

Customer Protection in Banks - Emerging Issues and Challenges

Dr. K. C. Chakrabarty



FORUM
OF FREE ENTERPRISE

INTRODUCTION

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

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

Nothing perhaps can inspire greater confidence among customers of Indian banks than the reassuring words coming from the Deputy Governor of the Reserve Bank of India, Dr. K. C. Chakrabarty, on issues that are of such vital concern to them, and especially for the depositors. At the Eighth M. R. Pai Memorial Award Function organized jointly by Punjab and Maharashtra Cooperative (PMC) Bank and All India Bank Depositors Association (AIBDA), Dr. Chakrabarty delivered his speech with thematic focus on customer protection of banks. Being an accomplished banker with over three decades of experience in commercial banking, his views and observations truly reflect the courage of his convictions. He also has a distinctive advantage, being now on the other side of the table, as a central banker. The Forum is, therefore, pleased to publish and offer this booklet to its avid readers, and contribute in a sense, to promoting the cause of customer protection in banks.

While providing the rationale for protection of financial services consumers, Dr. Chakrabarty rightly points out that "unchecked market forces and lax policies, combined with relaxed regulatory oversight, can result in customers being exploited even while effort to open financial markets to serve the bottom of the pyramid are made through inclusion measures", Indian policy makers are, thus, confronted with a major policy dilemma, namely, how to expand the scope of financial/banking products and services to hitherto neglected sections of the society without sacrificing the essentials of regulatory discipline and rigors. The burden is on the regulator to strategize the combination of financial banking inclusion without compromising the demands of customer protection.

Dr. Chakrabarty reflects on global and domestic initiatives relating to promotion of consumer rights and financial education. At the same time, he highlights several policy imperatives concerning issues of (a) inflation adjusted adequate return for depositors; (b) mitigating discriminatory practices in interest rates to bulk versus retail depositors; (c) transparency in pricing of deposits and credit; (d) reduction in charges of financial services; (e) strengthening of modern banking services like net, mobile, ATM, EFT; (f) leveraging ICT based technology, and "focusing on offering minimum bouquet of products and services at affordable prices to all sections of the society". In all this discourse, what stands out is his deep commitment to the cause of small and vulnerable sections of customers, whether depositors or borrowers. We wish policy makers and bankers genuinely pursue such suggestions with a view to creating a favourable environment for garnering household saving flows into banking.

Dr. Chakrabarty believes not just in the entitlement of customers, but also their empowerment through financial literacy. He points out that "customer education is an investment and not an expense". There are several other policy propositions which invite further research and analysis both at the academic and professional levels. We believe that perceptions and views expressed herein will have their relevance for long time to come. Surely, this booklet would be valuable to all the stakeholders in India's financial sector. And hope that all concerned, and bankers in particular, are listening...

Sunil S. Bhandare
Editor

Customer Protection in Banks – Emerging Issues and Challenges

by

Dr. K. C. Chakrabarty*

It is an honour and a privilege for me to be here this evening to participate in the award distribution ceremony in the memory of late Shri M. R. Pai. As you know, Mr. Pai was popularly called the 'uncommon' common man. He stood for what was right and what ought to be right. That he represented the consumer class of India at a time when almost every aspect of our life was dictated by state run monopolies is a tribute to his spirit and the enduring influence it has left on generations following him. The idea of setting up the Bank Depositors' Association is not small by any measure. During his lifetime, Shri Pai authored several titles, twenty eight, I am told, on a wide array of subjects. His books "Whither Indian Banking", 'Depositor Rights and Customer Service in Banks", "Bank Service Charges or Survival Charges", "Coin Shortage and Soiled Notes", "Consumer Activism in India" highlight his dedicated approach to consumer protection,

* The author is Deputy Governor, Reserve Bank of India. The text is based on the address delivered at the Eighth M. R. Pai Memorial Award Function, sponsored by Punjab & Maharashtra Co-operative Bank Ltd, and arranged by the All-India Bank Depositors' Association (AIBDA) jointly with Forum of Free Enterprise on Thursday, September 6, 2012 in Mumbai.

depositor protection and safety of the banks themselves. When liberalization gained prominence, what one required was a well articulated strategy to handle customer issues in an era of competition. The notion of fair treatment to consumers, meaningful disclosures, transparency in pricing, non-exploitative pricing of services, etc were the essential elements that Shri Pai advocated throughout his life. These awards, therefore, are an important medium for sustaining the legacy of Shri Pai and spreading his message far and wide.

