POLICY BRIEF NOVEMBER 2014

Implementing the Pradhan Mantri Jan-Dhan Yojana

Key Takeaways

The government's Pradhan Mantri Jan-Dhan Yojana (PMJDY) launched in mission mode in August 2014 aims to provide access to basic financial services to all households in the country. To the credit of the government, the product as envisaged by the PMJDY has, for the first time, all services as defined under financial inclusion - savings, credit, insurance and pension. This is the first time there is a demand from customers for the product, and banks are seeing significant traction since the launch. Yet, this rush from the consumers has led to several practical issues that need to be addressed and this policy brief brings out the key challenges for the PMJDY mission to deliver meaningful and sustained financial inclusion.

Challenge	Recommendation
The PMJDY target of new accounts opened can reveal a false picture of success.	Effective monitoring is needed to measure true progress, going beyond just the number of accounts opened to track the number of accounts actually activated and transactions per account. De-duplication of accounts must be initiated through Aadhaar seeding as much as possible.
The PMJDY norm of minimum Rs. 5000 monthly remuneration to agents is a welcome guideline for commercial viability. However, it is unclear which bank/BC is actually paying this out to the agent, and what will be the recommended formula for fixed and variable components.	With each bank/BC operating on different models of payouts, the RBI/DFS should standardize the criterion for 'minimum payments including the fixed and variable components' and track relevant metrics of payment flows along the channel to make sure that the agent receives adequate commission on time.
Aadhaar is the best enabler for ensuring de-duplication of accounts and linking to DBT.	Legislation on Aadhaar and coverage of population must be speeded up. Yet, given current constraints on connectivity, use of One Time Passwords (OTP) must be allowed as an option to biometrics for DBT cash-out.
Customers as well as bank staff lack clarity on the overdraft facility.	The eligibility and pricing of the credit overdraft facility need to be spelt out and communicated to the customers, branch level staff and agents. Leaving these operational issues to the discretion of the bank/ branch manager can impair the sustainability of this facility. It is important that the DFS clarifies the assumptions and costs of operating the Credit Guarantee Fund, for instance, whether the default risk cover is to be borne by the customer or bank, how to avoid mass defaults etc.
Banks and BC agents are not certain about the reimbursement process for DBT commissions.	The DFS should clarify the process and turnaround time for reimbursing DBT commissions so that the payment flows can be planned to the last mile efficiently. Banks should provide credit limits for BCs against commissions accrued.
While the Finance Ministry has agreed to a 2% commission on DBT payments, at the state government level, this is not rationalised. Also the 2% may not be adequate commission for DBT delivery in certain remote areas.	There should be uniform guidelines on the commission for DBT payments across central and state schemes, and also equitable terms of sharing the commission between banks and BCs. The level of commission should also take into account the special requirements of pockets/regions that are difficult to access.
There is lack of clarity on the free insurance cover offered with the RuPay Card and its cost.	The PMJDY needs to be transparent and upfront about the duration and expiry date of its 'free insurance' cover in order to avoid a loss of consumer confidence, which can erode all the benefits being targeted.

Background

On August 28th, 2014, India's financial inclusion programme moved into a new mission mode, through the ambitious Pradhan Mantri Jan-Dhan Yojana (PMJDY) which consists of an integrated approach using six pillars: Universal access; Basic Banking Accounts with overdraft facility, Accident Insurance and Rupay Debit card; Financial Literacy; Credit Guarantee Fund; Micro insurance and lastly Unorganized Sector Pension Schemes. These pillars are to be implemented over two phases.

Phase I (15 Aug 2014 – 14 Aug 2015)

- Universal access to banking facilities (except Jammu and Kashmir, hilly and difficult terrain areas)
- Basic Banking Accounts for Savings, Remittance, and RuPay Debit card, with inbuilt accidence insurance cover of Rs 100,000
- Financial Literacy Programme

Phase II (15 Aug 2015– 14 Aug 2018)

- Overdraft facility of up to Rs 5,000/- after six months of satisfactory performance of saving/credit history
- Creation of Credit Guarantee Fund for defaults in overdrawn accounts
- Micro-insurance
- Unorganized sector Pension schemes (Swavalamban)

This multi-pronged approach is a significant improvement over earlier initiatives in several ways as it provides for the following:

- Universal coverage, including sub service areas in urban and rural India
- Online bank accounts linked to the Core Banking Systems
- Integrated offering of insurance, credit and payment
- Fixed point Business Correspondents (Bcs)
- Higher, minimum guaranteed income for Bcs

This policy brief looks at each of the pillars to analyze the key challenges that need to be addressed for the mission to translate into meaningful inclusion.

