Deregulation of Savings Banks' Deposit Interest Rates

Usha Thorat
Kishori J. Udeshi
S.S. Tarapore

FORUM
OF FREE ENTERPRISE

"Free Enterprise was born with man and shall survive as long as man survives".

- A. D. **Shroff**
Founder-President
Forum of Free Enterprise

EDITOR'S NOTE

In more than one sense this year's M. R. Pai Memorial Award function, organised jointly by the All India Bank Depositors' Association (AIBDA), Mumbai and the Punjab and Maharashtra Cooperative Bank Ltd (PMC Bank) with the support of the FORUM, was remarkably successful.

- First, the award sponsored by the PMC Bank was conferred on one of the most deserving persons, Dr. Sunita Narain, for her outstanding contribution to social and ecological issues, as well as her multi-dimensional achievements through "constructive activism" in such diverse fields as climate change, air and water pollution, water and food safety, wild life conservation, education, research and training.
- Second, it provided a unique opportunity for having interactive discussions with three former Deputy Governors of the Reserve Bank of India, Mrs. Usha Thorat, Mrs. Kishori J. Udeshi and Mr. S. S. Tarapore on the subject that is of topical interest from the perspective of bank depositors, namely, the issue of deregulation of savings bank (SB) deposit interest rates.
- Third, it was embellished by the release of the second edition of the biography of late Mr. M. R. Pai authored by Mr. S. V. Raju. It was an occasion for many of his friends and admirers to recall his great contributions, among other things, to the cause of consumer welfare and bank depositors' interest.
- Last, it evoked active participation from the distinguished audience, and more significantly from young professionals and college students.

The Forum, therefore, considers it appropriate to share with our wider audience a crucial aspect of this eventful function, namely, the presentations of three eminent former

RBI Deputy Governors. At the same time, we are also pleased to incorporate (a) two separate submissions made by the AIBDA on the issue of "Deregulation of Savings Bank Deposit Interest Rate" (marked as Annexure I and Annexure II); and (b) a well researched article authored by Dr. Ashish Das on the subject of "Savings bank Accounts - Interest Rate Deregulation" (Annexure III). In substance, the FORUM is seeking to make this booklet both comprehensive and useful from the perspective of all stakeholders, be they bank depositors, bankers, students, researchers or policy makers,

Apart from lucidity and cogency of arguments, what stands out from the inter-active discussions with three former Deputy Governors, is significantly broad convergence of their views in favour of deregulation of SB deposit rates, albeit there is some degree of variation both in the emphasis of their rationale and direction/sequencing of such a policy initiative. In fact, Mrs. Thorat suggests that let us "deregulate fully and see how the system responds rather than experiment with a floor. In the event, the common person's interest is shown to be adversely affected a floor can always be brought in".

Likewise, Mrs. Udeshi points out that "the Reserve Bank must stand firm on this decision as it did when it decided to implement the changeover to calculation of interest rate on Savings Bank deposit accounts on a daily product basis." Equally emphatically, Mr. Tarapore states that "…. the issue has been discussed threadbare and the time has come for action. The deregulation process should be initiated in the first half of 2011-12. Initially, the rate should be prescribed by the RBI as a range, say, 4.0-5.0 per cent".

Further, they have also constructively addressed various concerns about the likely unhealthy competition amongst banks, asset-liability mismatches, and so on as an aftermath of deregulation of SB deposit rates. At the same time, they have

emphasised the need for reasonableness of service charges, while recognising the imperatives of protecting margins and profitability of banks. Thus, there emerges a distinctively well-balanced and well-thought out approach manifesting in the views expressed by three former RBI Deputy Governors.

AIBDA is, therefore, extremely happy that there was intellectually stimulating discussion, and in most of the areas, it reflected the views of expressed in its submissions to the RBI. The first submission of AIBDA (Annexure I) specifically points out that the continuation of regulated interest rate regime for SB deposits has deprived market-based returns to saving bank depositors and strongly contends that existing interest rate policy is "not in sync with the process of the liberalization and deregulation of the financial sector in the country". The second submission (Annexure II) is in response to the issues raised during the meeting which the delegation of AIBDA had with the concerned RBI top officials.

AIBDA policy propositions are equally strongly reflected in a highly analytical work of Dr. Ashish Das (Annexure III), who is incidentally one of the active members of the Managing Committee of the AIBDA.

In the compilation and preparation of this booklet, we are pleased to acknowledge significant contribution of another active Managing Committee member, Dr. Amita Sehgal, especially in editing the core text of interactive discussions of three former Deputy Governors of RBI. We are sure this publication will be of great value to all concerned, and in particular to the bankers, while formulating their strategy towards a possible deregulatory SB deposit interest regime and savings bank depositors in protecting and promoting their own interests!

Sunil S. Bhandare
Editor

Deregulation of Savings Banks' Deposit Interest Rates

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This publication summarises the expert comments made at the panel discussion hosted by the All India Bank Depositors' Association on the occasion of the 7th M. R. Pai Memorial Award Function on 7th July, 2011.

Mrs. *Usha Thorat,* Director, Centre *for Advanced* Financial Research & Learning, (former Dy. Governor, the Reserve Bank of *India),* set *the* ball rolling with her well-researched comments on the issue.

Using the Discussion Paper put out by the Reserve Bank of India (RBI), as a backdrop, she spelt out her responses to the various questions raised in the Discussion Paper.

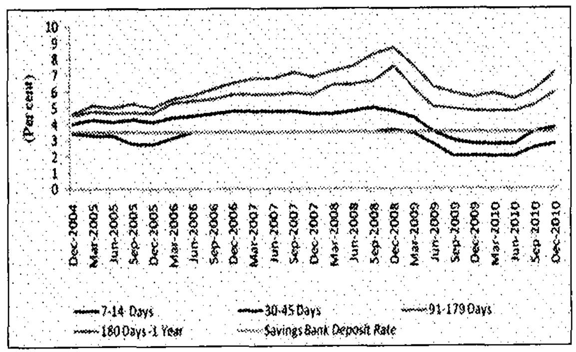
Should rates be deregulated? I don't think this is a question any more. The issue is timing. The best time to deregulate is when inflation is high. In this context the present timing is just right.

Should deregulation be introduced in one sweeping policy, or should *it* be *introduced* in a phased manner, subject to a "Floor *Rate"?* The RBI's Discussion Paper is not very clear on the meaning of a "phased manner". The argument for a Floor

Rate is to prevent banks fixing rates at very low levels when liquidity is plentiful. The following chart indicates that banks reduced interest rates on deposits in the 7 to 14 day bracket and even in the 30-45 days maturity when the system was awash with liquidity. Hence rates falling below 3.5 per cent on savings bank deposits cannot be ruled out. In such case, the more uninformed depositor – in this case the rural and semi urban depositor- may not move the deposits to longer maturities and could face very low rates at times of excess liquidity. Hence there could be an argument for a Floor Rate.

On the other hand, as is seen from Chart - 1 such periods since 2004 are short lived. It may be better to deregulate fully and see how the system responds rather than experiment with a Floor. In the event the common persons interest is shown to be adversely affected a floor can always be brought in.

