

Executive Summary and Recommendations

Financial Inclusion – Defined

The recent developments in banking technology have transformed banking from the traditional brick-and-mortar infrastructure like staffed branches to a system supplemented by other channels like automated teller machines (ATM), credit/debit cards, internet banking, online money transfers, etc. The moot point, however, is that access to such technology is restricted only to certain segments of the society. Indeed, some trends, such as increasingly sophisticated customer segmentation technology – allowing, for example, more accurate targeting of sections of the market – have led to restricted access to financial services for some groups. There is a growing divide, with an increased range of personal finance options for a segment of high and upper middle income population and a significantly large section of the population who lack access to even the most basic banking services. This is termed “financial exclusion”. These people, particularly, those living on low incomes, cannot access mainstream financial products such as bank accounts, credit, remittances and payment services, financial advisory services, insurance facilities, etc.

Deliberations on the subject of Financial Inclusion contributed to a consensus that merely having a bank account may not be a good indicator of financial inclusion. Further, indebtedness as quantified in the NSSO 59th round (2003) may not also be a reflective indicator. The ideal definition should look at people who want to access financial services but are denied the same. If genuine claimants for credit and financial services are denied the same, then that is a case of exclusion. As this aspect would raise the issue of credit worthiness or bankability, it is also necessary to dwell upon what could be done to make the claimants of institutional credit bankable or creditworthy. This would require re-engineering of existing financial products or delivery systems and making them more in tune with the expectations and absorptive capacity of the intended clientele. Based on the above consideration, a broad working definition of financial inclusion could be as under:

“Financial inclusion may be defined as the process of ensuring access to financial services and timely and adequate credit where needed by vulnerable groups such as weaker sections and low income groups at an affordable cost.”

The essence of financial inclusion is in trying to ensure that a range of appropriate financial services is available to every individual and enabling them to understand and access those services. Apart from the regular form of financial intermediation, it may include a basic no frills banking account for making and receiving payments, a savings product suited to the pattern of cash flows of a poor household, money transfer facilities, small loans and overdrafts for productive, personal and other purposes, insurance (life and non-life), etc. While financial inclusion, in the narrow sense, may be achieved to some extent by offering any one of these services, the objective of “Comprehensive Financial Inclusion” would be to provide a holistic set of services encompassing all of the above.

With a view to understanding the extent of exclusion, the Committee perused data put out by various sources. The summary of conclusions is indicated below :

Extent of Exclusion – NSSO Survey 59th Round

(a) General :

- 51.4% of farmer households are financially excluded from both formal / informal sources.
- Of the total farmer households, only 27% access formal sources of credit; one third of this group also borrow from non-formal sources.
- Overall, 73% of farmer households have no access to formal sources of credit.

(b) Region-wise :

- Exclusion is most acute in Central, Eastern and North-Eastern regions – having a concentration of 64% of all financially excluded farmer households in the country.
- Overall indebtedness to formal sources of finance alone is only 19.66% in these three regions.

(c) Occupational Groups :

- Marginal farmer households constitute 66% of total farm households. Only 45% of these households are indebted to either formal or non formal sources of finance.
- About 20% of indebted marginal farmer households have access to formal sources of credit.
- Among non-cultivator households nearly 80% do not access credit from any source.

(d) Social Groups :

- Only 36% of ST farmer households are indebted (SCs and Other Backward Classes - OBC - 51%) mostly to informal sources.

Analysis of the data provided by RBI thru' its Basic Statistical Returns reveal that critical exclusion (in terms of credit) is manifest in 256 districts, spread across 17 States and 1 UT, with a credit gap of 95% and above. This is in respect of commercial banks and RRBs.

As per CMIE (March 2006), there are 11.56 crore land holdings. 5.91 crore KCCs have been issued as at the end of March 2006, which translated into a credit coverage of more than 51% of land holdings by formal sources. Further data with NABARD on the doubling of agricultural credit indicates that agricultural loan disbursements during 2006-07 covered 3.97 crore accounts.

Thus, there are different estimates of the extent of inclusion thru' formal sources, as the reference period of the data is not uniform. Consequently, this has had an impact on quantifying the extent of levels of exclusion.

Strategy for Building an Inclusive Financial Sector

1. Overall strategy for building an inclusive financial sector may be based on :

- Effecting improvements within the existing formal credit delivery mechanism;
- Suggesting measures for improving credit absorption capacity especially amongst marginal and sub marginal farmers and poor non-cultivator households;
- Evolving new models for effective outreach, and
- Leveraging on technology based solutions. (Para 3.01)

National Rural Financial Inclusion Plan (NRFIP)

2. Looking at the enormity of the task involved, financial inclusion must be taken up in a mission mode as a Financial Inclusion Plan at the national level. (3.03)

3. The target for NRFIP could be to provide access to comprehensive financial services to atleast 50% (55.77 million) of the excluded rural cultivator and non-cultivator households, across different States by 2012 thru' rural/ semi urban branches of CBs and RRBs. The remaining households, with such shifts as may occur in the rural/urban population, have to be covered by 2015. (3.03)

4. Semi-urban and rural branches of commercial banks and RRBs may set for themselves a minimum target of covering 250 new cultivator and non-cultivator households per branch per annum, aggregating 11.15 mn. households p.a., with clear emphasis on financing marginal farmers, tenant cultivators and poor non-cultivator households. (3.04)

5. The national targets would have to be disaggregated State-wise with adequate focus on districts having a large percentage of population not accessing bank credit.(3.05)

6. Since per branch annual coverage under the Plan would be quite high in some of the North-Eastern, Eastern and Central States, needed support including financial assistance may be provided to banks operating in the above regions. (3.06)

7. To operationalise the NRFIP, DLCCs at district level shall draw up block-wise/village-wise maps of rural households not having access to formal credit sources. This information should be disseminated widely. District administration and Lead Banks will extend appropriate help to DLCC for completing the exercise in a time bound manner. This should to be dovetailed with the work being done by the monitoring mechanism set up at the district level for implementation of the recommendations of the CD Ratio Committee.

Thereafter, a State Level Rural Financial Inclusion Plan – SLRFIP shall be prepared jointly by the State Level Bankers' Committee (SLBC) and NABARD for arriving at a conclusive Financial Inclusion Plan for the State. With a minimum target coverage of 50% of currently excluded by the year 2012, States will be free to set for themselves higher targets. (3.07)

8. The Plan so prepared will thereafter be allocated institution-wise, among commercial banks and RRBs. Other institutions like cooperative banks, NBFCs, MFIs may also be asked to join in the task of financial inclusion with self-set targets. The progress in implementation shall be reported to and monitored at the DLCC.(3.08)

9. With a view to firming up the implementation of the recommendations of the Committee, it is proposed that GoI may consider constituting a National Mission on Financial Inclusion (NaMFI) comprising representatives of all stakeholders. The purpose of the Mission shall be to aim at achieving universal financial inclusion within a specific time frame. The Mission should be responsible for suggesting the overall policy changes required for achieving the desired level of financial inclusion, and for supporting a range of stakeholders – in the domain of public, private and NGO sectors - in undertaking promotional initiatives. Govt. may decide on appropriate representation from all stakeholders in the Mission. (3.09)

Commercial Banks

Specific recommendations for achieving the targets under NRFIP by leveraging the existing commercial bank branch network in rural areas would include the following :

Targets for rural / semi-urban branches

10. Given the existing staff strength, it should be possible for commercial banks (including RRBs) to provide access to credit to at least 250 hitherto excluded rural households at each of their existing rural and semi-urban branches. For this, banks will have to strengthen their staff and use a variety of delivery mechanisms. (4.18)

Targeted Branch Expansion in identified districts

11. In districts where population per rural and semi urban branch office is much higher than the national average, the DLCCs may identify centres for opening branches by commercial banks and RRBs in the next three years. (4.19)

12. For the North-Eastern Region, the Committee on Financial Sector Plan has already identified such centres and branch expansion plan as indicated therein may be implemented. (4.20)

Product Innovation

13. The excluded segments of the population require products which are customized, taking into consideration their varied needs. The products and services offered at present do not effectively meet these needs.