Today, the eighth M. R. Pai Memorial Award is being conferred upon SEWA. Madam Ela Bhatt could not attend this function but SEWA and Madam Bhatt are synonymous with each other. That does not mean that others such as Smt. Vyas or Smt. Kantaben have had a lesser role in the growth of SEWA. Starting her life in the legal department of the Textile Labour Association in 1955, Madam Bhatt went on to become the first General Secretary of SEWA in 1972.

She was one of the founders of Women's World Banking in 1979 and served as its Chair from 1980 to 1998. She has served as the Chair of the SEWA Cooperative Bank, Home Net and the International Alliance of Street Vendors. The awards and accolades she has been conferred with speak volumes about her work. The Padma Bhushan, Ramon Magsaysay Award, Right Livelihood Award and so many more! The AIBDA and the PMC Bank have done themselves proud by deciding to felicitate SEWA which, as an institution, symbolizes good customer service, fair treatment of customers, non-exploitative business practices and self-development, especially of the women folk. I take this opportunity to heartily congratulate SEWA and all their office bearers including Madam Bhatt, Smt. Vyas and Smt. Kantaben.

Since SEWA has been engaging with the vulnerable sections of the society, it is only apt that I take the opportunity to share some thoughts on customer protection, especially from the point of view of the vulnerable sections - small customers, poor people, etc. I would like to start by emphatically stating that protection of the consumers is a central issue in the world today, more so, in the under-developed and developing countries. With globalization having lent an irreversible change to the manner in which trade and businesses are being carried out across the world, the face of consumerism too has undergone a substantial change. The present day globally oriented economies are inundated by consumers' demands ranging from essential to luxury, and from latent to potential needs created artificially by the producers |suppliers of products|services. Fast paced product innovations, international character of trade, global consumer base, etc. have virtually created inseparable mutual dependence between the consumers and the product| service providers. Such dependence has always been characterized not only by innovations in products and services, which improve the prospects of consumers and suppliers, but also by growing conflict between the expectations of the two groups. Regrettably, the consumers have borne the brunt in this conflict. Despite the consumer being portrayed as the cornerstone of a successful economy, frequent incidents of exploitation of consumers remain a challenge for the governments and regulators alike.

Here, I would like to emphasize that customer protection initiatives are not just in the interests of the consumers, but also in the interests of the producers themselves, as the prospective demand for products and services would depend upon the continued well being of the consumers.

Need for Protection of Financial Services Consumers

Why do consumers of financial services need protection?

Financial services consumers need protection because they are at a structural disadvantage inasmuch as they have difficulty in exercising their collective might since their heterogeneity and mass make it difficult for them to organize themselves into pressure groups. The provider of service, invariably, has an upper hand. Additionally, the costs of procuring information can be high. Information asymmetry between financial service providers and customers, especially in emerging economies, works to the advantage of the former. Therefore, transparency rules or disclosure regulations should, at a minimum, seek to create standardized and comparable information about pricing, suitability of the product to different population groups, terms and conditions, and risks. Full disclosure of quality information should be combined with mechanisms to ensure that customers properly understand the information provided and its impact on their personal financial decisions.

For countries where banking with formal institutions is still emerging, consumer protection measures must be a top priority as a large number of the targeted client groups come from the most vulnerable and low income segments. This is a major challenge for the credibility and sustainability of the entire financial system. If not properly addressed, some of the problems faced by these consumers could lead to a long-term mistrust in formal financial institutions and a loss of confidence in the banking system. Unchecked market forces and lax policies, combined with relaxed regulatory oversight, can result in customers being exploited even while efforts to open financial markets to serve the bottom of the pyramid are made through financial inclusion measures.

Is Regulatory Intervention Needed in Financial Consumer Protection?