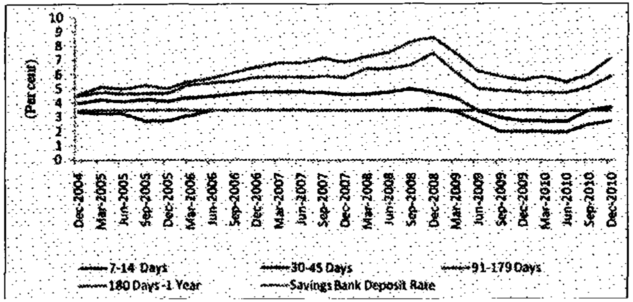
Chart 1



Source: Page 11 of the Discussion Paper, R.B.I., April 28, 2011.

All categories of savers will gain – as the same banks should not be allowed to differentiate in terms of interest rates based on location of the depositor or size of minimum balance. Hence all categories of savers will gain especially the rural, the pensioner and the small saver. Chart 2 shows that saving bank rates will move more in tandem with the short term rates especially up to 30 days and if deregulated would tend to go up. On the other hand, the rates paid on FDs of shorter term may come down.

Chart 2



Will unhealthy competition push up rates and increase cost of credit hampering growth? There is no theory in the world that can support this argument. Overall cost of deposits may go up because it can be argued that SB rates have been kept artificially low. But this cannot be attributed to unhealthy competition as over time the system will adjust. In fact competition in this area as in other areas can only be good for the system. On the other hand, is it possible that given the captive saver especially in rural and semi urban areas which account for 40 per cent of the amount of deposits, there would be concerted action to keep rates low especially by PSBs for whom the ratio could be higher? Can they afford to do so hoping their customers in the urban areas do not migrate to the private sector banks? The true nature of competition will be reflected when the outcomes are analyzed.

The banks will have to take a view on pricing depending on the share of savings bank to total deposits as also the population group-wise distribution of saving bank deposit accounts.

Table 1 and 2 show the bank group-wise position in this regard.

Table **1:** Distribution of Savings Deposits **(%)** March **2009**

Category	Current account	Savings accounts	Total CASA
SBI Group	11.4	27.5	38.9
Nat. Gp	10.7	24.0	34.7
Private sector	13.7	19.7	33.4
Foreign banks	25.2	14.1	39.3

(Source: BSR)

Table **1:** Distribution of Savings Deposits (%) March **2009**

Category	Rural	Semi-Urban	Rural+ Semi Urban	Urban	Metro	Urban+ Metro
SBI Group	**15**	**32.6**	**47.6**	**27.7**	**24.7**	**52.4**
Nat.Gp	**17**	**20.1**	**37.1**	**25.6**	**37.3**	**62.9**
Private Sector	**4.3**	**14.8**	**19.1**	**28.2**	**52.7**	**80.9**
Foreign	**Neg.**	**Neg**	**0.1**	**7.6**	**92.3**	**99.9**
RRB	**62.3**	**26.8**	**89.1**	**9.9**	**0.1**	**10**

(Source: BSR)

Will there be ALM *mismatches* if fhe share of SB accounfs reduces? The argument put forth is that banks with higher share of CASA are able to support long term lending such as for infrastructure as these constitute stable funds. First, if interest rates rise for savings bank accounts, with all other rates remaining unchanged, why should the share of SB accounts go down? On the other hand, it should increase. Even Basel 3 recognises savings bank accounts as stable funds-where covered by deposit insurance and where used for transactions, the stable funding factor is taken as 90 per cent in other cases it is 80 per cent. The RBI paper indicates the core component at around 90 per cent.

The issue is not one of ALM mismatch – rather the argument is that banks are now able to use low cost SB accounts to reduce the cost of lending to infrastructure – hence will interest rates for infrastructure lending go up? Much would depend on the impact on the overall cost of deposits. Looking at share of SB accounts, one per cent increase in interest rates will increase cost of deposits and correspondingly credit by 25 bps on the ceteris paribus assumption. But this does not take into account the impact of deregulation of interest on savings accounts on the interest paid on short-term fixed deposits..

Should higher inferesf be paid on accounfs wifhouf cheque book facilify? Should banks pay interest monthly on SB accounts as in case of loan accounts? What if the charges on savings bank accounts are hiked to compensate for the increase in interest rates? These are very important issues. The deciding principles should be reasonableness, fairness, equity and transparency. For cheque book facility and other special facilities banks should charge on cost covering principles with an element of cross subsidy for special category persons. For basic banking accounts, or no frills accounts, there could be restrictions on operations but the fees should be minimal. A Committee set up by RBI under Mr. Sadasivan had articulated certain principles for

ensuring reasonableness in fixing and communicating the service charges. These were:

- For basic services to individuals, the banks will levy charges at the rates that are lower than the rates applied when the same services are given to corporate/legal entities.
- For basic services rendered to special category of individuals (such as individuals in rural areas, pensioners and senior citizens), banks will levy charges on more reasonable terms than the terms on which the charges are levied to other individuals.
- For the basic services rendered to individuals, banks will levy charges only if the charges are just and supported by reason.
- For the basic services to individuals, the banks will levy service charges ad-valorem only to cover any incremental cost and subject to a cap.
- There is another regulatory issue viz. one relating to the resting period. The current RBI regulations say that interest on deposits should be paid at quarterly or longer rests. The regulations also say that on loans interest can be charged at monthly rests. But while switching over from quarterly to monthly rests, banks should take care to see that rates did not go up merely on account of switch over. But for all practical purposes, banks can compound and charge interest at monthly rests for loan accounts while for deposit accounts they cannot have less than quarterly rests.

Mrs. Usha Thorat concluded by pointing out that the current asymmetry between the periodicity of interest paid to depositors on their savings account and the interest charged on their loan account needs to be reviewed by regulators in order to address the existing anomaly.

The discussion was fhen taken *further* by Mrs. *Kishori* J. *Udeshi,* Chairman, Banking Codes and Standards Board of India, (former *Dy.* Governor, Reserve Bank of India).

The late Mr. M.R. Pai was a legendary crusader who fought for the rights of depositors and it is only befitting that the All India Bank Depositors' Association has organized an interactive session on the issue of Deregulation of the Savings Bank interest rate on the occasion of the M.R. Pai Memorial Award.

While the rate of interest on term depositswasderegulated a long time back in 1996-97, the issue of deregulation of the Savings Bank interest rate was examined in the Reserve Bank several times but not considered for implementation because it was felt that the time was not right. Now that the Reserve Bank has brought the issue centre-stage for discussion, it implies and bankers too have recognized that the question is not whether to deregulate but when to do so. Even when the Reserve Bank does take the decision to deregulate Savings Bank rate, it will do so after giving the banking industry sufficient notice. In this context, one can visualize reports appearing in the media, nearing the due date for implementation of deregulation, that the time is not right. Needless to say the Reserve Bank must stand firm on this decision as it did when it decided to implement the changeover to calculation of interest rate on Savings Bank deposit accounts on a daily product basis. The process of deregulation of interest rates began in the 1980s and hopefully with the deregulation of Savings Bank interest rate this reform process will end in 2011.