- (a) Savings : Savings products to meet the specific requirements of the poor need to be evolved. SHGs may be utilized for tapping the small savings by providing incentives to SHGs with suitable back-end technology support. Banks can develop medium and long term savings instruments by issue of pre-printed deposit receipts to SHGs which in turn can be sold to SHG members. Banks could be given the freedom to develop their own products, suited to local requirements and felt needs of the poor
- (b) Credit : A savings-linked financing model can be adopted for these segments. The approach should be kept simple which should guarantee the beneficiaries a credit limit, subject to adherence to simple terms and conditions. Credit within a specified limit can be made available in 2-3 tranches, with the second and subsequent tranches disbursed based on repayment behaviour of the first tranche. This is to ensure that the vulnerable groups do not get into a debt trap; it would also ensure good credit dispensation.
- (c) Insurance : Banks can play a vital role in this regard –by distributing suitable micro-insurance products. (4.21)

Incentivising Human Resource – Measurable performance indicators

14. Lending to low income groups and providing inclusive financial services need motivated bank staff. Such motivation is a function of attitudes and beliefs as also a system of incentives / disincentives put in place by the bank's management for special efforts / failures to achieve desired levels of financial inclusion. (4.22)

15. The existing staff posted to rural branches can be incentivised within a framework of performance parameters including covering of new households through deposit and loan accounts, increase in business in existing and new small loan / deposit accounts, increase in number of SHGs / Joint Liability Groups (JLGs) formed

and credit linked, efforts put in for promotion of asset management skills and developing linkages to promote credit absorption. (4.23)

Funding

16. There is a cost involved in providing credit plus services and adopting technology applications. Commercial banks are expected to meet a part of the costs. In the initial stages some funding support may be extended through specially constituted Funds. (4.24)

Financial Inclusion Funds

17. Two funds may be constituted – a Financial Inclusion Promotion & Development Fund, with NABARD, for meeting the cost of developmental and promotional interventions and a Financial Inclusion Technology Fund, with NABARD to meet the costs of technology adoption. Each Fund will have an initial corpus of Rs. 500 crore, with a start up funding of Rs. 250 crore each, to be contributed equally by GoI / RBI / NABARD and annual accretions thereto. Banks will be eligible for support from the Funds on a matching contribution of 50% from the Fund in regard to districts other than tribal districts and 75% in case of branches located in tribal districts identified under the Tribal Sub Plan. (4.25)

Financial Inclusion Promotion and Development Fund

The Financial Inclusion Promotion and Development Fund will focus on financing the following interventions :

Farmers' Service Centres (FSC) :

18. The Centres will network on the technology front with Agricultural Universities / KVKs, farmers clubs, the formal extension machinery of the State Governments, technical staff of banks, portals of national level Commodity Exchanges, etc. Such FSCs can be financed by the banks on the pattern of agri clinics. In the initial stages, some support by way of viability gap funding may be provided.(4.26)

Promoting Rural Entrepreneurship :

19. Commercial banks may consider setting up institutions like farmer training centres and Rural Development and Self Employment Training Institutes (RUDSETI) for developing skills among farmers / rural entrepreneurs for effectively managing the assets financed. (4.27)

Self-Help Groups :

20. The SHG movement is yet to catch up on a big scale in regions manifesting high levels of exclusion (Central, Eastern and North-Eastern Regions). Funding support for promotion, nurturing and credit-linking of SHGs can be extended. (4.28)

Developing HR – Addressing attitudinal issues thru' training :

21. Lending to the poor raises, interalia, issues of attitudes towards the poor as viable and profitable customers. The Committee has observed that : (4.29)

There is a positive correlation between training received by the branch managers and their overall attitudes. (4.30)

The training module developed and tested for commercial banks and RRBs in the College of Agricultural Banking, Pune may be used / adopted by banks for bringing about the right mindset among branch staff. (4.31)

Resource Centres

22. Resource Centres, apart from facilitating members of mature SHGs to graduate to micro-enterprises, also helps in ensuring long term sustainability of SHGs. The cost of setting up such centers can be met out of this Fund and / or the MFDEF. This is discussed in detail later in the Report. (4.32)

Federations

23. As indicated later in the Report, funding support may also be extended from this Fund and / or MFDEF for voluntary establishment of federations. (4.33)

Capacity building of BFs/BCs

24. Funding support, on priority basis, to be extended to specialized institutions which provide capacity building inputs to BFs/BCs, as discussed later in the Report.(4.34)

Financial Inclusion Technology Fund

Technology Applications for Greater Financial Inclusion :

25. Extending outreach on a scale envisaged under NRFIP would require the application of low-cost technology solutions, which call for certain levels of funding support for rolling out such IT-based and inclusive financial sector plan. (4.35)

26. Funds Guidelines

NABARD, in consultation with RBI, may prepare detailed guidelines for operationalising the Funds. (4.36)

Procedural Changes

Simplifying Mortgage Requirements

27. Enabling legislation has been passed in some States for acceptance of a simple declaratory charge as equitable mortgage. This may be done by all the State Governments. (4.37)

Exemption from Stamp Duty for Loans to Small and Marginal Farmers:

28. Stamp duty may be waived in respect of loans for small / marginal farmers, tenant cultivators and oral lessees. (4.38)

Saral Documentation for Agricultural Loans

29. NABARD, in cooperation with a core group of bankers, has prepared a one page document for agricultural loans up to Rs.1 lakh. This may be adopted by all banks. (4.39)

Nodal Branches (ADB Model)

30. One branch of the lead bank at the block / taluka level may be identified as the nodal branch to address the issue of exclusion. Lead banks may strengthen these nodal branches with technical staff to provide agricultural / business development services in farm and non-farm sectors respectively, comprising technical inputs and extension

services. The services of the nodal branch technical staff may be made available to all other branches in the block, under an appropriate cost sharing arrangement. (4.40)

31. In some districts, where RRBs have dominant presence, sponsor banks may assist the RRBs in putting in place arrangements for technical staff for providing credit plus services. NABARD may defray the cost of such technical staff, particularly, in the North-Eastern Region. (4.41)

Business Facilitators / Business Correspondents (BFs/BCs)

32. RBI has permitted banks to use the services of NGOs / SHGs, MFIs and other civil society organisations as intermediaries in providing financial and banking services through the use of BF and BC Models. (4.42)

33. The response of the banking system has been of low key and the model is yet to be fully grounded. (4.48)

Following **recommendations** in respect of the BF/BC Model are made:

Business Facilitators (BFs)

34. Originally, only individuals who were insurance agents could act as BFs while no individuals could be placed as BC. This was later on widened to include retired officials, viz., Government servants like postmasters, school teachers and headmasters, who were considered by RBI as eligible to act as BF. Banks may make use of this relaxation and use individuals as indicated above as BF. (4.51)

35. Banks may appoint ex-servicemen/ retired bank staff as their BFs. (4.52)

36. Banks should ensure that the banking awareness created by BFs get converted to business potential by providing suitable banking services like mobile outlets. (4.53)

37. Banks may facilitate easy roll-out of this mobile banking model through simplification and rationalization of back-end processes and front-end procedures so that banking operations are made more customer-friendly. (4.54)

Business Correspondents (BCs)

38. In addition to the institutions presently allowed by RBI to function as BCs, individuals like locally settled retired Government servants like postmasters, school teachers, ex-servicemen and ex-bank staff, whose relationship with the banking system through a pension account has already been established, may be permitted to act as BCs. (4.56)

39. Further, MF-NBFCs may be allowed to act as limited BCs of banks for only providing savings and remittance services. (4.57)

40. Technology has to be an integral part in sustaining outreach efforts thru' the BC model. Ultimately, banks should endeavour to have a BC touch point in each of the six lakh villages in the country. (4.58)

41. In order to sustain and encourage the arrangements, banks may formulate suitable incentive mechanism for BCs linked to the number of accounts opened/ transactions put through by them. Further, banks may consider placing BCs even in areas having their own branches. (4.59)

