S S Mundra: Banking renaissance – inclusion, innovation & implementation

Chief guest address by Mr S S Mundra, Deputy Governor of the Reserve Bank of India, on "Banking Renaissance: Inclusion, Innovation & Implementation" at the seventh Annual Banking Conference "Bank on it, 2014", Mumbai, 11 October 2014.

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1. Shri Arun Tiwari, Chairman, Union Bank of India; Dr. Rajan Saxena, Vice-Chancellor, Narsee Monjee Institute of Management Studies (NMIMS); Dr. Shamsuddin Ahmed, Dean; Dr. Vrinda Kamat, Professor and Programme Chairperson (MBA Banking); Shri. C. B. Ramamurthy; faculty and students of the School of Business Management, NMIMS University; distinguished invitees, members of the print and electronic media, ladies and gentlemen! At the outset, let me commend the NMIMS for imparting excellent education and practical knowhow to its students thereby equipping them to take on leadership roles in various organizations. Institutions such as the NMIMS are playing a key role in developing skilled and capable manpower and are, consequently, serving the nation.

2. It is, therefore, a pleasure for me to be amidst these budding management professionals this morning to deliver the opening address at the seventh Annual Banking Conference "Bank on it, 2014" organized by the NMIMS University. I observe that the Conference has hosted some illustrious speakers in the past and deliberated upon various pertinent issues impacting the banking system.

3. Before I get down to the theme of the Conference, let me begin by quoting two famous Americans.

> ***"It is well enough that people of the nation do not understand our banking and money system, for if they did, I believe there would be a revolution before tomorrow morning."*** – Henry Ford, founder of the Ford Motor Company
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> ***"I sincerely believe that banking establishments are more dangerous than standing armies, and that the principle of spending money to be paid by posterity, under the name of funding, is but swindling futurity on a large scale."*** – Thomas Jefferson, the principal author of the Declaration of Independence (1776), and the third President of the United States

Now that you know what some of the leading statesmen of the world have to say about banks and the banking system, I am not sure whether we should attempt to spread greater awareness about them and risk a revolution! Also imagine these comments came at a time when the credit card, mortgage loan and other personal loans were not even known. However, as a career banker with over thirty five years of experience in banking, I would like to comfort you that the bankers and the banking profession is not as iniquitous, as these two gentlemen would like the world to believe.

Why the call for banking renaissance?

4. On a more serious note, let me now turn to the theme for the Conference, which is "Banking Renaissance: Inclusion, Innovation & Implementation". As you might know, the word "Renaissance" has a French origin meaning *re-* "back, again" + *naissance* "birth" (from Latin *nascentia*, from *nasci* "be born"). Renaissance refers to a period which witnessed a revival of European art and literature under the influence of classical models in the 14th–16th centuries. Another dictionary meaning of renaissance is "*a revival of or renewed interest in something"*.

5. I am not too sure in what context has the word "Renaissance" been referred to in the theme of this Conference. Obviously, you could not be talking of revival of interest in

classical mould of banking and about innovation in the same breath. Likewise, I am not too sure whether it has something to do with a revival of or a renewed interest in banking, as I don't think the interest of the society in banking, more so, in a developing economy like ours, has ever waned. My understanding of the theme for the Conference is that we probably need to deliberate about the innovative measures needed in our banking sector which would render it more inclusive, vibrant, productive, efficient and above all, customer-centric. Therefore, in my address today, I would speak with this basic presumption and I do hope that I am not veering away from the theme.

