Fostering Consumer Inclusion in Financial Services

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Introduction

- **Half the world is unbanked: 2 billion adults and 200–250 million micro and small businesses are excluded from formal financial services.**

- **Rest of the world has much to learn from India's spectacular financial inclusion programme Pradhan Mantri Jan Dhan Yojana.**

- **Fostering financial inclusion depends upon innovations in regulation and policy development, technology, business models, incentives to open bank accounts, consumer access to financial knowledge, effective financial consumer protection rules, redress mechanism.**

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World Bank: Financial Inclusion

- **Financial inclusion means that individuals and businesses have access to useful and affordable financial products and services that meet their needs – transactions, payments, savings, credit and insurance – delivered in a responsible and sustainable way.**

World Bank 2017

Financial Services Inclusion

Formal accounts use varies widely across regions, economies and individual characteristics.

Account penetration worldwide:

- **2 billion adults don't have basic account.**
- **59% adults without an account: cite lack of enough money as key reason**
- **Other barriers: distance from financial service provider, lack of documentation papers, lack of trust in financial service providers, and religion.**
- **Some groups more financially excluded: women, rural poor, and other remote or hard-to-reach populations, as well as informal micro and small firms most affected.**
- **9% gender gap in developing countries: in 2014, 59% men and 50% women had an account .**

Similar pattern for electronic transactions (ATM, debit cards, & e- payments)

(World Bank 2017)_

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Financial Inclusion for MSMEs

- More than 200 million formal and informal micro, small and medium-sized enterprises (MSMEs) in emerging economies lack adequate financing to thrive and grow.

- MSMEs cite lack of collateral and credit history, and business informality as main reasons.

(World Bank 2017)

Financial Inclusion Required by:

Sustainable Development Goals

Goal 1: End poverty in all its forms everywhere.

Target 1.4: By 2030, ensure that all men and women, in particular the poor and the vulnerable, have equal rights to … financial services, including microfinance.

United Nation Guidelines on Consumer Protection

Para 66 – 68 Financial Services

67. Member States should adopt measures to reinforce and integrate consumer policies concerning financial inclusion, financial education and the protection of consumers in accessing and using financial services.

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Disadvantaged & Vulnerable Consumers

UN Guidelines for Consumer Protection (UNGCP) special recognition for "disadvantaged and vulnerable consumers":

Term used at least four times (para 5 (b), 11 (a), 42 and 77)

Also reference to specific such groups in:

Para 8: "particularly the rural population and those living in poverty";

Para 42: "special attention should be given to the needs of vulnerable and disadvantaged consumers, in both rural and urban areas, including low-income consumers and those with low or non-existent literacy levels";

Para 45: "particularly of low-income consumer groups in rural and urban areas";

Para 47: bearing in mind the need to reach rural consumers and illiterate consumers'.

Consumer Financial Services

1. **Payment : Mechanism for money transfer and payment for goods & services**
   (Cash, cheques, payment cards, postal and money orders, wire transfers, remittances, online funds transfer, etc.)

2. **Borrowing : Using future funds now**
   (Secured and unsecured - credit cards, overdrafts, payday loans, student loans auto loans, mortgage loans and margin loans, pawnbroking. Also implicit borrowing built into commercial structures, e.g. hire purchase)

3. **Saving: Storing future funds**
   (Saving accounts, fixed deposits, variable annuities, provident funds)

4. **Management of Risk: Mitigating financial risks**
   (Principally insurance, but also financial products , e.g. put options to protect portfolio declines)

5. **Investment: Increasing future funds**
   (Mutual funds, investment products of financial institutions)

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The Indian Experience

2011 Census:

- **41.3% of total households and 45.6% of rural households did not have access to formal banking services.**
- **72.7% of farmer households out of a total of 89.3 million households did not have access to credit from institutional sources (formal credit sources) and hence relied on family or moneylenders.**

Long History of Financial Inclusion Efforts

Nationalization begun in 1955, intensified in 1969 and 1980, had extending banking to the unbanked in rural and urban India as a principal objective.

From at least 1974 priority sector banking for availing credit to disadvantaged segments of society.