42. To begin with, the BC model envisaged by RBI could be implemented widely. In due course, when the BCs reach a higher level of turnover, they should bear commensurate financial responsibilities. (4.60)

43. Banks may appoint any individual/institution of their choice as BCs, after exercising due diligence. This will facilitate greater acceptance of the BC Model by banks. (4.61)

44. Funds may be provided to specialized institutions which provide capacity building inputs to BCs. Such funding support could be extended on priority basis to most excluded areas/ sectors of the society. (4.62)

45. SLBC convener banks may initiate discussion with their respective State Governments regarding routing government payments through BCs using the smart card or other relevant technology on a pilot basis. (4.63)

46. SLBCs may undertake a study to identify organisations having the capacity to serve as customer service points and BC. In States like Andhra Pradesh and Kerala, the VOs and Kudumbashree structures already exist and these can be used as customer service points. (4.64)

47. Training modules for BFs/BCs may be prepared in vernacular and in culture sensitive pictorial forms. (4.65)

Role in microfinance

48. Deepening the outreach of the microfinance programme is an effective way in reaching out to the excluded segments. Commercial Banks have played a very important role in the SHG-Bank Linkage Programme having linked 15.95 lakh SHGs, forming more than 54% of the total SHGs credit-linked in the country. This programme should be strengthened and carried further, playing a key role in financial inclusion. (4.66)

Financing poor farmers

49. Joint Liability Groups (JLGs) of the poor such as landless, share croppers and tenant farmers is another innovative mechanism towards ensuring greater financial inclusion. Commercial Banks can actively promote such groups for effectively purveying credit and other facilities to such clients. RBI may encourage banks to adopt the JLG model for lending to SF/MF, tenant cultivators, share croppers and oral lessees. (4.67)

Making Marginal Farm Holdings Viable and Enabling their Financial Inclusion

50. The following recommendations are made :

- Government programmes aimed at enhancing agricultural productivity should be effectively linked with bank credit. (eg. Banking Plan in post-watershed projects).
- A massive programme for financing minor irrigation structures (wherever ground water levels are safe or where surface irrigation potential is available) may be undertaken specifically targeting marginal farm households.
- Supplementary activities like dairy, small poultry, sheep-rearing etc. have to be specifically targeted for marginal farmers, tenants and non-cultivator households. A National Dairy Plan (NDP) has been prepared to target production enhancement in 323 potential districts. Similar initiatives may be considered for other sectors also like poultry, horticulture, etc.
- Farm aggregation models including contract farming fully protecting the interests of farmers could be an option. Credit-marketing linkage can also be effected.(4.68)

Regional Rural Banks

Post-merger, RRBs, with 14494 branches, represent a powerful instrument for financial inclusion. Their role and relevance in financial inclusion is crucial as :

- In rural areas, they account for 37% of total offices of all Scheduled Commercial Banks.
- 91% of the total workforce in RRBs is posted in rural and semi-urban areas as compared to 38% for other Scheduled Commercial Banks.
- In rural areas, RRBs account for 31% of deposit accounts and 19% of deposit amount of all Scheduled Commercial Banks. Lower average deposit amount per account in RRBs as compared with commercial banks implies their better reach to small depositors.
- Share of RRBs in loan accounts is an impressive 37% in rural areas.
- Of all the scheduled commercial banks, RRBs account for 34% of branches in NE, 30% in Eastern and 32% in Central regions . Incidentally, these regions manifest financial exclusion of a high order.
- Of the total 29.25 lakh SHGs credit linked by the banking system (as on 31 March 2007), 31% linkage is done by RRBs. More significantly, the more backward a region, greater is the share of RRBs. In North Eastern Region, it is 56%, Central region 48% and Eastern region 40%.
- RRBs have also played a significant role as Self Help Promoting Institutions (SHPIs). As many as 104 RRBs (31 March 2006) are functioning as SHPIs with grant assistance from NABARD.

Keeping the above in view, the following recommendations are made for RRBs.

Recommendations

51. RRBs should extend their services to unbanked areas and increase their credit to deposit (CD) ratio. The post-merger scenario of RRBs poses a series of challenges for them and these are to be addressed. The following areas would require attention from the point of view of financial inclusion :

- Setting exclusive targets for microfinance and financial inclusion,
- Providing funding support &
- Providing technology support. (5.26)

No further merger of RRBs

52. Further merger of all RRBs at State-level across sponsor banks is not required. It may not also be desirable if there has to be a firm reinforcement of their rural orientation with a specific mandate on financial inclusion. Therefore, the process of merger should not proceed beyond the level of sponsor bank in each State. (5.27)

Recapitalisation of RRBs with negative Net Worth

53. Recapitalisation of RRBs with negative net worth has to be given a serious consideration as it would facilitate their growth, provide lenders a level of comfort and enable their achieving standard capital adequacy ratio. (5.28)

Widening network and Expanding coverage

54. As on 01 April 2007, RRBs are covering 535 districts. They may be directed to cover all unbanked areas in these districts, taking the village as a unit, either by opening a branch (wherever feasible) or through the BF / BC model in a time bound manner. 87 districts in the country were not covered by RRBs as on 01 April 2007 and their area of operation may be extended to cover these districts. (5.29)

Strategic microfinance plan with NABARD support

55. RRBs have the potential and capability to emerge as niche operators in microfinance. They are playing a major role in the SHG - Bank Linkage Programme especially also as SHPIs. Their dual role has special meaning in areas which face severe financial exclusion and which do not have a sufficient presence of well performing NGOs. However, to upscale the programme to a level where it can really make a visible impact, RRBs need handholding particularly in the areas of training, promotion and development. NABARD may provide required assistance. (5.30)

56. NABARD should prepare a strategic action plan RRB-wise, for promotion and credit linkage of SHGs. RRBs may be asked to form, nurture and credit link at least 3,000 SHGs in districts covered by them in North-Eastern, Eastern and Central Regions. A Memorandum of Understanding (MoU) may be signed by RRBs with NABARD for a period of 5 years - with NABARD providing the promotional and development assistance out of the "Financial Inclusion Promotion and Development Fund" and RRBs forming, nurturing and providing financial services to SHGs. RRBs may accomplish the task with the support of individual rural volunteers, BFs, their staff members, etc. NABARD may closely monitor the programme - with focus on qualitative aspects. (5.31)

NRFIP for RRBs

57. The strategy recommended for NRFIP for commercial banks would be equally applicable for RRBs. They would require promotional, funding and technology support in different areas as outlined below. RRBs may endeavour to cover a large part of their incremental lending through the group mode (SHGs/JLGs) as it will enhance their outreach to financially excluded. Lending through group mode would also keep NPAs at low level. (5.32)

Pilot testing of BF / BC Model by RRBs

58. RRBs should adopt the BF and BC models as a major strategy of financial inclusion. NABARD should extend the required support including running pilots in selected banks. The proposal for a technology based intervention under the BC model would be equally relevant for RRBs. However, RRBs would require some handholding in implementing the proposal. NABARD may identify 10 RRBs across the country, giving greater weightage to regions manifesting higher levels of financial exclusion and work in strategic alliance with these RRBs and their sponsor banks in implementing the proposal. The RRBs identified by NABARD for the project will require to develop a core banking software for proper integration of the technology model proposed. NABARD should enter into a MoU with identified sponsor banks and RRBs and provide initial funding and technology support. (5.33)

Separate credit plan for excluded regions

59. The RRBs operating in predominantly tribal areas and having high levels of exclusion may prepare annual credit plans having a separate component for excluded

groups, which would integrate credit provision with promotional assistance. Refinance and promotional support may be provided by NABARD to RRBs on a large scale for implementation of these credit plans. (5.34)

Computerisation

60. With a view to facilitating the seamless integration of RRBs with the main payments system, there is a need to provide computerisation support to them. Banks will be eligible for support from the Financial Inclusion Funds on a matching contribution of 50% in regard to districts other than tribal districts and 75% in case of branches located in tribal districts under the Tribal Sub Plan. (5.35)

