

## S S Mundra: Financial inclusion in India – the journey so far and the way ahead

Address by Mr S S Mundra, Deputy Governor of the Reserve Bank of India, at the BRICS Workshop on Financial Inclusion, Mumbai, 19 September 2016.

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Shri Santhosh Kumar Gangwarji, Honorable Minister of State for Finance, Government of India; Shri Ashwani Kumar, Chairman, IBA & CMD, Dena Bank; Shri Rajiv Rishi, Deputy Chairman, IBA & CMD, Central Bank of India; Dr. Madnesh Kumar Mishra, JS(DFS) & Mission Director-Financial Inclusion, GOI; delegates to the Workshop; ladies and gentleman! At the outset, I would like to compliment Department of Financial services, GOI and IBA for organizing this workshop on Financial Inclusion under the BRICS Forum. It is indeed a pleasure for me to speak to you from this Forum today.

2. Financial Inclusion is a much cherished policy objective for us in India and our economic policy has always been driven by an underlying intent of a sustainable and inclusive growth. Although I would not dwell at length about the virtues of financial inclusion before this learned audience, I would still like to draw reference to a profound ILO Declaration of Philadelphia (1944) which states that *“Poverty anywhere is a threat to prosperity everywhere.”* The policy makers in India too i.e. Government of India and the RBI, had an early realisation about the implications of *poverty for financial stability* and have endeavored to ensure that poverty is tackled in all its manifestations and that the benefits of economic growth reaches the poor and excluded sections of the society.

3. I wish to use this Forum to brief you on our journey towards the goal of universal financial inclusion in India, the challenges encountered and the way forward. But before, I get into the subject proper; let me for the benefit of our international participants, state our definition of Financial Inclusion.

*“Financial Inclusion is 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 mainstream institutional players**”.*

### Role of RBI in financial inclusion

4. As I said earlier, RBI has been pursuing the goal of financial inclusion for a long time. RBI's financial inclusion efforts can be traced back to the 1960s when the focus was on channelizing of credit to the neglected sectors of the economy and weaker sections of the population. While the Government of India nationalized the banking operations of few commercial banks in two tranches in 1969 and 1980; RBI also took initiatives like laying down priority sector lending requirements for banks, Lead Bank Scheme, establishment of Regional Rural Banks (RRBs-1975–76), Service Area Approach (1989), Self-Help Group-Bank Linkage Programme (1989–90), setting up of Local Area Banks etc., all aimed at making available benefits of banking services to the masses.

5. Although these measures resulted in impressive gains in enhancing the outreach of banking services and extent of credit to the population, there were certain structural challenges which impeded the progress of financial inclusion. On the supply side, absence of technology was a major impediment as it restricted expansion of banking services to far-flung areas of the country comprising of 600 thousand plus villages. In the absence of technology, developing a cost-effective delivery model also remained a challenge.

6. Since 2006, RBI has adopted a planned and structured approach to address the issues of financial inclusion. RBI's approach has been to focus both on the demand as well as on the

supply side. This has in a large way been possible due to the availability of technology and its gradual adoption within the banking processes. Let me elaborate on some of these measures and consequent achievements.

7. Institutionalization of the framework of Banking Correspondents (BCs) has been a major step towards enhancing access of banking services. RBI advocated a combination of “Brick and Mortar” structure with “Mouse and Click” technology for extending financial inclusion in geographically dispersed areas.

8. On the regulatory side, the banks were mandated to open at least 25 per cent of their new branches in unbanked rural centers. Taking into account the difficulties encountered by common people in meeting the “Know Your Customer (KYC)” requirements for opening bank accounts, several measures were taken. For example, RBI allowed banks to accept self-certification for opening of basic service bank accounts. RBI has encouraged banks to open Aadhaar<sup>1</sup> Enabled Bank Accounts by linking Aadhaar numbers of individuals, wherever available, with the Basic Savings Bank Accounts opened for them, so that their credit histories can also be built up over time.

9. Co-terminus with the above efforts, RBI also 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). The first two phases of FIPs implemented over 2010–13 and 2013–16 were interspersed with the implementation of PMJDY by the Government of India during 2014–15, whereby the supply side efforts received an extra push.