My views on the transition to a deregulated Savings Bank interest rate are from three perspective angles:

- encouraging the savings habit of households;
- strengthening financial inclusion and
- protection of depositors.

Let me begin with the first issue. It is important to note that the RBI data shows that the ratio of saving deposits to aggregate deposits has shown a decline from 2005-2009 and the ratio now stands at 22.1% (2% drop from 24.0 in 2005). How will deregulation help? For decades the depositor has been getting a negative rate of return on his savings bank account. With deregulation, he may still get a negative return but competition will ensure that the return will be better than today. Here I would draw your attention to the experience of certain Asian economies like Indonesia and Malaysia which implemented interest rate deregulation, primarily because real rates were negative but through their deregulatory process on the interest rate structure combined with the central banks' credible monetary policy measures for anchoring inflation expectations these economies have been able to have a sustained positive real interest rate structure. If they can do it we can also hope to achieve that goal.

When market forces are at play there will be bound to changes and there could be times when the rate moves downward. There are, therefore, some who contend that a fixed rate is better than this uncertainty of return on savings. But this is akin to saying that if the common man's need is three 'chapatis' per day he should be satisfied with getting his ½ chapatti regularly every day rather than one or two or even six on different days. Yes, the savings bank interest rate was 6% in 1992.

On the issue of financial inclusion there are reports from banks that if the savings bank interest rate is to be deregulated then charges for ATM, cheques, transfers will also go up and that this would not be in the interest of financial inclusion. Here, I would raise two points: One, a gentle reminder to banks that for decades the Savings Bank account-holders have been passively and submissively subsidizing the term deposit account-holders and borrowers and secondly, that the goal of financial inclusion is not something meant only for the Reserve Bank or the Government. It is a goal which every mature banker must understand, accept and own.

Banks are presently free to frame their Savings Bank rules and charges and as per their Code commitments they are required to give one month's notice to their customers if they are going to bring about any change in either the charges or terms and conditions. Therefore, with a firm belief in the wisdom and maturity of bankers, I would not recommend any further regulation of charges over what exists at present. Here, I would share a quotation of the Governor of the Bank of Canada, John Crow, who, while delivering the C.D. Deshmukh Memorial Lecture in the mid-90s had said "***deregulation*** does not mean ***de-supervision***". We need to heed this sagacious advice and the Reserve Bank would do well to keep strict supervisory control on what banks are doing so that there is no obstacle in the progress towards complete financial inclusion. If one or two banks do misuse the freedom available to them at present then the remedy for this is not regulatory prescription for all bankers but supervisory actions against such errant bankers.

Let me now turn to the important issue of depositors' protection. The deregulation of the Savings Bank interest rates coupled with technology may lead to product innovations by banks. In 2001 when Hong Kong deregulated the Savings

Bank interest rate a number of banks there launched new products. We have to be prepared for such an outcome. We must protect the depositors. Since we have yet to make progress in our efforts towards financial literacy, the Reserve Bank must, in the interest of protection of depositors, regulate the introduction of new financial products. At least in the first few years of deregulation the Reserve Bank must be in the loop.

Lastly, in a scenario where banks compete with one another in offering attractive interest rates it is necessary for the Regulator to play a major role in protecting depositor's - by letting them know the financial soundness of the banks in which they deposit their savings.

Mrs. Udeshi concluded by giving out a strong mandate to the Deposit Insurance and Credit Gurantee Corporation (DICGC) to act as a vigilant overseer of depositors' interests. She ernphasised that DICGC should play a very pro-active role in this regard in rating banks on their financial soundness and making their rating known to the depositors. She reiterated that there is an imperative need for empowering the DICGC with powers to safeguard the interests of depositors.

Eminent Economist and prolific writer on economic and banking issues, Mr. Savak Tarapore then took over the discussion giving it a clear focus by relating Deregulation of Savings Bank Deposit Rate and Depositors Rights.

In April 2011, the Reserve Bank of India (RBI) released an excellent Discussion Paper on the issue of deregulation of the Savings Bank Deposit Interest Rate. The Discussion Paper is well balanced and sets out the pros and cons of deregulation and the Paper reveals a slight tilt by the RBI that the time has come for deregulation of this deposit rate. My views on this are summarised as under.

Sequencing and Timing of Deregulation

For a successful process of deregulation it is necessary to properly work out the sequencing and timing of the reform. The issue has been discussed threadbare and the time has come for action.

- The deregulation process should be initiated in the first half of 2011-12. Initially, the rate should be prescribed by the RBI as a range, say 4.0 per cent - 5.0 per cent.
- The rate determined by a bank should be applied uniformly to all its savings bank depositors and any discrimination between depositors, by size or location, should be strictly prohibited.
- The RBI should ensure that once banks are given discretion to fix rates, a uniform rest should be prescribed (quarterly rests could be applied for the quoted rate as in the case of term deposits). Some other regulatory issues would also need attention.
- Banks should be cautioned that the rate quoted by an individual bank does not erode its net interest margin. This has to be achieved by blending the proportion of Savings Bank deposits and term deposits and the rates quoted thereon. If operated properly the net interest margin would improve.
- Once the system stabilizes, the RBI could remove the ceiling but retain the floor. The entire process of deregulation is best completed in rapid steps during 2011-12.

Link Between Short-term and Long-term Interest Rates

There is a need to have a better appreciation of the link between the short and long rates. Analytically, the long rate is the average anticipated short rate, adjusted

for risk and uncertainty. In a mature financial market the short rate and the long rate are reasonably aligned. In fact, the present Indian government securities market reflects a model of how the long and short rates should be aligned. For instance, in the recent period, the 91 days treasury bill is around 8 per cent, the one year rate is around 8.3 per cent and the 15 year rate is around 8.5 per cent. Contrast this with the bank's deposit rate structure. The regulated Savings Bank rate is 4 per cent while the one year term deposit rate, which is determined by banks, is in many cases, over 9 per cent. The problem is not the deregulated term deposit rates but the RBI's regulated Savings Bank rate which is presently fixed at a very low level of 4 per cent. Savings Bank holders should not be required to subsidise term deposits and borrowers.

Banks Case Against Deregulation

Some banks have argued that deregulation of the Savings Bank deposit rate will spell disaster for the entire banking system. They have also argued that deregulation should be total or the status quo should be maintained. Banks advocate that, with deregulation, they should be allowed to offer larger Savings Bank depositors a higher rate and smaller Savings Bank depositors can be discriminated against. It is asserted that if RBI deregulates the Savings Bank deposit rate, banks would not undertake financial inclusion and would not encourage No Frills Accounts. Deregulation should not sanctify the law of the jungle where the predator attacks the weaker creatures.

There is an insidious prevailing thought, particularly within the government and the banks, that depositors have nowhere to go and would meekly part with their savings at low deposit rates. This is a dangerous line of thinking.

The late Mr. L.K.Jha, Governor RBI 40 years ago, said that in a fair system the endeavour should be to provide the highest possible rate to depositors while providing the lowest possible rate to borrowers. The banking system has moved away from the Jha dictum and there is a clear tilt in favour of borrowers.