Evolution of banking

6. But before I get into the subject proper, just to set the context, I would like to briefly highlight how the modern day banking has evolved. Banking, in the form that we know today, might have evolved during the 17th century. However, even in ancient Mesopotamia, all the modern banking practices such as deposits, interest, loans and letters of credit seem to have existed. The practice of safe-keeping and savings also seem to have been in existence in the temple of Babylon as early as 2000 B.C. Closer home, Kautilya, in his Arthashastra written in about 300 B.C., has also mentioned about the existence of powerful guilds of merchant bankers who received deposits, and advanced loans and issued hundis (letters of transfer). In the modern times, an experienced Scottish goldsmith, William Paterson, is credited with the idea of setting up a national bank in Britain in 1688, which gave birth to the Bank of England. The modern day banking, in its simplest form, is meant to facilitate financial intermediation between the savers and the borrowers. It also seeks to act as a safe place to store money and earn some return in the process, as also a place to seek simple financial solutions to individual problems. The advent of technology in modern times has heralded three distinct phases in banking: a) Computerization of back office processes during the 1980s, b) Facilitating higher customer convenience during the 1990s and c) Enabling lifestyle/life stage banking during the 2000s. Thus, over time, the banks have witnessed significant changes in their outlook and have emerged as financial supermarkets offering a range of complex financial products and services on a round the clock basis, duly customized to the needs of their customers through multiple delivery channels.

7. RBI, as the regulator of banks in India, has increasingly deregulated the sector and has allowed the market players to develop products and services best suited to their customers. As a result, both in terms of products & services and delivery channels, there has not been any dearth of innovations. On the product front, the innovations have led to emergence of complex offerings like swaps, derivatives and securitization, while on the other hand, the delivery channel is no more limited to brick and mortar branches, but has spread to modern, technology-driven channels like ATMs, mobile, internet and the social media, besides the Business Correspondent model. Thus, over the years, there has been tremendous amount of progress and innovations in the sector. However, these developments have, simultaneously, raised certain pertinent questions:

- Whom have these innovations benefited?
- Are these product offerings demand driven?
- Have the banks addressed the "suitability and appropriateness" question?
- Have the charges for various services been made transparent and non-discriminatory? Why banks are still a place where ordinary mortals fear to tread?
- Why has a large section of the society remained financially excluded despite sincere efforts of the regulator as well as the policy makers?

8. Having an insider's view of India's financial system, first as a commercial banker and now as a central banker, I intend to use this opportunity today to share my perspectives on the approach adopted by RBI as the regulator of Indian banks for making the Indian banking

sector more inclusive and relevant to a large cross-section of the Indian economy and society. I shall also delve on the challenges which the banking system is encountering in realizing the goal of universal financial inclusion and the innovation and reforms that may be necessary to overcome some of these challenges. I also wish to emphasize that having bright and innovative ideas do not have any meaning until and unless they are acted upon. I, therefore, compliment the organizers for including "implementation" as an element of the theme for the conference, as I believe that rigor in implementation is extremely important for realization of the dream of universal access to financial services and products.

Why is financial inclusion necessary?

9. The ILO Declaration of Philadelphia in 1944 proclaimed that "Poverty anywhere is a threat to prosperity everywhere." It is universally agreed now that Financial Inclusion helps build domestic savings, bolster household, domestic and financial sector resilience and stimulate business and entrepreneurial activity, while exclusion leads to increasing inequality, impediments to growth and development. Thus, financial inclusion is an important tool for poverty alleviation as it not only connects individuals to the formal financial system, but also inculcates savings habit among them. Hence, Financial Inclusion or inclusive banking is a precursor for inclusive and sustainable economic growth.

Financial exclusion: dimension of the problem

10. An accusation that has come to be levied against the banking sector in the aftermath of the Financial Crisis is that it has failed to be "inclusive". Let me tell you that the Indian banking system is not alone in failing the "inclusion" test. It is only the degree of exclusion that varies between different jurisdictions. The Financial Inclusion Action Plan (FIAP) developed by the G20 Global Partnership for Financial Inclusion mentions that the universal financial inclusion initiative requires bringing the 2.5 billion people (or about half the working age population) currently excluded, into the formal financial system.