### Snapshot of progress

10. Let me quote some numbers.

- i) The number of banking outlets in villages went up from 67,694 in March 2010 to 5,86,307 in March 2016 after RBI permitted appointment of BCs and laid out a roadmap for spreading banking services in rural India through a mix of bank branches and BC outlets. In addition, the number of urban locations covered through BCs has also surged from 447 in March 2010 to 1,02,552 in March 2016.
- ii) The Basic Savings Bank Deposit Accounts (BSBDAs) have gone up from 73 million in March 2010 to 469 million as on March 31, 2016. Under the PMJDY alone, until June 1, 2016, 220 mn accounts have been opened with an approximate balance of Rs. 384 bn.
- iii) There were 47.31 million small farm sector credit accounts and 11.3 million small non-farm sector credit accounts with an outstanding of Rs. 5130.7 billion and Rs. 1493.3 billion outstanding respectively as on March 31, 2016. The number of small farm and non-farm sector credit accounts stood at 24.3 million and 1.4 mn respectively in March 2010.
- iv) The total number of transactions in BC-ICT accounts which were around 26 million during 2010–11 have increased to 826.81 million as on March 31, 2016.

11. For most other countries these numbers may appear overwhelming, however, we still have a long way to go here in India and we are extremely mindful of that. There are plenty of challenges – low volume of transactions in the basic bank accounts, inactive BC outlets, inaccessibility, poor connectivity etc. Last year, RBI had set up an Expert Committee on Medium Term Path for Financial Inclusion under ED (Deepak Mohanty) which was tasked to

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<sup>1</sup> Aadhaar is a unique identifier for all individuals in the country.

draw up a medium term and long term roadmap for FI. The committee has made about 80 actionable recommendations which are being pursued by RBI.

12. Following a paradigm shift in the Financial Inclusion landscape, a need was felt for convergence of the FI efforts of various stakeholders. Accordingly, RBI has reconstituted the high-level inter-institutional Financial Inclusion Advisory Committee (FIAC) for undertaking a continuous review of the policies on FI; monitoring of the progress in Financial Inclusion and the financial literacy; evaluation of its impact through conduct of study/surveys and for preparation of a National Strategy for Financial Inclusion.

### **Other recent measures**

#### **New banking entities permitted in the financial inclusion space**

13. RBI has granted in-principle approval to some entities to set up differentiated banks namely “Small Finance Banks” (SFBs) and “Payments Banks” to further the cause of financial inclusion in the country. Other than serving as vehicles for savings, SFBs and Payments banks are expected to enhance the supply of credit to small business units, small and marginal farmers, micro and small industries and other entities in the unorganized sector and enable provisions for cost-efficient remittance services in a secured technology driven environment respectively.

#### **Role of payment system in promoting financial inclusion**

14. Considering the strong linkage between financial inclusion and the payment systems, RBI has taken several steps. Some of these include encouraging use of Mobile Banking, pre-paid instruments in the form of digital wallets and mobile wallets, operationalization of the Aadhaar Bridge Payment System (ABPS) and Aadhaar-Enabled Payment system (AEPS) etc.

#### **Increasing brick and mortar presence**

15. While there is considerable improvement in access of banking services through a mix of physical and virtual mode, it is believed that there should be a fair balance between the number of BCs and brick and mortar branches for better alignment of the inclusion efforts. Accordingly, it is mandated to open physical bank branches in all villages above a population of 5000 in a phased manner. We feel this would also enable banks to not only provide quality financial services but also timely support to their BC network.

#### **Creation of BC registry and certification**

16. The BC Model is a critical lynchpin of our Financial Inclusion initiative. We believe that to support the BC structure, a vital first step is developing a BC Registry. This would not only ensure greater oversight on the functioning of BCs but would also provide more confidence to the end customers. A scheme for graded certification/ training programme for BCs is also being introduced to enable the BCs with a good track record and advanced training to handle complex tasks that are beyond deposits and remittances.