Depositors should wake up

Bank depositors should support the objective of the All-India Bank Depositors' Association** in defending the depositors' rights. Banks and the authorities should also realize that the depositors would not take it lying down while they are being trampled upon by the system. Improved financial literacy would enable depositors to look for other avenues if they are not treated fairly by the banks. It is time depositors ask the question "why banks?" Depositors must recall the words of the late Mr. M.R. Pai that depositors are the legitimate owners of banks as without depositors there would be no bank. If banks and authorities continue to ignore the rights of depositors, they have to be prepared to face a depositors' revolt.

Concluding Observation

On the deregulation of the Savings Bank Deposit Rate I have, on many occasions, quoted the dictum of the World War II US General George S. Patten who said " Lead, follow or get out of the way." Till recently, the RBI was not willing to follow any of the three options. To the credit of the RBI it now appears to have decided to lead the March to an orderly deregulation of the Savings Bank Deposit Rate.

** *The Ail-India Bank Depositors' Association (Mumbai), - AIBDA -established in 1968, owes ifs existence to the late M.R. Pai. It is an informal organization which takes up depositors' disputes with banks.*

All India Bank Depositors' Association – Mumbai (AIBDA)

Deregulation of Savings Bank Deposit Interest Rate
Submission to the RBI

Preamble:

India has witnessed the process of calibrated and progressive liberalization, deregulation and globalization of her economy from early 1990s. As an integral part of this continuous reforms process, we have also experienced gradual reforms in the financial sector. RBI also started the process of gradual deregulation of interest rates in early 1990s. While the process of deregulation of interest rates on term and fixed deposits was completed by RBI in October 1997, it has continued with regulating the interest rate on Savings Bank Deposits.

Doubtless, the continuation of such regulated interest rate regime has deprived market-based returns to saving bank depositors. AIBDA strongly contends that the present interest rate policy on Savings Bank Deposits is not in sync with the process of the liberalization and deregulation of the financial sector in the country.

Experience of Partial Deregulation:

The banks in India participated in the process of gradual deregulation of term and fixed deposits with increasing maturity. As a result, a more competitive and yet a stable structure of Fixed Deposits interest rates has come to be effectively evolved over a period of time. The credit for this achievement surely goes to individual bank using its own discretion as well as to competitive market space to determine FD rates, given its liquidity and asset-liability position. However, Savings Bank Deposits Interest Rate (SBDIR) have remained static at 3.5% p.a. since 2003 (and now enhanced to **4% p.a.** with effect from 3rd May 2011), as it still continues to be regulated by RBI. This has resulted in SB Depositors being deprived of market-determined returns even in a liberalized framework of our economy.

Also, this seems to have created a sense of complacency amongst banks that SB deposits, which account for a significant portion of their over-all deposits (or loan-able funds), that there is almost an assured source of cheaper funding for them on a virtually perpetual basis. This feature is certainly not in conformity with the philosophy and strategy of building competitive market environment amongst bankers.

Need for Completing Reforms:

It is in this context that AIBDA strongly contends that in a liberalizing economy the role of the regulator is: (a) to protect consumer interest; and (b) to create healthy competition in the market place. Hence, the RBI, as a monetary authority and an over-arching financial regulator, must complete the reform of deregulating deposits interest rate by extending the deregulation to SB Deposits.

However in order to protect the small depositor and to ensure heaithp competition, RBI should determine the floor rate from time to time depending on its monetary policy without prescribing any ceiling rate. This would speed and strengthen the process of financial inclusion as well as would ensure (receipt of) market-based returns to SB depositors due to competition amongst banks.

Issue-Wise Feedback

Issues 1&2:

AIBDA suggests that SBDIR should be deregulated immediately keeping the existing administered rate of 4% p.a. as the floor rate *without prescribing any ceiling rafe.* The floor rate prescribed by RBI needs to be changed from time to time, depending upon its monetary policy and the prevailing inflation scenario. The prescription of floor rate should be a permanent feature to protect the interest of small depositor.

Issue 3:

There should not be any discrimination in prescribing SBD interest rate by a bank across the span of its saving bank deposit holders and a uniform rate of interest policy must be prescribed across the span such savers.

However, savers like senior citizens/pensioners/people in rural areas find it difficult to change their bank, and as a result their loyalty to the respective bank becomes permanent feature. Such groups of savers need to be appropriately rewarded with some incentives such as additional interest over the floor rate (at least 50 basis points higher) or enough flexibility for individual banks to introduce innovative products in relation to their SBD accounts.

Issue 4:

AIBDA would like to stress that concern regarding a possible intense competition amongst banks is ill-founded and the fear of asset liability mismatch is misplaced. The banking sector has responded to the deregulation of term and fixed deposits interest rates with considerable maturity taking into account its liquidity and asset-liability position.

Indeed, this sector ought to have been exposed to competition in SBD interest rates much earlier, so that SBD account holders were not deprived of fair returns on their SB deposits based on market conditions. Moreover, the market situation is being constantly monitored by RBI and therefore, it is imperative that RBI completes the reforms process in deregulating interest rates on all kinds of deposits, prescribing appropriate floor rate for SBD interest from time to time. This will pave the way for healthy competition amongst banks, ensuring market-based returns to SBD account holders.

Issue 5:

The interest rate on all saving bank depositors in a bank must be uniform. The levying or waiving of service charges for cheque facility or any other facility may vary from bank to bank, as per the dictates of the competitive market environment. Individual bank would frame the policy under the able guidance of its Board of Directors, which is always deemed to be autonomous and professional in its functioning.

While on the subject, we take this opportunity to emphasize the need to stipulate the Fair and Reasonable service charges based on average costing exercises of different banks so that banks do not capitalize on the marketing and competitive strategies to attract CASA deposits and recover the higher interest paid by increasing service charges on the traditional services (like cheque collection, demand drafts and so on) offered by banks. Savings Bank Accounts are the bedrock of banking in India. Despite emergence of debit cards, most depositors rely on their savings bank deposits account for the purpose of daily transactions. Hence, it is essential that transaction costs are not increased on any pretext.

Deregulation of Savings Bank Deposit Rates

A Revised Submission to RBI from AIBDA

Preamble

We had extensive deliberations with the members of the Management Committee of AIBDA as well as with other stakeholders on the issue of deregulation of savings bank deposit rates. All these were essentially based on the interactions, which the representatives of AIBDA had with the Deputy Governor of the Reserve Bank of India (RBI), Dr. Subir Gokarn along with his senior colleagues on August 1, 2011. Also, the AIBDA has taken into consideration the viewpoints expressed by various bankers independently and their representative organisation, namely, Indian Banks' Association.

Accordingly, the following revised submission is being made to the RBI for its favourable consideration. Needless to say, the AIBDA will be happy to respond to any clarifications or queries from the RBI, either in writing or in personal interactions with its concerned officials.

A Revised Submission to RBI from AIBDA

At the very outset, we wish to state that AIBDA represents all Bank depositors including senior citizens, pensioners, small or large depositors, "no frill account" holders in all rural/semi-urban/urban/metropolitan parts of India. There is no exclusivity of any particular class of depositors in our existing structure.