11. That brings us to the question how inclusive is the Indian financial system? Census 2011 gives us some answers. Out of 24.67 crore households in the country, only about 14.48 crore or 58.70 per cent households had access to banking services. Further, of the 16.78 crore rural households only about 9.14 crore or 54.46 per cent households were availing of banking services. But that is only one aspect of the financial exclusion story. The statistics on number of individuals or households that are credit-linked makes for an even more gloomy reading. The World Bank Findex Survey (2012) points out that only about 35% of Indian adults had access to a formal bank account and a meager 8% borrowed formally in the last 12 months. If we were to broaden the canvas and examine the exclusion in the other financial segments of insurance and securities market, the situation is far worse.

Initial efforts at financial inclusion

12. Having recognised early the social and economic imperatives of broader financial inclusion, both Government and the Reserve Bank have pursued this goal over the last several decades, but with limited success. Starting with the nationalization of banks, priority sector lending requirements, launching of Lead Bank Scheme, establishment of Regional Rural Banks (RRBs), Service Area Approach, Self-Help Group-Bank Linkage Programme- all these innovative programmes were launched with the aim of taking banking services to the masses. Starting in 1990s, however, the focus shifted to strengthening financial institutions as part of financial sector reforms. Despite all the above efforts, the extent of financial exclusion has remained staggering.

Why did these efforts fail?

13. The target driven approach to social banking could be counted as one of the main reasons for the failure of these efforts as these initiatives could never become part of the business strategies of banks. The banks were more interested in somehow trying to meet the lending targets, mostly at subsidized rates of interest, or with subsidy from the Government under various government directed schemes. The banks never treated social banking as a viable and profitable business proposition. They always worked under the presumption that the poor can neither pay normal interest rates nor could they earn enough without subsidies; while in reality the poor continued to pay exorbitant interest rates to informal sources of finance. For any activity to become sustainable and scalable it has to be viable. Regrettably, there has never been a concerted effort on the part of the banking system to identify specific business opportunities within these groups and to develop viable business models to realize them. I would like to reiterate our firm belief that banking for poor is viable and scalable only on commercial lines, of course, without an exploitative intent.

Reform era setback

14. During the period starting mid 1980s and till about 2005, the regulatory focus shifted to consolidation and profitability of banks. Since social initiatives, as argued earlier, were not integrated with business plans and were thought of as non-viable, they were the first casualties. A number of rural branches were closed down or merged or were shifted to semi-urban areas as they were considered unviable.

Excessive reliance on public sector banks

15. The thrust of social initiatives has always been on the public sector banks while the private sector banks and foreign banks have not been given adequate social obligations. Besides, too many authorities involved in pursuing financial inclusion also, at times, resulted in dissipation of structured and planned efforts.

Absence of technology

16. In the absence of appropriate enabling technology, reaching far flung areas of the country without a brick and mortar structure, proved to be a difficult and expensive ordeal.

What has changed now?

17. In the last few years, it has been realized that for financial inclusion to become a reality, there has to be a sustainable business and delivery model. Further, availability of technology as an enabler has now created avenues for developing cost effective solutions for the mammoth task of providing banking services to six lakh plus villages in the country. The lessons learnt from the initial attempts at promoting financial inclusion have also proved to be vital inputs in recalibrating our financial inclusion strategy.

RBI's approach to financial inclusion

18. The failure to achieve meaningful progress in financial inclusion forced the regulators and policy makers to have a rethink on the approach. It began with defining what Financial Inclusion actually meant and where should the energies be focused. RBI has defined Financial Inclusion as "the process of ensuring access to appropriate financial products and services needed by all sections of the society in general and vulnerable groups such as weaker sections and low income groups in particular, at an affordable cost in a fair and transparent manner by regulated, mainstream institutional players". Thus, financial inclusion has two fold objectives:

- To connect the excluded with the formal banking system in order to help them gain an understanding of the financial services available and equipping them with the confidence to make informed financial decisions.
- Providing door step banking services to all the six lakh villages and meeting their life cycle financial needs through appropriate savings, credit, remittance and insurance products.

