

JAIIB updates- Retail Loan Products

Reverse Mortgage

This is a new product available in the Indian Banking to suit the financial needs of senior citizen. Currently it is being offered by 7 PSU banks, One private sector bank and two housing financing companies. The salient features are as under:

- Available for senior citizen above the age of 60 years either singly or joint with the spouse in which case one of them should be over 60 years of age.
- Maximum period initially is 15 years and extendable in case of need
- Only against residential property in name of and under self occupation of the senior citizen
- Maximum amount is Rs 100 lacs subject to availability of sufficient value in the residence
- Residual life of the residential property should be more than 20 years
- Margin of minimum of 30 % is stipulated and gets reduced with the age of the person. In other words a person of 70 years will be eligible for higher amount than a person of 62 years.
- Disbursement can be any one of or a combination of lump sum amount, monthly payments and a credit limit. In case of lump sum amount there is generally a ceiling on amount (generally Rs 15 lacs) and restriction on purpose (medical expenses)
- If borrower chooses monthly payments to a lump sum payment he would be getting higher amounts because of interest costs
- Can be repaid at the end of the tenor by sale of the property by borrower or his/her legal heirs
- Monthly payments paid to the borrower are tax free
- No restriction on the purpose of the loan excepting speculative activities
- Excepting the processing charges there are no stamp duty charges like in a mortgage loan since the property is not transferred to the bank during the currency of the loan and only an agreement is entered into.

Learning points:

This article gives the details about the new product which is available in the Indian banking and which is not covered in the book on Principles and Practice of banking.

Financial inclusion and Information Technology

(source: A speech by Deputy Governor Smt. Usha Thorat)

The banking system has grown enormously in the last five years and has improved its strength, efficiency and resilience. There have also been significant improvements in the payments and settlements system and electronic payments and RTGS is now much more in use. IT has played a major role in these achievements. Today banks have centralised operations, and offer various products using IT. In a way IT has become an important component of banking strategy.

2. At the same time, large number of households continues to be excluded from the formal banking system and as per some recent surveys their share has increased. The extent and reasons for exclusion are many and have been well documented. **RBI's latest Currency and Finance (RCF) recently released points out that despite the broad international consensus regarding the importance of access to finance as a crucial poverty alleviation tool, it is estimated that globally over two billion people are currently excluded from access to financial services (United Nations, 2006).**

3. While no universally accepted definition of financial inclusion is available. Broadly, financial exclusion is construed as the inability to access necessary financial services in an appropriate form due to problems associated with access, conditions, prices, marketing or self-exclusion. There is no single comprehensive measure that can be used to indicate the extent of financial inclusion across economies. Specific indicators such as number of bank accounts, number of bank branches, that are generally used as measures of financial inclusion, can provide only partial information on the level of financial inclusion in an economy.

4. Rangarajan Committee showed that 111.5 million households had no access to formal credit. It also showed that 17 million households were indebted to moneylenders. The recent Arjun Sengupta Report on financing enterprises in the unorganized sector has pointed out that only 2.4 million out of 58 million units in this sector (with investment of less than Rs 25000) have got credit from commercial banks. It is observed that lower the asset class or income, higher the degree of exclusion.

5. A very interesting analysis by the RBI shows that the major reason for increase in the overall household debt and the increase in the share of households indebted to non-institutional sources between 1991 and 2002 was a significant increase in current farm expenditure and household expenditure, especially in rural areas. The 'household expenditure' includes expenditure incurred on purchase of residential plot; purchase, construction, addition/alteration of building for residential purposes; purchase of durable households assets, clothes, among others and expenditure on medical treatment, education, marriages, and ceremonies. Thus, the 'household expenditure' includes many items for which households may find it difficult to obtain loans from institutional sources. Another survey also suggests that a large portion of loan is taken by the households for meeting financial emergency, medical emergency and social obligations. These three purposes accounted for about 53 per cent of the loans availed of by indebted earners. Furthermore, more than 60

per cent earners, indebted to non-institutional sources, took loans for the aforesaid three purposes.

6. Some of the other causes for above behaviour are deceleration in bank credit to households since 1990s due to Banks' impaired balance sheets and tightening of prudential norms and the slowdown in formal credit to households in the context of the slowdown in agriculture and allied activities. Since 2002, several policy initiatives have been taken by the Government/Reserve Bank to improve the credit flow to agriculture and the needy sectors. These measures had a significant positive impact on financial inclusion as revealed by the data for subsequent period. It is quite clear that financial inclusion has to be an urgent national priority if we are to achieve inclusive growth. The major challenges in banks extending services to the excluded are large costs of covering the huge numbers (cost of enrollment) , relative high maintenance costs for such accounts, small ticket size for each transaction, need for communication modes suited to the illiterate and in local language, affordability of the product or service, need for local acceptance and involvement of locally acceptable personnel, need for large scale coverage including over difficult geographic terrain and areas where there is no electric power or normal telecommunication facilities. The challenge also lies in offering to low income households and unorganized enterprises a simple loan product which is not based on or linked to the purpose of the loan, the collateral or assets held or income earned by the household but is purely based on cash flow and credit record of the household.

7. Looking to 2020, it is even more apparent that the task of banking the unbanked will be truly daunting. Nearly 600 million new customers' accounts will have to be opened and serviced through a variety of channels leveraging on IT. The need for informality in credit delivery and easy access is demonstrated by the fact that SHGs and MFIs constitute the fastest growing segment in recent years in reaching out to small borrowers and are able to effectively address the small ticket and last mile issues. In the four years between 2003 and 2007, small borrower bank accounts (credit) i.e upto Rs 25000 increased marginally from 36.9 million to 38.6 million, while SHGs' borrowing members grew from 10 million to 40.5 million and MFIs' borrowers grew from 1.1 million to 8 million. In 2007-08, MFIs have added 6 million clients increasing their outreach to 14 million.

8. To ensure that the challenges of banking the un-banked are met effectively and converted into growing and sustainable business for banks, there is no alternative to adoption of IT solutions on a very large scale and range. IT solutions are required to capture customer details, facilitate unique identification, ensure reliable and uninterrupted connectivity to remote areas and across multiple channels of delivery, offer multiple financial products (banking, insurance, capital market) through same delivery channel while ensuring consumer protection, develop comprehensive and reliable credit information system so essential for efficient credit delivery and credit pricing, develop appropriate products tailored to local needs and segments, provide customer education and counseling , enable use of multi media and multi -language for dissemination of information and advice.

9. Recognising the several advantages of using bank accounts for disbursement of government benefits, many State Governments have decided to disburse NREGA payments and other social security benefits electronically through no frills bank accounts and in some States with such accounts operated through smart cards with bio-metric identification. Sharing of costs between Government and banks will also

be an incentive to banks. Such accounts that have been opened to receive government benefits/payments can become the base for a host of other financial services and facilitate the objective of financial inclusion.

10. To sum up the challenges are going to be banks using multiple channels for delivery of variety of financial services, developing synergies with MFIs and SHGs by introducing seamless IT based models linked to such intermediaries, availability of skilled manpower to facilitate the adoption of IT on such large scale, use of IT for credit information and efficient credit delivery and risk management in a much bigger way, moving away from the use of cash and emergence of enough leaders in the banking system especially in the public sector banks/RRBs and cooperative banks to recognize the opportunities and take advantage of their specific strengths including location.

Learning Points:

1. Challenges with regard to Financial inclusion
2. Extent of needed penetration
3. Role of Inf. tech. in extending coverage of financial services to the disadvantaged sections
4. Regulatory actions and support needed for achieving the desired results