Issues (i) and (ii):

Should savings deposit inferest *rate* be deregulated at this point of time?

Should savings deposit *interest* rate be deregulated complefely or in a phased manner, subject to a minimum floor for some time?

- First, AIBDA reiterates its position that the RBI need to announce and initiate the process of partial deregulation of savings bank deposit rates. Admittedly, the modus operandi (sequencing and timing) has to be decided by the RBI, such that the depositors' interest, especially of small depositors, is fully protected.

  Having thus said, AIBDA states that complete deregulation of savings bank deposit interest rate may not be a reality at this stage, given the fact that the protection of small depositors' interest is of utmost importance. Also, in the current uncertain global and domestic economic environment, it may not be possible to secure effective supportlparticipation of bankers, who would be more concerned with managing the strategies for protecting their profitability and avoiding possible asset-liability mismatches.

- Second, AIBDA perceives five different options; and each of them may have some positive or negative points. We set out those options as follows:

  (a) No floor or ceiling

  (b) Fix only ceiling (we rule out this option due to imbalance that it would cause in the interest rate structure)

  (c) Fix only floor

  (d) Fix different floor and ceiling

  (e) Fix same floor and ceiling (this is the existing regulated setup; we want this to be deregulated)

- Third, methods of rate fixation: AIBDA finds that as on date, there is no explicit method in place for fixation of interest rate on savings bank deposit. Therefore, under the proposed new dispensation, the RBI could think of linking the saving bank deposit rate to any of the key policy rates (repo or reverse repo) and/or inflation rate. (These are apparently the guiding rates for base rate and term deposit rates of the banks).

- Fourth, the current set-up has, broadly speaking, the following features:

Savings Bank Deposits ----- the interest rate fixed at 4%, but return not fixed. The latter effectively becomes a variable and the net return to the depositors is affected by

a) Interest application frequency (every 3 months or more);

b) Minimum average quarterly balance to be maintained for quarterly fee exemption;

c) Service charges on basic transactions carried out in the savings bank deposit account.

d) For small deposits, there are no standards to park funds under Term Deposit -- Requirement of a minimum amount (varies from bank to bank) to be able to open a term deposit.

Zero Balance No-frills Savings Account ----- once again, interest rate is fixed at 4%, but return is not fixed. The latter effectively becomes a variables and the net return to the depositors is affected by

a) Interest application frequency (every 3 months or more);

b) Service charges on basic transactions carried out in the savings bank deposit account.

- Fifth, **AIBDA strongly contends that** given the freedom to bankers in the current setup, RBI facilitates, what we believe, **'not quite transparent'** deregulated savings bank deposit interest policy **in terms of net return on funds parked under such accounts.** Therefore, **our recommendation** is to make overall measure on net return for savings bank deposit accounts simple and thereby transparent. As a first measure **make interest application frequency monthly.**

- Sixth, based on AIBDA's own evaluation of the five different options cited above, we make the following policy recommendations for RBI's consideration:

1) Regulate the floor rate to protect interest of small depositors.

The floor rate prescribed by RBI should be a permanenf feature and the floor rate may change from time to time depending upon its assessment of prevailing macroeconomic and inflation scenario.

METHOD for arriving at the floor rate

The floor rate should be pegged at half the repo rate rounded to upper complete percentage. With this method the savings bank (SB) rate will undergo a revision only after the repo rate undergoes a substantial change of 200 basis points. Since the interest application frequency will be monthly, interest rate can be changed on 1st of a month.

As an illustration, the above method leads to the following scenario for the floor rate of SB deposit account.

Repo rate (%)	Floor of savings bank rate (%)
...	
4 or less but more than 2	2
6 or less but more than 4	3
8 or less but more than 6	4
10 or less but more than 8	5
...	

The effect of the above method for calculating the floor rate can be retrospectively seen in the table below.

Date (1)	Repo Rate* (2)	SB Rate (3)	SB Floor (4)	Difference (5)=(4)-(3)
27-Apr-01	9.00	4.0	5.0	1.0
30-Apr-01	8.75	4.0	5.0	1.0
07-Jun-01	8.50	4.0	5.0	1.0
28-Mar-02	8.00	4.0	4.0	0.0
12-Nov-02	7.50	4.0	4.0	0.0
07-Mar-03	7.10	3.5	4.0	0.5
19-Mar-03	7.00	3.5	4.0	0.5
31-Mar-04	6.00	3.5	3.0	-0.5
26-Oct-05	6.25	3.5	4.0	0.5
24-Jan-06	6.50	3.5	4.0	0.5
08-Jun-06	6.75	3.5	4.0	0.5
25-Jul-06	7.00	3.5	4.0	0.5
31-Oct-06	7.25	3.5	4.0	0.5
31-Jan-07	7.50	3.5	4.0	0.5
31-Mar-07	7.75	3.5	4.0	0.5
12-Jun-08	8.00	3.5	4.0	0.5
25-Jun-08	8.50	3.5	5.0	1.5
30-Jul-08	9.00	3.5	5.0	1.5
20-Oct-08	8.00	3.5	4.0	0.5
03-Nov-08	7.50	3.5	4.0	0.5
08-Dec-08	6.50	3.5	4.0	0.5
05-Jan-09	5.50	3.5	3.0	-0.5
05-Mar-09	5.00	3.5	3.0	-0.5
21-Apr-09	4.75	3.5	3.0	-0.5
19-Mar-10	5.00	3.5	3.0	-0.5
21-Apr-10	5.25	3.5	3.0	-0.5
02-Jul-10	5.50	3.5	3.0	-0.5
27-Jul-10	5.75	3.5	3.0	-0.5
16-Sep-10	6.00	3.5	3.0	-0.5
02-Nov-10	6.25	3.5	4.0	0.5
25-Jan-11	6.50	3.5	4.0	0.5
17-Mar-11	6.75	3.5	4.0	0.5
03-May-11	7.25	4.0	4.0	0.0
16-Jun-11	7.50	4.0	4.0	0.0
26-Jul-11	8.00	4.0	4.0	0.0

** Repo rate represents the rate at which RBI lends to the banks, i.e. it injects liquidity into the system*

It can be seen that historically the SB rate fixed by the RBI has been close to the floor rate arrived at by the proposed method. In the above table, on an average the difference in the proposed floor rate and SB rate is around 25 basis points.

2) **A prudent decision on the prescription of a ceiling rate and the quantum may be taken by RBI.**

Issue (iii):

How can the concerns with regard to savers (senior citizens, pensioners, small savers, particularly in rural and semi-urban areas) be addressed in case savings deposit inferesf rafe is deregulafed?

The interests of the savers would be adequately protected by (A) implementing our suggestions to issues (i) and (ii) and by (B) ensuring that no discrimination is made by the banks while prescribing the savings bank interest rate across the span of all account holders.

To offer further protection, there must be a uniform method of crediting monthly interest and reasonable benchmark for service charges including some basic free transactions with additional free bonus for electronic transactions.

Issue (iv):

How serious are concerns relafing to a possible intense compefifion amongst banks and asset-liabilify mismafches if savings deposit interest rafe is deregulafed?