Strengthening Boards of Management

61. Post-merger, it is necessary that Boards of Management of RRBs are strengthened and powers delegated to them on policy and business operations, viz. introduction of new liability and credit products, investment decisions, improving market orientation in raising and deployment of resources, non-fund based business, career progression, transfer policy, etc. (5.36)

Tax Incentives

62. From 2006-07, RRBs are liable to pay income tax. To further strengthen the RRBs, profits transferred to reserves could be exempted from tax till they achieve standard capital adequacy ratios. Alternately, RRBs may be allowed tax concessions to the extent of 40% of their profits, as per provisions under Section 36 (1)(viii) of the Income Tax Act. (5.37)

NABARD to support HR development in RRBs

63. NABARD may continue to give special priority to RRBs to train their staff through its training institutions. NABARD may design suitable training programmes to enable RRBs to meet the challenges in the post merger environment. This training may also cover members of the Board of RRBs. (5.38)

Implementation of RBI initiatives for financial inclusion

64. All the recent circulars relating to financial inclusion, viz., no frills accounts, GCC, One Time Settlement (OTS) for loans up to Rs. 25,000, use of intermediaries, etc., should be implemented by RRBs. (5.39)

Local Area Banks (LABs)

65. RBI may allow new LABs to come into operation, especially in districts / regions manifesting high levels of exclusion, without compromising on regulatory prescriptions. LABs can integrate well with local financial markets and offer a host of financial services including savings, credit, remittances, insurance, etc. (5.40)

Cooperative Credit Institutions

Rural credit cooperatives, in India, have a very long history. Democratic in features, the cooperative movement was envisaged as a mechanism for pooling the resources of people with small means and providing them with access to different financial services. In the backdrop of the reform process underway for cooperative banks, they have a very significant role to play in facilitating greater inclusion.

Recommendations

Early Implementation of Vaidyanathan Committee Revival Package

66. All necessary steps should be taken for the early implementation of the STCCS revival package in all States. (6.31)

Cooperatives in SHG-Bank Linkage – Need for enabling legislation

67. In certain States, legislation has been enacted, admitting SHGs as members of PACS. Similar legislation in other States would require to be enacted to enable the emergence of cooperatives as effective SHPIs. Federations of SHGs may be registered in all the States under the Cooperative Societies Act or the parallel Self Reliant Cooperatives Act and availability of funds to these cooperatives for advancing loans may be considered by NABARD, based on objective rating criteria. NABARD may also set aside requisite funds for sensitising the cooperative movement in this regard.(6.32)

Use of PACS and other Primary Cooperatives as Business Correspondents

68. There are a large number of PACS and primary cooperatives under the parallel Acts located in rural areas where there are no other financial services outlets. Many of these cooperatives are in districts where the DCCBs are defunct or moribund. Such PACS could provide valuable services to their members if they get access to a commercial bank. RBI has already listed Cooperatives as eligible institutions under the BF/BC Model. (6.33)

69. In the circumstances, Cooperatives may make use of this opportunity atleast in States which have accepted the Vaidyanathan Committee recommendations. NABARD may be asked to suggest appropriate guidelines for the purpose, subject to the approval of RBI. (6.34)

Cooperatives Adopting Group Approach for Financing Excluded Groups

70. Micro-enterprises, in order to be successful, require larger funding which NGOs cannot provide. It will, therefore, be necessary to develop / test a new form of community based organisation other than SHGs which may be more appropriate to support members who engage in micro-enterprises. Those members of SHG who opt to graduate to micro-enterprises could be formed into JLGs or some similar organisation. (6.35)

71. The relations of mutual trust and support which is described as affinity in a SHG tend to be weaker in a JLG. Therefore, new forms of collateral or guarantee may have to be worked out. Guidelines circulated by NABARD may be adopted by banks.(6.36)

72. Further, the use of the BF model could be thought of to organize vulnerable segments of the population into JLGs. The pilot project presently under implementation by NABARD should be sufficiently broad based to cover the role of facilitators in formation and linkage of JLGs. (6.37)

Risk Mitigation - setting up of Credit Guarantee Fund

73. A Credit Guarantee Fund may be set up as a risk mitigation mechanism and also for providing comfort to the banks for lending to such JLGs (akin to the Credit

Guarantee Fund Scheme of SIDBI for Small/ Micro enterprises Industries - CGFSI - available for small-scale industries - SSI - at present). (6.38)

Self Help Group – Bank Linkage Model

The SHG-Bank Linkage Programme is a major plank of the strategy for delivering financial services to the poor in a sustainable manner. As at the end of March 2007, as many as 29.25 lakh SHGs have been credit-linked with banks, benefiting more than 400 lakh poor families. There is a need for further deepening and upscaling of microfinance interventions.

Encouraging SHGs in Excluded Regions – Funding support

74. If the SHG-Bank Linkage programme has to reach a critical scale, the Department of Women and Child Development at State-level should be actively involved in promoting and nurturing of SHGs. The State Govts. and NABARD may, therefore, set aside specific funds out of budgetary support and the Micro Finance Development and Equity Fund (MFDEF) respectively for the purpose of promoting SHGs in regions with high levels of exclusion. (7.28)

75. The spread of SHGs in hilly regions, particularly in the North-Eastern Region, is poor. One of the reasons for this is the low population density in hilly areas and weak banking network. There is a need to evolve SHG models suited to the local context. (7.29)

Capacity building of Government functionaries

76. Certain deficiencies like poor follow up, ineffective monitoring and inadequate training and capacity building efforts have been observed in the past. Adequate safeguards may, therefore, be devised and built in future programme implementation strategies. NABARD can also facilitate this process by providing support for capacity building of Government functionaries from grass root level upwards within the SHG framework. (7.30)

Legal Status for SHGs

77. As of now, SHGs are operating as thrift and credit groups. They may, in future, evolve to a higher level of commercial enterprise. The question of providing a simplified legal status to the SHGs may have to be examined in full, in this context. This would also facilitate their becoming members of PACS. (7.31)

Maintenance of participatory character of SHG movement

78. A movement of such large scale involving people's participation could lead to attempts towards politicization. This must be avoided. Sufficient care has to be taken to ensure that the SHG movement retains its participatory and self-help character. (7.32)

NABARD to open 'Project Offices' in identified Priority States

79. NABARD is managing the MFDEF with a corpus of Rs. 200 crore. One major focus of the Fund should be promoting the SHG-Bank Linkage Programme in States where it has been comparatively slow moving. NABARD has already identified 13 States with large population of the poor, but exhibiting low performance in implementation of the programme. The ongoing efforts of NABARD to upscale the programme in the identified States need to be given a fresh impetus. (7.33)

80. NABARD can open dedicated project offices in the 13 States for upscaling the SHG - Bank Linkage Programme by strategizing interventions such as stronger involvement of State Governments, capacity building of NGOs, broadening the range of SHPI, etc. (7.34)

Incentive package for NGOs

81. Many of the NGOs have played a commendable role in promoting SHGs and linking them with banks. NGOs, being local initiators with their low resources are finding it difficult to expand in other areas and regions. There is, therefore, a need to evolve an incentive package which should motivate these NGOs to diversify into other backward areas. Incentive package could be in the form of expeditious and hassle-free grant support. (7.35)

RBI/NABARD to study the issue of ‘evergreening’

82. A certain element of “evergreening” of loans is reportedly taking place among credit linked SHGs. This, if established, is a matter of concern. RBI/ NABARD may expeditiously study this aspect and come out with suggestions for reversing this unsettling trend. (7.36)

Transparency in maintenance of records

83. In order to ensure sustainability of the SHGs, their activities and linkages, there should be better transparency in the books of accounts maintained at the group level. These books should reflect the position of deposits in members’ accounts, interest paid on savings, distribution of corpus or operating surplus among members, evergreening of loan accounts, etc. Banks, with the help of NABARD, should evolve a checklist for concurrent monitoring of SHGs. (7.37)

