a segmented approach specific to different categories of borrowers and different credit segments. Similarly, in respect of urban and rural areas, different approaches would be required. For instance, the centres in rural and semi urban areas could concentrate on financial literacy and counselling for farming communities and those engaged in allied activities. The centres in metro/urban areas could focus on individuals with overdues in credit cards, personal loans, housing loans, etc. Thus, the challenge is to tailor differential literacy and counselling mechanisms depending upon the need.
- vi. Sixth, an important issue from the financial literacy perspective is that of content design and appropriate delivery medium and mechanism suitable to the particular target group.
- vii. Lastly, as lack of awareness is major stumbling block in such initiatives, it is necessary to give wide publicity to the concept of credit counselling and the free availability of such services. Effectively utilizing the various mass communication channels and leveraging information technology would assume importance in this context.

## **VI. Conclusion**

I hope the FLCC of Federal Bank would bring “Ashwas” or relief to the common person. The bank, based on the experience gained, may like to consider opening more such centres in other districts of the State in due course as the benefits of such initiatives flow back to the banks. We need to collectively strive to deepen and broaden the agenda for inclusive development; and to ensure that no individual, community or region is denied the opportunity to participate in, and benefit from the development process.

I wish the Trust all the success.