The RBI's regulated floor and ceiling rate would address the concern of unhealthy competition in an adequate manner. The concerns for asset-liability mismatch would be insignificant as revealed from past experience of deregulation of term deposit rate.

Issue (v):

Should higher inferesf rafe be paid on savings deposits wifhouf a cheque book facilify?

The decision on this may be left to the Bank's Board of Directors. The market competition would encourage bankers to innovate products and price discovery in the long run by offering incentive to depositors who are least costly to serve.

In the opinion of AIBDA, the challenge lies in introducing partial deregulation in such a manner that it protects small depositors from low returns and yet gives an opportunity to get market based higher returns driven essentially by healthy competition.

Savings Bank Accounts- Interest Rate Deregulation

Ashish Das*

Abstract

For long, the regulated savings bank (SB) interest rate remained downward sticky even when the market conditions were favourable for an increase. This could be attributed, among other reasons, to commercial banks' prevail in convincing the Reserve Bank of India (RBI) on its excessive cost in maintaining such accounts. However, with the advent of technology in servicing the account (like ATM, NEFT, Core Banking Solutions, Net-Banking, Inter-Bank Mobile Payment Service, etc.), the cost to serve, for the providers, has drastically reduced. This fact never got discounted appropriately while arriving at the SB interest rate or even the service fees. As a consequence banks gained considerably (net profit of scheduled commercial banks for 2009-10 being ₹ 57,109 crore) through unwarranted high net interest margins and service fees and commissions,

The SB interest rate was decreased in March 2003, from 4% to 3.5%, when inflation was around 3%. In April 2010, after RBI changed the method of calculating interest on SB accounts, the depositors saw an increase in their returns on savings. However, the fluctuating inflation has been very high in recent years. The SB deposits are the major source of savings (investment) for many depositors, including pensioners, small savers and senior citizens. Not having the ability to be good money managers, such persons are getting high negative returns on their hard earned monies.

This raises several questions: (a) How long can RBI maintain *status* quo by focusing only towards banks' interests and depriving depositors by not offering meaningful net return? (b) Is it an opportune time to completely deregulate the SB interest rate? (c) Is it time to partially regulate through prescription of only a floor on the SB interest rate (thereby protecting bulk of such savings depositors held by households, including households in rural and semi-urban areas)? (d) What are the related regulatory issues concerning SB accounts? We attempt to address these in this note.

**The views expressed in the paper are those of the author and not necessarily of the institution to which he belongs. Dr. Ashish Das is a Professor of Statistics, I.I.T., Mumbai. E-mail: ashish@math.iitb.ac.in*

I. Introduction

1. As on March 2009, the scheduled commercial banks held a staggering 492 million savings bank (SB) accounts attributing to 74% of total number of different types (current, savings and term) of deposit accounts, and majority of such depositors are from the household sector.

2. The Reserve Bank of India (RBI) has recently initiated a discussion on the deregulation of interest rates on SB deposits. The SB interest rate, being decided by RBI, is one of the few administered rates in India.

3. The issue of interest rate deregulation of SB account is not new. As early as April 29, 2002, RBI's Monetary and

Credit Policy, presented by Dr. Bimal Jalan, raised this issue as quoted below:

"Interest Rate on Savings Account - No Change

In the recent years, banks have been given freedom in fixing inferesf rafes on various deposit liabilities, and flexibility in offering *interest* rafes depending upon tenor and size of deposits *with the* approval of their Boards. The only interest rafe on deposits side, which is regulated by RBI is on 'savings *account' with* cheque facility. This rate is at present *4.0* per cent per annum.

However, alfhough the nominal interest rate is *4.0* per *cent* per annum, the yield on such deposifs works out to *3.4* per cent per annum only as inferest is payable on *the* minimum balance between *tenth* and last day of each monfh. Nearly *four-fifths* of such saving deposits are held by households. In view of *the* present deregulafed *interest* rafe environment and *the reduction* in inferest rafes on Government's small savings schemes in the recenf period, *there* is an apparenf case for deregulation of interest rates on savings accounf also. However, considering the fact that bulk of such savings deposits are held by households, including households in rural and semi-urban areas, on balance, it is not considered as opportune *time* to deregulate the *interest* rate on savings accounf for fhe present. In any case, the presenf effective yield of *3.4* per cent is quife reasonable in relation to other prevailing interesf rafes on even short-term instruments."

4. The decision to decrease the SB interest rate, from 4% to 3.5%, was taken in February 2003 when the inflation for

the period January-December 2002 averaged 2.5%. The SB rate remained downward sticky even when the market conditions were favourable for an increase. In April 2010, after RBI changed the method of calculating interest on SB accounts, the depositors saw an increase in their returns on savings. However, the fluctuating inflation has been very high in recent years. Even though, starting October 2009, RBI had been exiting from the accommodative mode and had increased the repo rate 9 times leading to market driven increase in the term deposit rates, RBI chose to peg the SB interest rate at 3.5% throughout the period. The SB deposits are the major source of savings (investment) for many depositors, including pensioners, small savers and senior citizens. Not having the ability to be good money managers, such persons are getting high negative returns on their hard earned monies.

5. Apparently, since 2002-03 there was a strong feeling among a section of the banks to deregulate the SB rate in line with the term deposit rates. That never came through (probably to protect select banks from aggressive competition). Even, safeguarding the interests of the common man, benchmarking of a minimum rate never saw light of the day. Thus, the system then and the system now, both appear to be stacked against the common man,

II. Interest Rates and its Application

6. RBI, since March 2003, maintained the SB interest rate at 3.5% per annum. Due to the then existing oblique method of computing such interest, the effective rate of interest had been much lower (approximately 3%). The change in the method of computing interest since April 2010, aligned the effective rate to the declared rate of 3.5%. Thus, effectively, RBI fixed the banks' interest cost on savings

deposits, the raw material for them to do business, at very low levels, viz.:

3.8% during November 1, 1994 through March 31, 2000;

3.4% during April 1, 2000 through February 28, 2003;

3.0% during March 2,2003 through March 31, 2010;

3.5% during April 1, 2010 through May 2, 2011;

4.0% during May 3, 2011 till date.

Effective SB rates even lower than declared rates

7. The various transitions of nominal rates and the corresponding effective rates of interest on SB account, since 1978, are presented in Table 1 below. It can be seen that until April 2010, the effective SB rates were lower than the corresponding declared rates.