SHGs to evolve norms for distribution of surplus

84. Many of the SHGs do not have the practice of distributing the surplus generated from their business activities within the group and the awareness on this issue among the SHG members is very low. There is a need to evolve norms for distribution of surplus (akin to dividend) especially at the time when a member drops out of the group. (7.38)

Need to restructure design & direction of SGSY subsidy

85. Subsidies provided under SGSY need to be restructured. Linking credit with subsidy is not an effective approach for reaching out to the poor. There is a need to formulate a single programme synergising the positive features of SGSY such as specific targeting of Below Poverty Line (BPL) families, etc. and those of the SHG – Bank Linkage Programme such as group cohesiveness, discipline, etc. (7.39)

86. While recognizing that individual subsidies are distortionary, the Government may consider redirecting subsidy in the SGSY Programme for the following purposes:

- Capacity building of NGOs and other field based agencies such as Krishi Vigyan Kendras, to form and strengthen SHGs.
- Exposure visits to successful models by bankers, government officials and SHG leaders etc.
- For strengthening input supply and marketing arrangements. (7.40)

87. Some of the State Governments like West Bengal and Andhra Pradesh have initiated efforts in this direction. Further, it is understood that the proposals are awaiting approval of the GoI. The approaches adopted by these States for bringing synergy between SGSY groups and the SHGs of the linkage programme can be studied so that the same can be replicated in other States. The broad features of the proposed convergence model are indicated in Annexure V of the main report. (7.41)

88. The need for technology adoption for effective disbursement of Govt. subsidy should be recognized. The existing dispensation of subsidy under SGSY and payouts under NREGP could be routed thru' bank accounts, with suitable technology support.(7.42)

Interest rate subsidy

89. Certain States are reportedly providing a subsidy on interest rates being charged by banks to the SHGs. The margin available to SHGs is sufficient to take care of operational costs, even after considering the small amounts of loan provided to members. Thus, a subsidy on interest rates cuts at the very root of the self help character of SHGs. The subsidy could be re-directed towards capacity building efforts or in providing input supplies and marketing support to the SHGs. (7.43)

Resource Centres

90. For ensuring the long term sustainability of SHGs and for helping the members of mature SHGs to graduate from microfinance to micro-enterprises, Resource Centres on the lines of the Andhra Pradesh Mahila Abhivruddhi Society (APMAS) can be set up in different parts of the country. (7.44)

91. There are a large number of SHGs which are well established in their savings and credit operations. Their members want to expand and diversify their activities with a view to attain economies of scale. Many of the groups are organising themselves into federations and other higher level structures. To achieve this effectively, resource centres can play a vital role. (7.45)

92. Resource centres can be set up by various stakeholders such as NGOs, banks, Government departments, NABARD at the State/ district level to play an important role in preparing training modules, developing a cadre of trainers, conduct of field studies and in promoting interface between SHG members and service providers. The specific role of Resource Centres would be :

- To work towards a comprehensive capacity building of SHGs,
- Share innovative ideas and models that can be replicated elsewhere,
- Enhance functional literacy among SHG members,
- Support livelihood interventions among SHG members,
- Facilitate availability of all services to SHG members under one roof. (7.46)

93. The cost for setting up Resource Centres can be met out of the Financial Inclusion Fund and/ or the MFDEF. (7.47)

SHGs to provide alternative savings products

94. Most of the SHGs encourage compulsory savings with equal small amounts by members on a regular basis. SHGs need to offer a wide range of savings products so as to capture the huge potential of savings that remains untapped. Groups should be free to design savings products suiting to members' requirements. Certain level of

experimentation could be attempted by the Resource Centres in designing new saving products and NABARD should encourage and support such experiments. (7.48)

Adoption of JLG Model to cover marginalized groups

95. A scheme for financing JLGs of tenant farmers and oral lessees has been evolved by NABARD for implementation by all the commercial banks, RRBs and Cooperatives. The adoption of the concept of JLGs, if properly grounded, could be another effective method for purveying credit to mid-segment clients such as small farmers, marginal farmers, tenant farmers, etc. and thereby reduce their dependence on informal sources of credit. (7.49)

From Microcredit to Microenterprise - Challenges

96. The present challenge is to induce SHGs and their members to graduate into matured levels of enterprise, factor in livelihood diversification, increase their access to the supply chain, linkages to the capital market and appropriate production and processing technologies. (7.50)

97. A spin off of this challenge is how to address the investment capital requirements of matured SHGs, which have initially met members' consumption needs and are now on the threshold of taking off into "enterprise". There is evidence in MYRADA experience where lending for productive purposes has already been given greater emphasis by SHGs. The Community Managed Resource Centres (CMRCs) organized by MYRADA provide a variety of linkage services to SHGs and individual entrepreneurs among SHG members. This model requires to be studied. The SHG - Bank Linkage Programme needs to introspect whether it is sufficient for SHGs to only meet the financial needs of their members, or whether there is also a further obligation on their part to meet the non-financial requirements necessary for setting up business and enterprises. Ideally, it must meet both. (7.51)

Greater role for NABARD

98. While greater emphasis is needed for growth and spread of SHGs across the country, the quality in terms of outreach of financial services, capacity building, sustainability etc., needs to be reemphasized. NABARD shall play a pro-active role and identify new initiatives that will contribute to effectively improving outreach to the poor thru' SHGs, MFIs, etc. (7.52)

Federations

99. Federations, if they emerge voluntarily from amongst SHGs, can be encouraged. However, the Committee feels that they cannot be entrusted with the financial intermediation function.

In Andhra Pradesh, federations are registered as societies under the MACS Act. The SHG members (as individuals) are permitted to be members in the federation. In Uttarakhand, SHGs are permitted to become members of PACS directly. Other States may adopt similar enabling legislation. (7.53 & 7.54)

100. Voluntary establishment of federations could be supported out of the Financial Inclusion Fund and the MFDEF. While extending support, it should be ensured that :

- Federations emerge voluntarily, on the felt need of the SHGs,
- Federations provide other value added services to member SHGs. Based on a study of Federations operating across the country, a broad list of such services and

the modus operandi of federations in providing such services can be prepared and circulated by NABARD.

- Federations, in terms of distance, operate in close proximity to members. (7.55)

Urban Microfinance

101. There are no clear estimates of the number of people in urban areas with no access to organized financial services. This may be attributed, in part at least, to the migratory nature of the urban poor, comprising mostly of migrants from the rural areas. Even money lenders often shy away from lending to urban poor. (7.56)

102. There have been a few instances of MFIs venturing into this area of lending to urban poor who are undertaking micro-enterprises and small business activities. Urban branches of banks, even though having manpower and technology support, are not attuned to SHG lending or microfinance. (7.57)

103. Opening of specialised microfinance branches / cells in potential urban centers exclusively catering for microfinance and SHG - bank linkages could be thought of, to address the requirements of the urban poor. BFs / BCs could be the mechanism to reach the target clientele in these areas. Banks can also consider associating with MFIs undertaking urban microlending as a viable option. (7.58)

Amendment to NABARD Act

104. At present, NABARD is permitted, as per its Act and Mandate, to support micro finance activities in rural and semi-urban areas only. An enabling provision be made in the NABARD Act, 1981 permitting NABARD to provide micro finance services to the urban poor. (7.59)

Micro Finance Institutions

Introduction

105. Firm data regarding the number of MFIs operating under different forms is not available. However, it is roughly estimated that there are about 1,000 NGO-MFIs and more than 20 Company MFIs. Further, in Andhra Pradesh, nearly 30,000 cooperative organizations are engaged in mF activities. However, the company MFIs are major players accounting for over 80% of the micro finance loan portfolio. (8.02)

Definition of MFI

106. The proposed Microfinance Services Regulation Bill defines microfinance services as “providing financial assistance to an individual or an eligible client, either directly or through a group mechanism for an amount, not exceeding rupees fifty thousand in aggregate (Rs.1,50,000 if for housing purposes) (8.03)