In any industry where market forces and competition play out freely, regulatory intervention may not be required. However, as the financial services industry, or more specifically, banking is a highly regulated service industry with stiff entry norms, consumer protection cannot entirely be left to the market forces. The regulator, therefore, has a role in protection of customers of financial services. The regulator's role is all the more important in an emerging economy like India, with its varied needs and priorities - ranging from sustainable high inclusive growth to maintaining financial stability, protecting customers and at the same time, accelerating the pace of financial inclusion of the hitherto excluded population groups. The regulator has to focus on the twin objectives of extending financial access to unbanked areas and protection of customers. The role played by RBI in protecting the depositors' interests by appropriate regulatory intervention is not very well understood and appreciated.

Global Initiative

The global financial crisis of 2008 highlighted the plight of the silent majority that represented the critical mass called the customer base of banks. The G 20 countries, of which India is a member, focused on financial consumer protection principles, which were developed by the OECD with inputs from the Financial Stability Board (FSB) members. The G 20 leaders have indicated that the principles cover the entire financial services sector and notably loans, savings and investment, and could include general references to: the tightening of requirements applicable to finance professionals; the tightening of requirements to provide consumers of financial products with both general and personalized information; the promotion of financial

education and advisory functions; the protection of customers' assets and deposits; the obligation to take account of consumers' creditworthiness; the introduction of penalties for abuses; access to banking services; and the scope for grievance redressal systems.

In India, we are yet to evolve a statutory framework defining the rights of the consumers in the financial sector. In the interim, palliatives like Standards and Codes, fair practices, Ombudsman Schemes, etc. are being used with varying degrees of success and levels of customer satisfaction. I would like to emphasize that organizations like the AIBDA have a key role to play in fostering financial awareness at the community level.

Depositors Issues

Let me now turn my attention to some issues which would be more germane to us all from the perspective of a depositor. It is commonly seen that borrowers' issues hog the limelight, while issues facing the depositors get left out. For instance, the debate on the level of interest rates in the economy is more conditioned from the borrowers' viewpoint. It almost seems forgotten that depositors also need to be given an adequate return adjusted for inflation. If financial intermediation, *inter alia*, involves channeling savings into investments, then depositors' interests have to be equally weighed. If the system does not incentivize depositors to save a part of their earnings through the banking channel, banks would have to search for costlier and more volatile funding alternatives.

There are several issues, particularly, with regard to pricing of deposits, which need to be addressed by banks. A glaring example is the disparity¹discrimination in the interest rates offered to different kinds of depositors - retail versus

bulk. This is rather counterintuitive because retail deposits, which are inherently more stable, are offered lesser returns than the more volatile bulk deposits, even when the deposits are booked on the same day. This amounts to depriving the vulnerable but favouring the rich.

Is the pricing of deposits and credit transparent, non-discriminatory and reasonable?

The pricing freedom conferred on banks comes with a lot of responsibility. The banks' pricing power is partly due to the stiff regulatory entry barriers resulting in monopolistic conditions being manifest at the regional and local levels. However, this condition should not be used for unfair pricing practices. For instance, the quoting of interest rates for a specified number of days is fraught with many customer related issues. If the bank is quoting a particular rate of interest for a period of, say, 500 days, what should be the rate for a depositor who may like to place a deposit for, say, 501 days or 499 days? Banks need to take a close look at their non-customer friendly tactics in deposit pricing. Further, some banks provide the auto sweep-in and sweep-out facilities. Is the pricing in all these cases transparent? If a deposit is placed through the sweep-in mode for 180 days and for some reason the transactions in the account necessitate a sweep-out, say, after a fortnight, then the effective interest rate the depositor might get may be lower than the savings bank interest rate applicable to his account.

In an analogous manner, on the credit side, how easy is it for a common person with small means to get a loan and that too, at a fair and non-discriminatory price? The issues of loan pricing and the discrimination that some banks resort to, needs to be opposed by consumers and consumer organizations alike. The loan pricing has to be transparent,

non-exploitative, easily comparable with like products in the market place and communicated in simple understandable terms to the consumer.