#### **Financial inclusion Plans for banks (2016–19)**

17. To sustain the momentum of achieving the financial inclusion objectives by setting FIP targets for banks, the third phase of Financial Inclusion Plans for the next three years 2016–19 has been initiated. Under the third phase, the focus is on more granular monitoring of the progress made by banks under FIPs at district level.

## Demand side interventions

18. Having spoken about the progress and some recent measures taken by RBI on supply side, let me talk about an equally important, but less focussed, demand side aspects of Financial Inclusion. As I mentioned earlier, banks have opened about 440 million accounts under the push from RBI and the PMJDY and hence, it is right time to focus on the demand side which is to focus on enhancing capabilities so that the individual is in a position to not merely avail the offered services, but is also capable of demanding preferred products and services suitable to her need/choice. Our belief is that unless the demand side measures adequately supplement the supply side measures, the goal of financial inclusion would remain the proverbial “wild goose chase”.

## Financial Literacy Centres (FLCs) / rural self employment training institutes

19. Banks in India have been mandated to set up FLCs for extending financial literacy. Currently, about 1380 FLCs across India are functional which adopt a tailored approach to conduct of camps. Special focus is given on people newly inducted into the banking system. Besides this, tailored camps are conducted for five different target groups i.e. farmers, small entrepreneurs, SHGs, School students and senior citizens. Going forward, given the challenges of skewed distribution of existing FLCs in a few states, limited outreach and to have an exclusive focus on financial literacy at the ground level, we are encouraging banks to set up CFLs (Centres for Financial Literacy) at the block level on a pilot basis in a few states.

20. The Rural Self Employment Training Institutes (RSETIs) have been set up by various banks all over the country at the district level. The key objective of RSETI is “Short term training and long term hand holding with assistance to credit linkage for trainees”.

## Direct benefit transfer and Aadhaar seeding of accounts

21. An important driver for enhancing the demand side of financial inclusion is Direct Benefit Transfer (DBT). It has the potential to be game changer. If entitlements under various state sponsored schemes starts directly flowing into the bank accounts of individuals under DBT mode, it can act as a catalyst to encourage saving habit leading to build up of investment and seed capital for availing productive credit.

Let me now come to the way forward.

## Way forward

22. I feel in order to motivate and nudge consumers to begin seeking formal financial services, there is need to focus on what I have named 3 Ps- Products, Processes and People. Let me elaborate.

- a) **Suitable Products.** The traditional approach of “*take it or leave it*” is not going to work for the people who are new to the financial system. Many of them do not have a continuous income stream. Their incomes are generally seasonal and hence erratic. Also, many have only a meagre amount to save and their needs are widely different from those of regular consumers. All these necessitate a customer centric product design taking into consideration the lifecycle needs of customers at every stage. Simultaneously, it is also important to prevent ***mis-selling of financial products*** to the newly inducted customers without due consideration around suitability. I have also noticed overzealousness in few quarters to provide credit to the new entrants to the fold of the financial sector. It is important to ensure that this overzealousness does not result in ***over-indebtedness***. We must be mindful of the fact that these individuals have entered the formal financial system after a lot of pushing and prodding and it would be difficult to bring them back into the formal financial sector, if they leave feeling cheated/dejected.

- b) **Transparent Processes.** Another area of concern is transparency in the processes. By transparency, I mean an objective communication about the products, procedures, documentation and other necessary formalities to be completed while making a financial transaction. Transparent processes result in greater trust and confidence in the financial system.
- c) **Committed People.** Both the suitable products, and the transparent processes need to be complemented by committed people who are willing to listen keenly, empathize with the consumers and willing to walk that little extra to welcome the customers into the formal financial system.

### **The 3x3x3matrix**

23. I believe once the above 3 Ps are in place, a focus on **3x3x3 matrix** would be important for enhancing financial capability of individuals and for achieving financial inclusion. The 3x3x3 matrix refers to three sections of the society which need a greater focus, pitching of products based on three kinds of surpluses that people generate and the three types of institutions that have a central role to play.

### **The three section approach – improving credit absorption capacity**

24. Firstly, in India, when we talk of inclusive growth, there are three sections that would warrant special focus. i) the small and marginal farmers, share croppers, ii) micro and small industries and iii) the low salary earners in the unorganized sectors. Collectively, this section makes a significant part of the population that needs enhancement in their financial capabilities. Also, these sections are extremely important contributors to the country's GDP and labour force.