107. Greater legitimacy, accountability and transparency will not only enable MFIs to source adequate debt and equity funds, but could eventually enable MFIs to take and use savings as a low cost source for on-lending. (8.05)

Recognising MF-NBFCs

108. There is a need to recognize a separate category of Micro finance – Non Banking Finance Companies (MF–NBFCs), without any relaxation on start-up capital and subject to the regulatory prescriptions applicable for NBFCs. Such MF-NBFCs could be defined as companies that provide thrift, credit, micro-insurance, remittances and other financial services up to a specified amount to the poor in rural, semi-urban and urban areas. (8.07)

109. At least 80% of the assets of MF-NBFCs should be in the form of microcredit of upto Rs.50,000 for agriculture, allied and non farm activities and in case of housing, loans upto Rs. 1,50,000/- per individual borrower, whether given through a group mechanism or directly. (8.08)

MF-NBFCs as BCs

110. To enable the poor to have access to savings services, MF-NBFCs may be recognized as Business Correspondents of banks for only providing savings and remittance services. (8.09)

Relaxation in FIPB guidelines

111. Current guidelines used by FIPB (Foreign Investment Promotion Board) require a minimum of US\$ 500,000 equity investment from a foreign entity. MF-NBFCs' initial capital needs may not be very large and the Committee is of the view that the minimum amount of foreign equity for MF-NBFCs may be reduced to a level of US\$ 100,000/-. (8.10)

112. NABARD may extend equity support out of its MFDEF to such MF-NBFCs based on objective rating / criteria. NABARD may accord priority in providing equity support to those MF-NBFCs operating in regions featuring high levels of exclusio(8.11)

113. The SEBI Venture Capital Guidelines may permit Venture Capital Funds to invest in MF-NBFCs. (8.12)

Tax Concessions

114. MF-NBFCs may be allowed tax concessions to the extent of 40% of their profits, as a proportion to their business portfolio in excluded districts as identified by NABARD without attracting tax. For this, MF-NBFCs may be included as eligible institutions under Section 36(1) (viii) of the Income Tax Act. (8.13)

MF-NBFCs as microinsurance agents

115. The IRDA Microinsurance Guidelines, 2005 may permit MF-NBFCs to offer microinsurance services as agents of regulated life and non-life insurance companies.(8.14)

Code of conduct

116. A voluntary mutual code of conduct, already prepared, covering aspects including mission, governance, transparency, interest rates, handling of customer grievances, staff conduct, recovery practices, etc., may be made mandatory for MFIs.(8.15)

Accounting and Disclosure Norms

117. The Institute of Chartered Accountants of India (ICAI) may be involved in formulating appropriate accounting and disclosure norms for MFIs. (8.16)

118. Banks lending to MFIs may undertake studies on the cost of funds of MFIs, risk premium, etc. and exercise a lender's discipline in enforcing reasonable rates of interest and acceptable modes of recovery. (8.17)

Unifying regulatory oversight

119. RBI may consider bringing all regulatory aspects of microfinance under a single mechanism. Further, supervision of MF-NBFCs could be delegated to NABARD by RBI. (8.18)

Micro Finance Bill

120. While Section 25 Companies could be covered by the Micro Financial Sector (Development and Regulation) Bill, 2007, cooperatives can be taken out of the purview of the proposed Bill. (8.19)

Technology Applications

Technology – The Driving Force for Low-cost Inclusion Initiatives

121. Technological developments in the recent past have provided the perfect launch pad for extending banking outposts to remote locations without having to open bank branches. This could be achieved by leveraging technology to open up channels beyond branch network and create the required banking footprints to reach the unbanked so as to extend banking services similar to those dispensed from branches. (9.01)

122. The Committee, while concurring with the RBI's advisory group for IT-enabled financial inclusion, is of the view that nearly all pilot models converge on certain essential components and processes to be followed in technology application. The essence of a majority of the models under consideration features the issue of a smart card to the farmer on which all his transactions are recorded, a hand-held terminal with the BC at the village level and a Central Processor Unit (CPU) linking the smart cards and BC terminals with the banks. There are also other models where smart cards are dispensed with and mobile telephones, etc., are used. (9.02 / 9.03)

123. The fundamental outlines of the existing technology-based models may be examined for application in such manner and to such extent as may be deemed fit. (9.04)

124. The operating costs of the various models are expected to be minimal and can be easily absorbed by banks as the increase in business volumes will justify the incremental operating costs. Also, the costs are substantially lowered if the infrastructure is shared. It is, therefore, recommended that shared infrastructure among different banks enabling nationwide financial inclusion would confer large scale benefits and also enable effortless transfer of funds between the card holders of various banks. (9.06)

125. Essentially, the start up costs are the initial investment costs comprising cost of the smart card, terminals with the BC and the CPU. The Committee is of the view that the Financial Inclusion Technology Fund can provide the necessary support for defraying part of the costs. (9.07)

Optimisation of Existing Infrastructure

126. The Committee is of the opinion that the existing banking infra-structure and NGOs which have already made extensive inroads in rural areas should be made optimal use of for enabling outreach of banking services. The BF/BC models backed by technology applications should encourage a role for the small players and integrate them with the national system. The Committee is of the opinion that the State

Governments should make payments under National Rural Employment Guarantee Scheme and Social Security Payments thru' such technology based solutions. (9.09)

Building database

127. The creation of a national data-base, sectoral, geographic and demographic reports, and also a payment system benefiting the card holders from the under-privileged/ unbanked population will not be possible without the extensive use of IT. This alone can bring down the costs of the small ticket transactions of the poor and make nationwide financial inclusion a reality. (9.10)

128. The technology suppliers and banks should evolve common minimum standards for ensuring inter-operability between their systems. (9.11)

Remittance Needs of Poor

129. Ahmednagar DCCB has implemented a system of low cost anywhere banking solution which has a facility of card to card transfer. Savings / current account holders at all its 280 branches have a choice to keep their savings bank account or a part thereof in a separate account at the bank's head office. Customers can have access to this account from all the bank branches. It was learnt that the customer is charged only Rs.4 per transaction. Such experiments may be studied for replication. (10.09)

130. A low value card linked to a bank account, which can be encashed at PoS and which allow transfer of small amounts from one card to another would alleviate remittance problems. This would substantially increase banking outreach as at present there are about 3 lakh PoS as compared to around 70,000 scheduled commercial bank branches and 22,000 ATMs. However, a majority of PoS machines are now located in urban and semi-urban areas. It is expected that as the system takes roots, more PoS will come in rural areas, facilitating such transfers. (10.10)

131. The e-kiosks in villages could be yet another source of operating a remittance system that is accessible to the poor. (10.11)

Other Recommendations

132. The following suggestions would substantially address the remittance needs of the poor in the country :

- i. The combined network of nearly 70000 branches of scheduled commercial banks (including RRBs) and a network of more than 1.50 lakh post offices can ideally provide the institutional mechanism for extending remittance facilities in remote areas. With adoption of appropriate technology, it may be possible to bring down the transaction costs which would encourage and enable the poor to make use of such remittance facilities. A committee may be set up with representatives from RBI, Department of Posts, NABARD and commercial banks for exploring the feasibility of integrating postal network with the banking system and developing a nation wide remittance system.
- ii. The remittance product could be an electronic product similar to "Instacash" where a 16 digit code is given to the originator of the transaction, and the beneficiary can take the amount from select post offices by giving the code, and identity proof. This product should be available across banks, post offices and other institutions and be affordable. Another option could be to credit the remitted amount to a central server at the originating point and at every touch point should be able to withdraw it.