Significant initiatives: regional rural banks (1975), service area approach (1989) self-help group-bank linkage programme (1989, 1990), microfinance initiatives, use of business correspondents by National Bank for Agriculture and Rural Development (NABARD) , and simplified norms on know-your-customer by Reserve Bank of India (RBI).

Swabhimaan – nationwide financial inclusion programme launched February 2011 by Government and Indian Banks Association to bring banking services to 73,000 unbanked villages by March 2012

Pradhan Mantri Jan Dhan Yojna (PMJDY) 2014

Nearly 290.6 million accounts opened in 3 years (170.7 million in rural areas and 110.0 million in urban areas.

Women opened 140.5 million accounts.

Use of RUPay cards increased to 220.7 million.

Decline in Zero balance accounts from 76.8% in September 2014 to 21.4% in August 2017.

Spectacular Success Story

Deficits to be Addressed

- Improve regulatory coherence in financial services regulation, e.g. banking and insurance
- Set targets beyond number of accounts opened and dormant accounts; usage and frequency, access by disadvantaged (physically challenged: vision and hearing impaired, elderly, etc.).
- Expand ATM network (arrangement with the 140,000 post offices in rural areas?).
- Address technical shortcomings: frequent breakdowns and lack of connectivity, problems with hand-held devices, provide equipment to all business correspondents and ensure they are transaction ready.
- Expand acceptance network for debit cards.
- Reduce attrition rate of business correspondents (expanding functions to remittances, marketing insurance schemes and promoting approved mutual funds?).

Deficits to be Addressed

- **Expand use of mobile channels: India was ranked only 11th of the 26 developing countries studied for mobile adoption trailing amongst others Kenya, South Africa and Brazil .India however obtained a 100% score for both commitment and regulatory environment (Brookings 2017).**
- **Focus on technological innovations: integrated machines for cash withdrawal and deposits, voice commands for available facilities, etc.**
- **Develop innovative products to meet needs of Indian households.**
- **Reduce sluggish approval processes at banks. (RBI 2017)**
- **Provide for redress mechanism**

Charan Singh (2017), RBI (2017), Lena Datwani (2017), Saksham Khosla (2017), Smita Aggarwal (2017).

Requirements to Foster Financial Inclusion

Innovations in:

- **Regulation and policy development,**
- **Technology,**
- **Business models,**
- **Incentives to open bank accounts,**
- **Consumer access to financial knowledge,**
- **Effective financial consumer protection rules,**
- **Redress mechanism.**

Consumer Issues with Financial Services

High Costs:

- Large differential between saving/deposit rates and lending rates.
- High charges - financial institutions earn more from charges than interests.

Unsuitable products:

- Promotion of charge and credit cards instead of debit cards, risky investment accounts instead of saving and deposit accounts.
- Products designed to ensnare consumers into credit products that lock them into a cycle of debt.

Unequal contracts:

- Excessive technicality & misleading information that obfuscate rather than inform.
- Unequal contracts including right of lender to change terms at any time and for any reason. Increased intermediation and conflicts of interest
- Increased intermediation and conflicts of interest.

Mann, Ronald (2010), Omarova S.T. (2009), Porter, Katherine (2008), Warren, Elizabeth (2007)

Financial Information, Education, Literacy & Capability

- Confusion between information and education.
- New financial products cannot be understood by consumers even with financial education.
- Financial education often consists of little more than disguised product marketing that exacerbates consumer's behavioural biases.
- Stakeholders have diverse objectives in financial education.
- Need for regulators to work with credible, conflict of interest free third parties for consumer financial literacy.

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Boundedly Rational Consumer

Assumption:

- **Self-governing, i.e., active, assertive and capable consumers who continuously search, compare, switch and complain are adequate to sustain a competitive financial services market.**

In reality:

- **Difficult, even with basic services (saving, borrowing, credit and risk management)**

- **Virtually impossible with new investment products**

The sophisticated investor is a very rare species. Consumers are at best only boundedly rational.

Consumer financial protection is an essential component of financial inclusion.

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Thank you

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