25. The credit absorption capacity of the farmers can be enhanced through consolidation of fragmented landholdings by ushering in land reforms or through pooling of land holdings in an SHG format. Efforts to enhance the credit absorption capacity must also be supplemented through financial literacy and vocational training initiatives, comprehensive insurance cover against failure of crop & innovative practices in farming. Farmers also need to be sensitized about the concept of financing against warehouse receipts to avoid distress sale of produce at low prices.

26. Enhancing financial capability of mainly the micro and small entrepreneurs from amongst the larger MSME fold would help these entrepreneurs to move away from the informal to the formal sources of finance. Micro and small entities are typically enterprises with little or no credit histories and with inadequate expertise in preparing financial statements etc. They would, hence, need to be served with relevant products and at low cost by employing innovative credit scoring models.

27. There is also a pressing need to scale up the skills of the low salary earners in the unorganized sector through training inputs. Integrating the skill development initiatives with secondary and intermediate level education would address the challenge of low education levels and also provide school dropouts with employability skills. Dearth of formal vocational education, high school dropout rates, inadequate skill training capacity, negative perception towards skilling, lack of industry ready skills even in professional courses, continue to stand out as some of the major causes of poor skill levels in the workforce. It is heartening to note Government's commitment in encouraging entrepreneurship in the country through the new national skill development mission.

### **The three surpluses approach – suitability in products and services**

Let us now look at what I call as 3 surpluses.

28. The first group is the one that generates adequate surpluses. These people should be sensitized about different avenues to invest so as to reach their financial goals with ease. These may include investing in the capital market through shares, mutual funds, gold bonds etc. The second category of people generate meagre surpluses. They are the people who will be most suited for products like recurring deposits, SIPs etc. The third category comprises of people who have recently come into the financial system, who live on subsistence income and do not generate any meaningful surpluses. Our role as far as this group is to encourage them to use the basic bouquet of financial products like BSBDA for daily transactions as well as introduce them to electronic remittance channels. Similarly, customised basic term insurance and pension products currently being made available to this target Group under the Government of India initiatives can also go a long way in providing them some financial security in the longer term.

### **The three Institutions approach – endless opportunities**

29. The first category of institutions is whom I would call “Existing & Included”. It refers to the banks which have traditionally been leaders in bringing people in the formal financial system. These “included” institutions must look to deliver on the promise of ensuring the 3 Ps. Under the second category are institutions whom I refer to as “Existing, but not included” in the FI Grand Plan in a structured way. They are financial Intermediaries like NBFCs and MFIs that have a good last mile reach and should be leveraged upon. The third type is of the new institutions that will start operations soon. Three SFBs have already started their operations. Seven other entities hold in-principle approvals. We believe that they will be able to bring in technology backed innovative last mile practices to serve their customers. The bottom-line is that a coherent approach must be worked out so that the relative strengths of the three types of institutions can be leveraged upon.

### **Conclusion**

30. The vision for Financial Inclusion as envisaged by the Committee on Medium Term Path to Financial Inclusion is that by 2021, empowered by formal finance, over 90 per cent of the hitherto underserved sections of society would become active stakeholders in economic progress. This is very much possible but it would require focussed efforts both on the supply side as well as on the demand side. There is a strong business case in catering to the underserved sections of the society, given the vast developments in the frontiers of digital technology.

31. In conclusion, I would say that the cherished goal of universal Financial Inclusion can be achieved only through synergistic efforts between the mainstream financial entities and fringe players like rural co-operatives, NBFCs, MFIs, credit societies, NGOs ,etc. All of them have to play a complementary role in championing the cause of financial inclusion. Time is ripe to weave a financial inclusion tapestry where all these institutions can fit in a manner which brings about their contribution in the most efficient manner. This is where the efforts of the Government and RBI are currently focussed. I hope we can draw some useful lessons from the experiences of other countries within the BRICS Forum and build upon them as we continue our journey towards attainment of universal financial inclusion.

Thank you!