- iii. Banks should endeavour to have a BC touch point in each of the six lakh villages in the country. There should be a micro-bank in every village.
- iv. Banks should introduce card-based remittance products which can be encashed all over the country. This may be card to card transfer, or simply a scratch card type remittance card. (10.14)

Micro Insurance

133. Micro-insurance should provide greater economic and psychological security to the poor as it reduces exposure to multiple risks and cushions the impact of a disaster. Micro-insurance in conjunction with micro savings and micro credit could go a long way in keeping this segment away from the poverty trap and would truly be an integral component of financial inclusion. (11.02)

134. In 2003, GoI constituted a Consultative Group on Micro-Insurance to examine existing insurance schemes for rural and urban poor. The report of the consultative group has brought out the following key issues :

- Micro-insurance is not viable as a standalone insurance product.
- Micro-insurance has not penetrated rural markets. Traditional insurers have not made much headway in bringing micro-insurance products to the rural poor. (In addition, the Committee feels that micro insurance has not penetrated even among the urban poor).
- Partnership between an insurer and a social organisation like NGO would be desirable to promote micro-insurance by drawing on their mutual strengths.
- Design of micro-insurance products must have the features of simplicity, availability, affordability, accessibility and flexibility. (11.04)

135. The Committee studied four different models for delivering micro-insurance services to the targeted clientele, viz., the Partner-Agent Model, Full Service Model, Community Based Model and Provider Model. (11.11)

Recommendations

Leveraging the Existing Network for Micro-Insurance

136. To economise on costs and to increase the outreach of micro-insurance to the poor, the insurers need to utilize existing Government organisations and NGOs, having greater acceptability among the financially excluded. The partner-agent model for delivery where the insurer underwrites the risk and the distribution is handled by an existing intermediary, seems apt in this scenario. (11.12)

Linking micro credit with micro insurance

137. The Committee concurs with the view that offering microcredit without micro-insurance is financial behaviour fraught with risk. There is, therefore, a need to emphasise linking of microcredit with micro-insurance. (11.13)

Further, as it helps in bringing down the inherent risk cost of lending, the Committee feels that NABARD should be regularly involved in issues relating to rural and micro insurance to leverage on its experience of being a catalyst in the field of micro-credit.(11.14)

Implementation Strategy for Micro-Insurance

138. The Committee has identified major areas for formulation of strategies for effective implementation of micro-insurance programmes as explained in the following paragraphs : (11.15)

Human Resources Requirement and Training

139. To tap the huge micro-insurance potential, IRDA may consider putting in place an appropriate institutional structure for deciding on service packages including premia and formulating strategies for effective promotion of micro-insurance. There is also a felt need for development, of both full-time and part-time staff, thru' effective training in insurance marketing and servicing concepts. (11.16)

Operations and Systems

140. To address the requirements of the huge market potential available, appropriate systems should be evolved for tracking client information, either manually or using technology. While a technology platform may take time for setting up, in the long-run, the same will be cost-effective and reliable. Similarly, the procedures for claims, premium payments / renewals and other services should be formalized along with increased customization of products to stimulate demand.(11.17)

Development of Adequate Feedback Mechanism

141. Keeping in view the diverse nature of market requirements, suitable mechanisms to collect market intelligence, collating and interpretation of the same in a formally structured manner, is important for product development and process refinement. (11.18)

Development of Data Base

142. High costs of penetration and acquisition often leads to higher pricing of products, thereby impacting client outreach and market depth. Building up historical data base on risk profiles, claims, settlement ratios, etc., will facilitate in better pricing of products, based on actual rather than presumed risks. Besides enabling cost reduction, warehousing of such data will make the market more transparent for entry of more operators. (11.19)

Consumer Education, Marketing and Grievance Handling

143. The micro-insurance sector is unique in the sense that there is an ongoing challenge to explain the concept and benefits to the insured. Creating awareness thru' use of pictorial posters, local folk arts and street theatres might be useful to explain the mechanisms of insurance. Local community-based organisations could organize premium collections, as they have better access to the local people. To make it more acceptable to the people, micro-insurance products, apart from covering only risks, should also provide an opportunity for long term savings (endowment). (11.20)

Product Development / Process Re-engineering

144. Customised product development to suit the varying requirements of the local populace is a pre-requisite. The processes / procedures are to be streamlined and simplified, to facilitate easier access for the rural poor. Information should be made available in vernacular for easy understanding of the terms on offer. (11.28)

Using Existing Infrastructure

145. Micro-insurance service providers can use the existing banking infrastructure and also adopt the agency-mode (NGOs, SHGs, NBFCs, etc.) for providing services, thereby leveraging on the existing physical branch network and reducing costs. (11.30)

Use of Technology

146. The technology platforms being envisioned to facilitate financial inclusion should enable micro-insurance transactions also. Towards this end, there is a need to integrate the various modules - savings, credit, insurance, etc. - into the technology framework so that holistic inclusive efforts are possible in the rural areas. (11.31)

Review of existing schemes

147. There are a large number of group life and health insurance schemes which are run by various central ministries and State Governments. The level of actual coverage in terms of claims preferred and settled in such schemes is disturbingly low. These schemes should be reviewed by an expert group set up by the IRDA. (11.32)

Life Insurance:

148. A wide range of products are available but penetration is really limited in rural areas. The procedural requirements at the time of entry and in case of claims settlement are cumbersome. The commission structure for agents is also heavily weighed in favour of getting new policies with very little incentive to service existing policies. In this regard, Micro Insurance Guidelines (MIG) 2005 issued by IRDA has provided for equal commission throughout the life of a policy and this will now remove the disincentive in servicing existing policy holders. (11.34)

Health Insurance:

149. In case of Health Insurance, penetration level is even much lower than Life Insurance. The two categories viz., Critical Illness and Hospitalisation are the main product segments. Some State Governments have developed Health Insurance schemes which are still in very early stages.

150. The Committee has observed that the mutual health insurance models have advantages of its members performing a number of roles such as awareness creation, marketing, enrolment, premium collection, claims processing, monitoring, etc. Under this arrangement, the costs of offering small-ticket health insurance gets significantly reduced. The high co-variant risks such as epidemics will have to be taken care of by a mutual entity taking re-insurance for such risks.

151. IRDA has also suggested that the capital requirements for stand-alone health insurance companies be reduced to Rs.50 crore as against Rs.100 crore for Life Insurance Companies and the Committee endorses the same. (11.35)

Crop Insurance:

152. This is a very important risk mitigation arrangement for small and marginal farmers. However, leaving the discretion to notify crops/regions to state governments has contributed to adverse selection. Further, claims settlement based on yield estimation has been cumbersome and the sampling area for crop cutting experiments is very large. An alternative model based on weather insurance has been attempted. To make it more effective, there is a need for having a large number of smaller

weather stations. The Committee recommends that policies be evolved to make crop insurance universal, viz., applicable to all crops/regions and pricing actuarial. (11.36)

Livestock Insurance:

153. As in Life Insurance, the problem lies in the process of enrolment and claims settlement. Several pilots indicate that the involvement of local organisations like SHGs, dairy co-operatives, NGOs and MFIs improves the quality of service, reduces false claims and expedites claims settlement. The Committee recommends that these experiences be studied and adopted by insurance companies. (11.37)

Asset Insurance:

154. This could cover a wide range including residential buildings, farm and non-farm equipments and vehicles. The main constraint seems to be lack of distribution channels appropriate for lower income groups. The Committee again recommends that involving local NGOs, MFIs, SHGs, etc. as distribution channels as well as facilitators of claims settlements would be quite useful. (11.38)

Demand Side Causes And Solutions for Financial Inclusion

The Committee's Report has so far concentrated on supply side issues of financial inclusion and what can be done to enhance supply of financial services, through increased outreach by existing institutions, enhancing their incentives to serve the excluded and adding new distribution channels. The Committee is of the view that financial exclusion is also caused by demand side issues. Unless some initiatives are taken on the demand side, or in the "real sectors", mere supply side solutions from the financial sector will not work. (12.01)

Recommendations

Human Development

155. Regions, segments and sectors financially excluded require substantial investments in human development. In particular, primary health, nutrition, primary education and vocational training need attention. The Twelfth Finance Commission had already taken a lead in this direction by earmarking additional funds for health and education in backward States. The Committee is of the view that this will lead to enhanced economic efficiency and consequent demand for financial inclusion, within a few years. (12.15)