It is expected that the Board of Directors of banks proactively engage in deciding the pricing policy of banks in regard to products and services. Their active engagement would reduce the number of complaints from common persons highlighting the problems faced by them in relation to interest rates and service charges. SEWA has led by example by providing entrepreneurial credit to people of small means with very minimal paper formalities and at affordable rates of interest. The result of this effort has been very low levels of loan delinquency and sustainable improvement in living standards of the small borrowers. This success needs to be replicated across the country.

Charges for financial services - still high

The number of bank customers, volume of transactions and penetration of banking led by leveraging of technology should have resulted in cost of financial products and services going down dramatically, especially where the pricing of products/ services is to be decided by the market forces. While this has happened in fields like publishing and telecom, the same is not true for the financial services industry. There is no justifiable reason for the level of financial service charges to remain where they are. Even within banking, the cost of smaller transactions has not gone down in the same proportion as the cost of larger transactions and poorer sections of the society have to bear its brunt. While it is well accepted that banks have to levy charges for services provided in order to ensure viability and sustainability of operations, the same should not be exploitative.

Strengthening Electronic (Net, Mobile, ATM, EFT/POS) Banking

The changing profile of banking from branch banking to non-contact banking, that is, from brick and mortar to mouse and click due to the advent of technology and new delivery channels has presented several opportunities and challenges. While this has made banking very convenient and accessible 24x7, the safety and integrity of the transactions and resolution of grievances in case of failed transactions raise a number of issues. Banks have always been taking the plea that the customer has to prove his innocence in such cases despite the fact that it is the bank's duty to provide a secure platform for putting through electronic banking transactions.

The Damodaran Committee had recommended that the onus of proving an unauthorized transaction should be on the bank since it has better infrastructure to handle such matters, as compared to individual customers. Further, in case of card products, we are yet to hear from the Indian Banks' Association about the zero liability clause or adequate compensation policies for misuse of cards. With increasing use of electronic banking, the challenge for regulators is to protect the identity and privacy of the customers while ensuring speed, integrity and safety of transactions. This is especially important as our entire strategy of increasing banking penetration is based on leveraging technology and if the trust in ICT based delivery channels is not established, it will be very difficult to reach out to the masses. Thus, protecting the rights of smaller/ more vulnerable customers and ensuring the integrity of the transactions is critical.

Who subsidizes whom?

An important aspect of SEWA's working has been its focus on equality and fair treatment of all its members ■ borrowers. We are yet to reach a stage where the organized financial services industry can confidently say that the poor sections of the society are not subsidizing the rich. This is a universal phenomenon and people are waking up to the reality now. Why the rich need subsidies in the matter of financial services? In times of turbulence, it is the small borrowers that are likely to be more regular in repaying their loans, thereby giving the much needed assurance of stability to banks' loan portfolios.

Financial Inclusion - Broad-basing the Consumer Movement

The consumer movement and the voice of organizations like the AIBDA would be strengthened if more people are provided access to the formal financial sector. The larger goal is to attain inclusive growth along with financial, economic and social stability. Financial exclusion is a problem across the globe. While in advanced economies it is more an issue of financial literacy, in emerging economies like India, it encompasses both financial access and financial literacy. Accordingly, we have a well-articulated and clearly defined approach to deepening the process of financial inclusion and integrating it with our financial literacy efforts. Let us not mistake financial inclusion for opening of only a bank account. It is more holistic than what we presume. Our approach is a bank-led strategy, leveraging ICT based but technology neutral delivery channels, focusing on offering a minimum bouquet of products and services at an affordable price to all sections of the society, especially the vulnerable, in a fair and transparent manner. Currently, the most vulnerable groups, in the absence of access to formal financial sector,

are forced to rely on moneylenders for finance, often at exploitative rates.

Financial Literacy – for all and by all

Merely providing access to financial products¹ services would not suffice. The demand side issues of financial literacy, which will empower the masses, also have to be tackled simultaneously. It needs to be understood and appreciated that all stakeholders need to collaborate to further financial inclusion and literacy, not only in the customer's interest, but in their own interest. We need to realize the fact that customer education is an investment and not an expense. As to who should be the target groups, there is a perception that financial education and financial literacy is only for the poor/excluded sections and that the well to do/ included sections of the society do not need it. This is far from the truth. Various levels of ignorance in matters of finance are observed across the broad social spectrum.