Planned and structured approach

19. RBI has been following a planned and structured approach to address the twin issues of demand and supply of financial services. The efforts have been aimed at creating an enabling environment for the banks. Wide-ranging strategies from a relaxation of regulatory guidelines to provision of new products and supportive measures have been adopted to achieve sustainable and scalable Financial Inclusion.

Bank- led model & leveraging technology

20. RBI has advocated a bank-led model for financial inclusion with thrust on leveraging technology. We firmly believe that the success of FI initiatives greatly depends on technology which would enable emergence of cost efficient delivery models. Though we have advocated the use of technology, we are agnostic to the platform to be used for pursuing financial inclusion objectives. Banks have been accorded the freedom to adopt solutions which can be easily scaled up and customized as per their requirements.

Recent innovations under financial inclusion

21. RBI has not been found wanting insofar as experimenting with innovative solutions to further the cause of financial inclusion is concerned. However, we have always believed that innovation does not mean developing complex solutions to simple problems. Also, innovation need not always involve cutting edge technology. Hence, some of the innovative practices we have encouraged banks to follow, merely involves making small adaptations and a change in mindset. Let me explain some of these initiatives.

a) Business correspondent / business facilitator model

22. Beginning January 2006, Reserve Bank has permitted banks to utilise the services of non-governmental organizations (NGOs), micro-finance institutions (other than Non-Banking Financial Companies) and other civil society organisations as intermediaries in providing financial and banking services through the use of Business Facilitator and Business Correspondent (BC) models with an objective of solving the list mile connectivity issue. Banks were encouraged to connect the BC network with their Core Banking Solutions (CBS) and also to develop offline solutions to overcome the network connectivity issues experienced in some areas. As the uptime of the equipments was of paramount importance, the banks were advised to ensure that equipment and technology used by BCs are of high standards. Interoperability of BCs at the retail outlets or sub agents of BCs has also been permitted, provided the transactions were carried out on-line, on CBS. The list of entities that can be appointed as BCs has also been expanded substantially over time.

b) Simplified branch authorisation

23. RBI has considerably relaxed the branch opening norms for banks whereby they do not require prior RBI permission for opening branches in centres with population less than 1 lakh. To further step up the opening of branches in unbanked centres, banks were mandated to open at least 25 per cent of their new branches in unbanked rural centres. Banks have also been advised to consider frontloading (prioritizing) the opening of branches in unbanked rural centres over a three year cycle co-terminus with their Financial Inclusion Plans.

c) Combination of branch and BC structure to deliver financial Inclusion- ICT based accounts – through BCs

24. RBI has been advocating a combination of Brick and Mortar structure and the BC network to extend financial inclusion, especially in geographically dispersed areas. In order to provide efficient and cost-effective banking services in the unbanked and remote corners of the country, RBI directed commercial banks to provide ICT based banking services – through BCs. These ICT enabled banking services have CBS connectivity to provide all banking services including deposit and withdrawal of money in the financially excluded regions. The use of smart cards, hand held devices / POS machines along with bio-metric authentication facilitates digitization of Financial Inclusion process.

d) Opening of basic saving bank deposit accounts (no-frills accounts)

25. On the products side, banks were directed to make available Basic Savings Bank Deposit Accounts (BSBDAs) for all individuals with zero minimum balance and facility of ATM card/Debit card, effectively making opening of a basic savings account a fundamental right for every eligible Indian citizen. Further, banks were also advised to provide in-built overdrafts in such basic savings accounts so as to meet the emergency credit needs of the customer and prevent them from having to approach money lenders in distress situations. The provision for entrepreneurial credit has also been simplified in the form of KCC for farm sector households and GCC for non-farm sector households.

e) Relaxed KYC norms

26. One of the major constraints faced by the people in getting linked to the formal financial system was the strict Know Your Customer (KYC) norms prescribed for opening bank accounts. To facilitate easy opening of accounts, especially for small customers, the KYC guidelines have been simplified to the extent that these accounts can be opened by way of a self-certification in the presence of bank officials. Further, to leverage upon the UIDAI initiative, RBI has allowed "Aadhaar", to be used as one of the eligible documents for meeting the KYC requirements for opening a bank account. Very recently, the RBI has also allowed banks to use the E-Aadhaar facility provided by UIDAI for KYC purposes.

f) Pricing of advances freed

27. Banks have been provided the freedom to decide the pricing of loans given to customers with a view to ensuring the economic viability of banks' Financial Inclusion initiatives.