Access to Land and Titling

156. The Committee is supportive of various Government programmes under which surplus land is distributed to landless and marginal farmers. The Committee has also noted that the Government has enacted recently The Forest Dwellers and Tribal Land Rights Act, 2006, which will ensure that those who had been cultivating a piece of land for decades in the middle of forests, will now get security of tenure. This will open up the possibility of their accessing credit from banks. (12.16)

157. The Committee has noted and endorses the recent move by NABARD to provide refinance for credit extended by banks and co-operatives to oral lessees and tenant farmers. This category of farmers has long been financially excluded due to lack of land titling or recorded tenures. Procedural changes in banks must be brought about to extend credit outreach to all such productive farmers. (12.17)

158. Banks hesitate to finance tenant farmers / oral lessees as they do not have documentary proof of their right to till the land for raising crops or for investment purposes. Recording of tenancy and ownership rights on land is an important measure to enable access to credit. (12.18)

159. Certificates by revenue officers or a system of land cultivation certificate by the Village Panchayats or local bodies may be made acceptable as documentary proof for cultivating the land. (12.19)

160. Computerisation of land records will lead to systematization of land records and overall availability of required information to banks facilitating their loan appraisal process. It is observed that 12 States have already initiated the process and GoI may advise all States to give priority for completing this process within a year. This will reduce cost to farmers in obtaining various documents and recording encumbrance. (12.20)

Access to Work – NREGA

161. Given the fact that nearly 80% of farmer households in the country are small and marginal farmers, who rarely have work on their own farms for more than 100 days a year, the availability of wage employment in the vicinity of their villages is critical. In this context the Committee noted the nation-wide roll-out plans supported by the National Rural Employment Guarantee Act (NREGA) which ensures that every household in need can ask for paid wage work for upto 100 days per year.(12.21)

162. The Committee endorses the creative use of the NREGP payments thru' bank accounts to enhance financial inclusion, as practiced in Andhra Pradesh. In Andhra Pradesh, the beneficiaries / depositors will be issued smart cards to enable transactions at several locations besides the bank branch. (12.22)

Infrastructure Support

163. The Committee noted the significant progress made for rural connectivity through the Pradhan Mantri Gram Sadak Yojana and the attempt to extend electric power to unconnected villages through the Rajiv Gandhi Gram Vidyutikaran Yojana. In several states the RIDF managed by NABARD has enabled the creation of much needed roads, bridges, irrigation canals, water harvesting structures and other useful infrastructure. The Committee endorses this and recommends a further impetus in the area. (12.23)

164. The National Development Council (NDC) has recommended that the normative allocation of RIDF funds among States should be decided by factoring in, *inter alia*, the CD ratio as a relevant criterion. This should be attempted by NABARD to improve equitable distribution of RIDF resources. (12.24)

Enhancing Productivity and Incomes

Productivity Enhancement

165. In this connection, the Committee has already recommended the establishment of Nodal Branches in each block to undertake intensive efforts for agricultural and business development services to farm and non-farm sector borrowers respectively. The Committee also recommends that banks explore tie-ups with government extension agencies, Krishi Vigyan Kendras, reputed NGOs working in

this field, agri-business clinics and corporates engaged in agricultural activities, to provide inputs, extension services and market linkages to the bank's borrowers so as to offer credit plus services and enhance the efficiency of credit. (12.26)

Value Addition – Primary processing

166. The Committee recommends that efforts should be made to ensure that all agricultural produce is subjected to primary and if possible secondary value addition locally. This means that post-harvest drying, sorting, grading and packing, can be done at the village level, preferably by women's SHGs. Farmers groups can come together to establish secondary value addition facilities such as groundnut shelling, cotton ginning, dal milling, rice hulling, fruit pulping, milk chilling, etc. (12.27)

Alternate Market Linkages

167. Roads, transport, power and water provide critical linkages in support of production-based activities. Social services like health, education, etc. contribute to improvements in the quality of rural life. State Governments should prioritise infrastructure planning, use of funds of the National Rural Employment Guarantee Programme (NREGP) for building critical infrastructure and encourage community participation in creation and maintenance of assets. (12.28)

Reducing Vulnerability

Risk Mitigation through Non-financial Channels

168. A vast majority of poorer households in India are exposed to high levels of risk and considered as not insurable at reasonable levels of premium. Their risk levels need to be mitigated through soil and water conservation measures, watershed development, installing protective irrigation and by using appropriate agronomic practices all the way from ploughing techniques to seed selection and timely farm operations. In the case of livestock rearers, risks can be reduced by proper herd management practices and mass vaccination for example against foot and mouth disease. It is only after this type of investments have reduced the risks in farming that the private expense in buying insurance can be affordable. (12.29)

Calamity Relief Fund

169. Repeated natural calamities and consequent rescheduling of bank loans take the debt burden beyond the repaying capacity of farmers. There is a need for the creation of a National Calamity Fund to address the problems of farmers in distress districts. Further, the subsidy on crop insurance may be directed more effectively towards the disadvantaged sectors. (12.30)

Managing Price Risks through Warehouse Receipts and Commodity Derivatives

170. Apart from the physical risks which impact crop yields, farmers also suffer from price risks. In bumper years, their harvest fetches low prices. In order to hedge against such price risks the right instrument is commodity derivatives, particularly futures options in which a farmer can be assured of selling his produce at a certain price in future. (12.31)

171. The Committee also noted that the Indian farmer is highly attuned to dealing in spot markets, traditionally known as Mandis, where the commodity is exchanged for cash. The Committee therefore supports any initiatives towards improving the transactional efficiency of spot markets. (12.32)

172. The Committee noted that several multi-commodity exchanges have come up in the last few years and that they are registering a large turn over. This enables farmers to discover the future price and take decisions related to crop selection. The Committee is supportive of such initiatives. (12.33)

173. However, the Committee noted the fact that a vast majority of financially excluded farmers have only a small marketable surplus and thus cannot benefit from the vibrant commodity exchanges, where the minimum traded lot is much larger than what the individual farmer has to offer. In order to extend the benefits of derivative exchanges to excluded farmers, aggregation mechanisms such as cooperatives need to come up. (12.34)

174. In the interim, financial instruments such as warehouse receipts and post-harvest credit can be offered so that farmers can avoid distress sales. The passage of the Warehousing (Development and Regulation) Bill, 2005 by Parliament is likely to open up a number of avenues for farmers to mitigate their price risks by encashing stock pledged in a warehouse to meet their cash needs, while waiting for the right price. The Committee is supportive of efforts to establish a chain of authorized warehouses throughout rural India, to provide such services, particularly when such warehouses are linked to PACS. (12.35)

Organising the Unorganised producers

175. In order for financial inclusion efforts to be sustainable, banks need to aggregate credit demand from the small borrowers. The celebrated mechanism for this is the SHG of which there are now more than 2.9 million in India linked with banks. (12.36)

176. Another well known mechanism for collective action is commodity cooperatives. There is no better example than the dairy producers cooperative societies established by the NDDB. (12.37)

177. The Committee recommends the establishment of similar commodity cooperatives to cover a large number of small and marginal producers all over the country. The effort for bringing the producers together can be undertaken by specialized agencies like NDDB and suitable NGOs, while the cost for this should be defrayed by either the Government or by the banks, or a combination thereof. (12.38)

178. The Financial Inclusion Fund cannot be used for a better purpose than supporting a competent and committed agency to organise commodity producer cooperatives in areas such as large cardamom in Sikkim, lac in tribal areas of Eastern Madhya Pradesh, Tasar in Northern Jharkand and seaweed in coastal Andhra Pradesh.(12.39)

179. The Committee endorses Government programmes such as *Velugu programme* in Andhra Pradesh, which promote organizing the unorganized producers, and recognizes that this cannot happen without the social intermediate of competent and committed NGOs. The legitimate expenses of such intermerdiaries need to be met.

Initially, banks can lend to groups based on considerations of viability; but this will eventually lead to individual lending as individual producers grow. This is the slow and steady process that the Committee recommends to build true financial inclusion.(12.41)