Rate of Interest on Savings Bank Deposit		
Effective from	Rate per annum (%)	Effective Rate per annum (%)
March 1, 1978	4.5	3.8
September 13, 1979	5.0	4.3
April 24, 1972	6.0	5.1
July 1, 1993	5.0	4.3
November 1, 1994	4.5	3.8
April 1, 2000	4.0	3.4
March 2, 2003	3.5	3.0
April 1, 2010	3.5	3.5
May 3,2011	4.0	4.0

8. Moreover, the nominal effective SB interest rate does not reflect the time value of money as over time inflation erodes the value of money. Real interest rates, on the other hand, adjust for inflation and thus measure the time value of money. Since year-on-year (y-o-y) inflation

reflects the behaviour of prices at two specific points of time, it does not give a proper feel of the prevalence of inflation in the recent period. We therefore take a 12 month moving average of y-o-y inflation of WPI. This gives a better picture of how the inflation had behaved in the recent past. We define the real rates = nominal effective SB interest rates minus 12 month moving average y-o-y inflation of WPI, i.e. $i = r + M(I)$, where

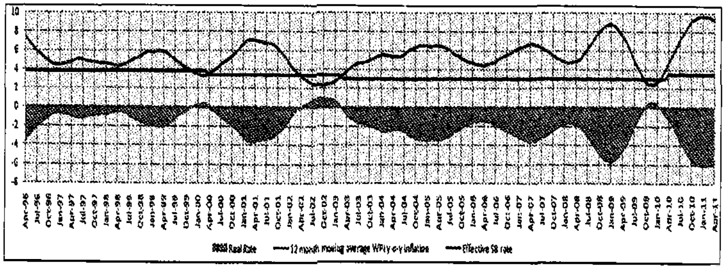
i = nominal effective SB interest rate;
r = real rate;
$M(I)$ = 12 month moving average WPI y-o-y inflation

Regulated low rates pinching pockets of poor persons

9. Based on past WPI inflation data, we see that every time the real rate turned positive, the regulator reduced the SB rate[1], never to take corrective action (in terms of increasing the SB rate) even on subsequent high negative real rates. Chart 1 provides this picture in very clear terms. From 2003 to 2009 the real rates on SB accounts remained at historically low levels and persisted there for six years. Barring the transitory reversal in end 2009, this high negative real rate continues to pinch the small savers till date. One can clearly see that at least during April 2005 and later in April 2007, there had been sufficient grounds to increase the SB rate from 3.5% by 50 to 100 basis points. This rate was artificially kept low to facilitate the banks in keeping their cost of deposits low (with small depositors having no bargaining power).

1 *The short period around end-2009 should be seen as an exception. During this period though the inflation was low due to base effects, the inflationary expectations were high and assessing that RBI had initiated its exit from its crisis driven expansionary stance.*

Chart 1



Deregulated service charges increase savers' agony

10. On one hand RBI regulated to keep these SB rates unreasonably low and on the other hand RBI left prescription of service charges to the individual banks. Though RBI asked banks to ensure that these charges are reasonable and are not out of line with the average cost of providing these services, it could not make the costing analysis transparent with respect to what component of service fees attributed to true cost and what attributed to profit margin. Thus unreasonableness in fixing the SB rates and the service charges on SB accounts persisted, leading to high net interest margins (NIMs) for banks and high profits in return.

Deregulation would help tame inflation too

11. A trend analysis of the SB interest rate vis-a-vis other rates like term deposit interest rates, SBI advance rates, repo and reverse repo rates indicate that the SB rates were due for an increase not in 2011 but much earlier. Charts 2 and 3 show that during 2007-08, the situation was similar to what prevailed in 2001-02, when SB rate was 4%. Still RBI preferred to let the SB rates remain downward sticky.

Chart 2

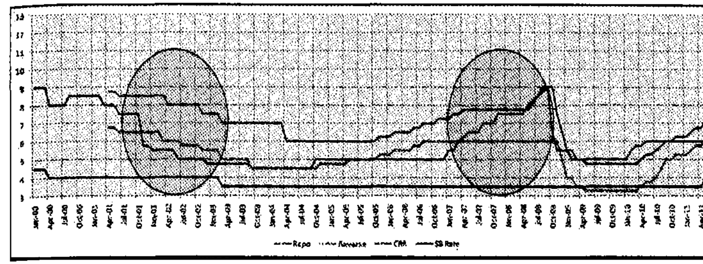
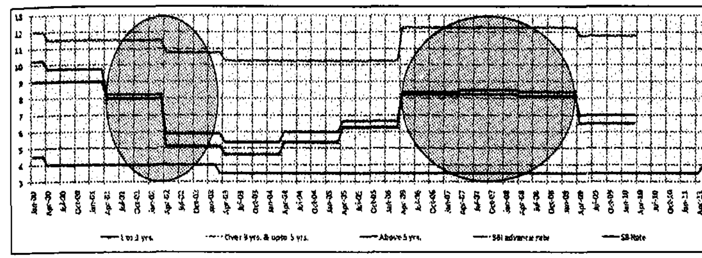


Chart 3



12. However, keeping in mind that SB interest application method had undergone a revision (daily balance method, effective April 1, 2010) in effect a rate of 3.5% is similar in return to 4% of pre-revised method of interest application.

13. Having said this, it may be noted that RBI has been taking baby steps to hike their policy rates (in order to strike a balance between containing inflation and ushering growth) resulting in persistence of inflation at a very high level for very long. One way to contain inflation is through making deposits more attractive, thereby reducing currency in circulation. A hike in SB rate would increase the cost of funds for the banks, thereby increasing their lending rates, leading to contracted demand and softer inflation. This will additionally bring a two pronged relief to the people -

an increase in the returns on their savings (reducing the significantly high negative real rate) and a lower inflation.

Interest application frequency – merciless for small savers

14. It is pertinent to add here that though interest is computed on a per annum rate basis, it is finally credited into the SB account after every three months if not more. In other words, throughout RBI's regulated regime of SB interest rate, there had been lack of standards on interest application frequency leading to annual percentage yield for such accounts being different for different banks. There is no good reason for introducing such flexibility in interest computation standards which keeps much scope for non-transparency and inconvenience of artificially created comparison requirement.

15. During the period 2002-03, RBI changed the interest applicationfrequencyfrom quarterly to monthly with respect to (i) interests on eligible CRR balances held by RBI; (ii) interests on loans taken by banks at RBI's prescribed bank rate; (iii) interest on loans taken by public from the banks. By reducing the interest application frequency, the yield of the product increases. Thus banks gained while receiving interest (at monthly rests) on CRR balances (that has since been discontinued) or on loans to public. However, just because of the manner of compounding periodicity (presently quarterly or more) for calculating interest on savings bank deposits and term deposits, the depositors' yield on their deposits is relatively less. Thus interest application frequency is an area where the depositors are presently getting a raw deal.

III. *Service Charges on SB Account*

16. An important aspect that needs to be kept in mind is fees attached to such SB deposit accounts. Few of the basic

needs and services for which fees are already deregulated are:

a) Minimum balance required fo maintain fhe savings bank account (bofh for with and without cheque facilify).

b) Charges levied for *not* maintaining minimum balance.

c) Debit card annual fee

d) Cheque book /leaf charges

e) Demand *draft* charges

f) Cash deposit charges

17. Thus, if one looks at the SB account in totality, the banks already enjoy freedom on how they would like to set their net costs (or net profits) for maintaining such SB accounts. A major concern is for small deposit accounts where a deposit of ₹ one crore with a bank may be associated to 50,000 SB accounts. In other words, on an average, balance maintained in these accounts is ₹ 200. Such accounts really do not deserve to receive high interests and if they do, that can be taken back in form of charges levied for not maintaining minimum balance. However, such charges that are levied for not maintaining minimum balance should not exceed the interest paid on the account. This led to the genesis of 'no-frill zero balance accounts', attracting small depositors to become financially included.