Financial literacy as a facilitator of financial inclusion

28. As financial markets are becoming increasingly complex with serious problems of information asymmetry, the need for financial literacy and education has become even more acute. Besides, there is a general lack of awareness among the financially excluded population about the benefits of being connected to the formal financial system. This highlights the importance of the task of promoting financial literacy, which faces numerous challenges in a country like India, on account of wide disparities in literacy levels, social/ economic development, widespread use of regional languages, etc. Recognizing the importance of financial literacy as the stepping stone towards financial inclusion, Reserve Bank has taken several steps in recent times for promoting financial literacy. "Project Financial Literacy" aims at disseminating information regarding the central bank and general banking concepts to various target groups (which includes school and college-going children and the rural/urban poor).

Implementation: issues and challenges

29. Let me now dwell upon some implementation challenges that need to be overcome if the goal of attaining universal financial inclusion has to be achieved.

a) Believing in financial Inclusion as a viable business

30. There is still a widespread belief that if the poor have to be provided financial services, it must be done in a subsidized manner or as an act of charity. And this belief has kept the poor bereft of these services while keeping the regime of rationing, queuing and patronage alive. Contrary to common perception, financial inclusion is a potentially viable business proposition because of the huge untapped market that it seeks to bring into the fold of banking services. Financial Inclusion, prima facie, needs to be viewed as "money at the bottom of the pyramid" and in order to tap this opportunity, banks would need to have in place an appropriate business and delivery model in line with their business strategy and comparative advantage. If the banks start believing in this business, they would be able to innovate and, in the process, start reaping the benefits of economies of scale. This will ultimately create an environment of competitiveness amongst banks which will benefit the unbanked population.

b) Monitoring performance

31. Along with the implementation efforts, the monitoring of the performance to access the impact is also very crucial. The impact assessment helps in initiating policies and removing barriers to Financial Inclusion. We have encouraged banks 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). A structured and comprehensive monitoring mechanism for evaluating banks' performance vis-à-vis their targets has also been put in place.

c) Leveraging the banking network for extending social benefits: direct benefit transfer

32. The introduction of direct benefit transfer by validating the identity of the beneficiary through Aadhaar will help facilitate delivery of social welfare benefits by direct credit to the bank accounts of beneficiaries. The government, in future, has plans of routing all social security payments through the banking network using the Aadhaar based platform as a unique financial address for transferring financial benefits to the accounts of beneficiaries. Besides providing timely delivery of benefits at the door step of beneficiaries, it would save Government the administrative cost involved in delivering cash to the intended beneficiaries and help minimize the chances of leakages in the system. Banks must initiate steps to proactively open bank accounts for all eligible individuals and seed these accounts with Aadhaar numbers for ensuring smooth flow of the social security benefits through the banking channel.

Pradhan Mantri Jan Dhan Yojana (PMJDY)

33. Pradhan Mantri Jan Dhan Yojana has been announced recently to give a further push to Financial Inclusion initiatives in India. The scheme has been launched with the objectives of providing universal access to banking facilities, providing basic banking accounts with overdraft facility and RuPay Debit card to all households, conducting financial literacy programs, creation of credit guarantee fund, micro-insurance and unorganized sector pension schemes. The objectives are expected to be achieved in two phases over a period of four years up to August 2018. Under the scheme, technological innovations like RuPay card and mobile banking are also being made use of. Banks are also permitted to avail of RBI's scheme for subsidy on rural ATMs and UIDAI's scheme for subsidy on micro ATMs to augment their resources at the village level.