At a minimum, the basic underlying message that must go across through our financial literacy initiatives is that where the return is more, risk is higher! Needless to mention, generating financial awareness is a continuous process encompassing the regulators, service providers, service consumers - the excluded and the included, and others. Organizations like the AIBDA have a key role to play in fostering financial learning and awareness at the community level. AIBDA must educate people that there are no free lunches and dinner! Besides generating awareness about the basics of investment and finance, information should also be given on the consumer protection and grievance redressal avenues available, including the Banking Ombudsman Scheme. The efforts being made by RBI to educate the society at large through outreach activities, awareness campaigns and town hall events are expected to

contribute to spread of financial literacy. What we are aiming at is creating a class of consumers that is aware, educated, enlightened and empowered by the financial sector. For this, we need a co-ordinated national level strategy focusing on all sections of the society, starting from school going kids.

Customer Education - Gold as an investment

There has been a lot of discussion on the utility of gold as an investment option. When depositors get lower returns on their financial savings they start looking for alternate avenues which could give better yields, such as gold. Besides, there are well-known socio-cultural reasons why people in India invest in gold. This reasoning cannot be viewed in isolation or independent of the general prosperity enjoyed by our countrymen a thousand or two thousand years ago. We were, by historical counts, a rich nation then. But today, we are not. In my opinion, this is an investment that has effectively given zero returns to many individuals. How many individuals have invested in gold, which is tradable on the basis of fineness ■ purity, and actually offloaded their gold holdings for a profit? The investment in gold by the poor is only due to lack of financial literacy. I don't advocate that the rich should not invest/ speculate in gold, but I do believe that the poor should not. The poor, by cutting consumption, and depriving themselves and their children of many immediate needs, buy gold which could ultimately land in someone else's coffers. Thus, apart from the beneficial impact that lesser gold imports can have on our current account deficit and protecting the wealth of the nation, this is also relevant for protection of interest of the poor. Organizations such as the AIBDA should work towards changing people's perceptions in this regard.

Legislative Reforms - FSLRC

The Financial Sector Legislative Reforms Commission (FSLRC), under the Chairmanship of Justice (Retd.) B N Srikrishna, is examining the aspects concerning changes 1 modifications that are required to the various financial sector statutes to make them vibrant and relevant to the present context. A key element of any financial sector legislative architecture must be a specific enactment of a law covering the financial sector consumers. Once the statute is in place, all arbitrariness and ad-hoc nature of decisions will be laid to rest and any violation of the law will be punishable as an offence. This is very essential if we want to have a properly defined set of rights for the consumers. The Approach Paper brought out by the FSLRC lists customer protection as the first objective of financial regulation and proposes some critical rights and protection for consumers.

Conclusion

The customer-centricity that we seek to bring into all our actions must be felt by the society at large. If we want to deliver quality customer care, it must be through an amalgam of financial inclusion, customer education and customer protection. There is no high or low priority in this regard. We need to move on all the fronts simultaneously and take the challenge head-on. While the Government and RBI may introduce several measures aimed at protecting the financial sector consumers, an effective mechanism for implementation of these measures by the market players is required.

All this is not possible without the active involvement and support of the society at large, especially the privileged groups and others who are willing to fight for consumer's rights. Responsible marketing, responsible lending,

responsible grievances redress mechanism and responsible consumer protection are not mutually exclusive but are inter-dependent. A true and lasting tribute to late Shri M R Pai and SEWA would be by raising the consumers' voice against any unfair practices and endeavoring to protect customer rights, especially those of small depositors, borrowers and other small bank customers. Today, let it be resolved by all those present that they will strive for a strong, effective and robust consumer movement.

This booklet is sponsored by

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"People must come to accept private enterprise not as a necessary evil, but as an affirmative good".

*- Eugene Black
Former President,
World Bank*

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Published by S. S. Bhandare for the Forum of Free Enterprise, Peninsula House, 2nd Floor, 235, Dr. D. N. Road, Mumbai 400001, and Printed by S. V. Limaye at India Printing Works, India Printing House, 42 G. D. Ambekar Marg, Wadala, Mumbai 400 031.

3/Dec./2012