Discourage paper based transactions – price them high

18. Except for electronic transactions, most of the paper based transactions, related to SB accounts, should be discouraged and thus charged appropriately. However, in situations where there is lack of facilities for electronic

transactions, corresponding paper based transactions should be priced reasonably.

Reduce costs by transiting to electronic modes of payment

19. Electronic payments, being cost efficient, can also enhance financial inclusion by extending financial services to the unbanked communities that were hitherto out of reach due to high operational costs. In so doing, such communities would be brought into the formal financial system and into the economic mainstream. This would enable them to enjoy lower cost of financial services and better means of savings.

Migration to core banking – a need for survival

20. Core banking solutions (CBS) were conceived to reduce the operational cost of banks and to ensure their existence in the ever increasing competitive environment. The banks that do not transit will perish in the modern world. The transition to CBS was not aimed at generating additional revenue for the banks. Its objective was to replace inefficient and expensive manual and paper based systems. The savings for the banks come as the cost for this computer intensive CBS is far less than a corresponding inefficient manual system.

Deregulate savings rate and mandate fee for basic services

21. The NIMs in India is among the highest compared to the developed and big developing countries. Banks should reduce their NIMs and service fees and maintain profits through evaluating their lending portfolio more intensely thereby reducing the provisioning burden. Banks should strive to migrate to cost efficient work processes so as to bring in reduction in their operation costs. The unreasonable NIMs and unwarranted high IT based electronic transaction costs should be curtailed. The Reserve Bank has rightly indicated in one of its communications, *"... given the cost and risks involved in handling paper instruments, banks need* fo *favourablyprice elecfronicproducfs and a situafion where electronic products are costlier than paper products is inexplicable..."* – the vital question now is wouldn't proper policies like deregulation of SB rate and proper RBI mandated fees on electronic transactions be the right path ahead in the public interest and the economy?

IV. Conclusion and Recommendations

22. It is felt that deregulation will lead to an increase in SB rates. Based on 12 private sector banks, accounting for 86% of the deposits of that sector, it is observed that as of March 2010 the sector's average share of current account and savings account (CASA) deposits to total deposits is 31%, with bigger players like HDFC Bank, ICICI Bank and Axis Bank having respectively 52%, 42% and 47% of such deposits. In contrast smaller private sector banks like Yes Bank have very small CASA share (about 10%). Such banks may like to exploit the deregulation of SB interest to attract more CASA deposits by hiking their SB rate (as their cost of operations is low on account of efficient use of technology), benefiting the depositors both in terms of returns and services. This is fair competition, though the organisations that are not in favour of deregulation call this unfair competition.

23. The prime question that one needs to address now is whether it is necessary to continue regulating SB interest rate, a rate which has mostly been downward sticky? While deciding the interest rate on SB account, RBI does consider its impact on bank's profit with due care. As one would observe (see, Section I), in the monetary and credit policy (2002-03), RBI had appropriately justified to the

banking sector as to why it is unable to reduce the SB interest rate. Again, the RBI's April 2006 annual policy statement for the year 2006-07 said:

"Based on a review of current monetary and interest rate conditions, including a careful consideration of the suggestions received from the IBA, it is considered appropriate to maintain the status quo while recognising that deregulation of this interest rate is essential for product innovation and price discovery in the long run".

24. However, when in the next annual policy statement for the year 2007-08 (in April, 2007), though there was a clear case for an increase in the SB interest rate, surprisingly, RBI preferred not to provide any reasons to the depositors as to why it decided against increasing the SB rate. This provides convenience and comfort only to the Banking Sector and not to the masses.

25. Is it that RBI is conscientious only towards banks in such matters and can afford to ignore any unvoiced feelings among the public? There is quite a trade-off in any deal as there are two faces of a coin. In 2007-08, with declared net profit of scheduled commercial banks at ₹ 42,731 crore and the average SB deposits at ₹ 7,28,306 crore, an increase of 50 basis points (then, effective 40 basis points) in the SB interest rate (from 3.5% to 4%) would have caused the banking industry a reduction of around 7% of their net profits.

26. Again, with T 12,39,762 crore as the average SB deposits during the one year period January 2010 through December 2010 (refer the March 2011 issue of fhe RBI Bulletin), this convenience of banks cost the depositors 0.5% of their SB deposits or about ₹ 6,200 crore. With ₹ 13,80,995 crore being the savings bank deposits as of

December 2010, and with market conditions indicating SB rate to be 4%, rather than 3.5%, it amounts to the banking sector gaining at least ₹ 580 crore every month at the cost of their SB depositors. Was it necessary for RBI not to increase the SB rate by 50 basis points even when the situation so demanded and let the banks pocket ₹ 580 crore of depositors' money every month?

27. So what are the consequences of deregulation of interest rates on SB deposits and should it be done now? The trend analysis of the savings deposit interest rate and other related rates indicate that it is time to take action and to give depositors their dues. And this action most desirably would be to act affirmatively to deregulate the ceiling on SB rate and maintain a floor rate of 4% per annum. Moreover, RBI should set appropriate standard to compute interest on savings and term deposits through prescription of monthly periodicity of interest disbursement. This would allow India to move towards correct and prudent accounting standards in conformity with international standards.

28. Surely, no one would like to ignore the needs of the majority in order to line the pockets of a favoured few. Thus, it is actually for some one in the RBI and in the bureaucracy to ponder on the issues discussed here.

Issues for feedback from public

29. In light of pros and cons of deregulation of SB interest rate set out in RBI's Discussion Paper, the Central Bank has asked for feedback from the general public on few issues. Below we provide summary of the responses.

- Should savings deposit interest rate be deregulated af this point of time?

- o₹ Yes, **SB** interest rate should be deregulated now. However, RBI should mandate alignment of interest disbursement at monthly periodicity in conformity with international standards and most of the domestic lending products.

- *Should savings deposif interest rafe be deregulated completely or in a phased manner, subject to a minimum floor for some fime?*
  - o₹ Deregulate in a phased manner (protecting bulk of depositors, including households in rural and semi-urban areas), maintaining a floor rate of 4%.

- *How can fhe concerns wifh regard to savers (senior cifizens, pensioners, small savers, particularly in rural and semi-urban areas) be addressed in case savings deposit inferesf rafe is deregulated?*
  - o₹ Concerns of the savers would be protected by maintaining a regulated floor rate and setting reasonable benchmarks on the service charges of IT based banking services. RBI should monitor the floor rate and change it as per market scenario.

- *How serious are concerns relating fo a possible intense compefifion amongst banks and assef-liability mismafches if savings deposif interesf rafe is deregulated?*
  - o₹ The concern on asset-liability mismatches is insignificant as reveled from past experience of deregulation of term deposit rates. Moreover, true competition, which is transparent, is always good.

- *Should higher interesf rafe be paid on savings deposifs without a cheque book facility?*
  - o₹ No. Instead have fee for cheque leaves. However, banks should have the freedom to offer higher rates for maintaining higher deposits in SB accounts.

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- Eugene Black
Former President,
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