Way forward

34. Banks' business models for financial inclusion should be designed to be at least self-supporting in the initial phase and profit-making in the long run, with an unwavering focus on affordability. The banks need to think and act differently and make themselves more flexible so as to meet even the smallest requirements of the rural population. Banks need to move from a cost centric model to a revenue generating model by offering a bouquet of deposit, credit and other products and services. The products and services should be designed in such a way that it suits the needs of people in unbanked rural areas.

i) BC model

35. There are multiple challenges being faced while implementing BC model. Sustainability and scalability of the BC model is essential. There are issues around BCs' cash management services and remuneration to be paid to them. There is a need to have a close look at the problems constraining the model and to develop practical solutions that help in realizing the full potential of this channel. More and more innovative products will have to be introduced which would benefit both banks as well as the rural people and at the same time make the BC model more viable.

ii) Differentiated banking

36. RBI is set to create a framework for licensing small banks and payments banks. These differentiated banks would be expected to serve niche interests and to meet credit and remittance needs of small businesses, unorganized sector, low income households, farmers and migrant work force. This aims at allowing a wider pool of entrants into banking to further Financial Inclusion.

iii) PMJDY

37. The objective of Financial Inclusion as defined by us is very much in sync with the objectives sought to be achieved under the PMJDY. We are fully committed to the implementation of the scheme and are trying to ensure that the efforts of RBI converge with the work under the PMJDY so that the common objective of financial inclusion is achieved. Further, the idea is to enable more transactions in these accounts and providing more credit products, which will not only help rural people to avail of credit at comparatively lower rates of interest but, at the same time, also make the financial inclusion process viable for banks. With implementation of PMJDY, it is expected that the beneficiaries of social security will get the direct credit of their entitlements without any leakage. However, for successful achievement of the same, it is to be ensured that there is timely and accurate listing of beneficiaries.

Message for students

38. Before I conclude my address, let me leave you with a couple of thoughts. Very shortly you would be venturing into the job market and start working. My advice to you is that you should choose your profession/vocation carefully and work hard in whichever field you opt for. But I would also advise you to work smart. Working smart, among others, also involves need for networking. You must choose your associates wisely and cultivate that association. My second thought is around what I call the theory of "1-2-3" being practiced in the professional job market. These days, the organizations seek to hire one person, pay him/her the salary of two persons and expect him/her to work equivalent to three persons. If you do not guard against that, you would end up burning out very early in your professional lives. My advice to you would be to develop the spirit of a marathon runner and not that of a sprinter. Only then would you be able to fully realize the potential imbibed by you through the quality education received from this esteemed institution.

Conclusion

39. Financial Inclusion cannot be achieved without the active and collaborative involvement of all stakeholders like RBI, other financial regulators, banks, governments, NGOs, civil societies, media, etc. Good intentions always need to be supported by concerted action for achieving goals. The support of policymakers, regulators, governments, IT solution providers and public at large would be essential to bring about a decisive metamorphosis in Indian banking and making it inclusive.

40. Finally, though Innovation is desirable, excess of the same could also mean higher cost and time overruns. It is important to strike a balance between no innovation and excess innovation. Innovation need not always be revolutionary. Enough on the financial inclusion front could be achieved even by thinking “inside the box”, that is, by focusing on doing the basics right. I would like to conclude by quoting Gene Roddenberry, “It isn’t all over; everything has not been invented; the human adventure is just beginning.”

41. I once again thank Narsee Monjee Institute of Management Studies University and the faculty and students of the School of Business Management for inviting me to this Conference for sharing my thoughts on a topical subject. I am sure that you would now have a better understanding of the issues involved and you would reflect on the challenges at hand in making banking inclusive. I am also confident that some of the students present here would join the banking sector and serve as torch bearers for “inclusive banking and inclusive growth” in the days ahead. I hope the deliberations during the day would also pick up some issues that I have laid down on the table. We have a lot of expectations from our youth and I do hope some of you could take up research in this area and come up with actionable solutions for financial inclusion.

42. I wish you a successful conference today as well as success in all your future endeavors.

Thank You.