Phase I Pillar 1- Universal Access

As on end March 2014, the national banking network consisted of 1.15 lakh branches (nearly 44,000 or 38% in rural areas) and over 1.6 lakh ATMs (nearly 23,500 or 14.5% in rural areas). However, branch banking has not been viable in remote and rural areas, largely on grounds of insufficient commercial scale, staffing and human resource constraints to serve rural areas cost-effectively. Earlier attempts to serve uncovered areas through a network of Business Correspondents (BC) have remained unsuccessful due to lack of commercial viability for BCs as well as the trust deficit between customers and bank agents. The PMJDY's first target is to expand the network to be accessible across India - every household in India (barring a few sensitive areas) will have access to banking services within a 5 km radius. The PMJDY seeks to attain this through a combination of instruments:

- Stripped-down versions of bricks-and-mortar bank branches, staffed by 2 or 3 persons, in 74,000 villages having population of 2000 and more, offering complete banking services including loans and third party payments. This will be implemented over 3-5 years.
- Fixed-point banking outlet (branch or fixed point BC) in all Sub Service Areas (SSAs), i.e. population of 1000-1500. Mapping has been done in 121 rural districts that cover the bulk of DBT payments, and has resulted in 1.3 lakh SSAs. Of these, nearly 50,000 SSAs are not yet covered by banking facilities. Fixed point BC outlets as proposed can offer basic banking services: account opening, cash deposit; cash withdrawal, funds transfer, balance enquiry and mini-statement facility.

Bank Mitr or Business Correspondents: The reach and effectiveness of the BC network is critical to financial inclusion targets and while there are 1.4 lakh BCs in rural areas, at least 75,000 are not functional, and there is a need to replace them. On the other hand, there are over 1.4 lakh Common Service Centres (CSCs) of which less than 15,000 are registered as BC outlets. The PMJDY has included a few innovative elements to make BCs more relevant and viable.

- The eligibility scope has been widened to include individuals, NGOs, CSCs, not-for-profit companies, cooperatives, and even NBFCs that do not take deposits. The PMJDY proposes to nominate all CSCs as fixed point BC outlets. BCs will be trained to carry out basic services and sell micro-insurance and pension schemes. They will also have a distinct visible identity and uniform, besides ID proof.
- BC outlets will be located at public places such as a panchayat, bus stand or a marketplace. Outlets will be fully equipped with computers, micro ATMs, biometric scanners, printer, web camera and Internet connection.
- Banks have been asked to provide BCs with loans of Rs 1.0 lakh for assets and Rs 25,000 for working capital.
- BCs shall receive (from banks) a minimum remuneration of Rs 5,000 per month besides variable transaction-linked revenues, to be commercially viable.

Challenges: To begin with, the proposal to set up 'stripped-down' versions of bank branches calls for capital investments and creation of permanent staff posts, which is a decision to be taken by individual banks. Given that banks have not penetrated these areas because of lack of commercial viability, the question remains of how this directive will be enforced?

Amongst the many operational issues that need to be addressed is the apportioning of uncovered areas among the various PSBs, ensuring that all identified villages are covered, without duplication leading to multiple branches in some villages and none in others.

While the PMJDY's proposals potentially address the major causes of the failure of earlier bank-led BC models, the onus of implementation eventually lies on banks and the first months since the launch have seen a widening in the existing fault-lines in the bank-BC relationship. Over the past few years, with banks chasing account opening targets set by

Table-1 : Banking Penetration Progress 2010-2014

	FY 2010	FY 2011	FY 2012	FY 2013	FY 2014
Banking Outlets in Villages					
• Branches	33378	34811	37471	40837	46126
• BCs	34174	80802	141136	221341	337678
• Other modes	142	595	3146	6276	-
Total	67674	116208	181753	268454	383804
Urban locations through BCs	447	3771	5891	27143	60730
Basic Savings Bank Deposit Accounts- branches					
No in millions	60.19	73.13	81.20	100.80	126.00
Amount in billions	44.33	57.89	109.87	164.69	273.30
Basic Savings Bank Deposit Accounts- BCs					
No in millions	13.27	31.63	57.30	81.27	116.90
Amount in billions	10.69	18.23	10.54	18.22	39.00
OD availed in BSBDA accounts					
No in millions	0.18	0.61	2.71	3.92	5.90
Amount in billions	0.10	0.26	1.08	1.55	16.00
Kisan Credit Cards (No in millions)	24.31	27.11	30.24	33.79	39.90

the government, there has been insufficient attention to the high level of dormancy in accounts and agents. The RBI and DFS must work at strengthening the bank-BC relationship this time around, and this calls for more effective monitoring of activity till the last mile.

Similarly, the PMJDY's intents for BCs remuneration terms and loan facilities for fixed point outlets need to be translated through appropriate banking circulars, and once again, be implemented by the banks. Discussions with banks indicate that there is insufficient clarity as to whether the Rs. 5000 minimum compensation will be fixed or have variable components as well, and also the automatic eligibility for the loans to equip BC outlets with the requisite infrastructure. With each bank/BC operating on different models of payouts, the RBI/DFS should standardize the criterion for 'minimum payments including the fixed and variable components'. The RBI/DFS should also track relevant metrics of payment flows along the channel as ensuring timely and appropriate payouts to the agent is crucial for the entire mission to be sustainable over the long term. .

Phase I Pillar 2- Basic Savings bank Accounts to adults in all households

The PMJDY seeks to provide zero-balance Basic Saving Bank Deposit Accounts (BSBDA) to adults in all households, and targets to cover an estimated 6 crore rural households and 1.5 crore urban households that are not presently covered by the banking sector. However, learning from the experience of high dormancy in basic accounts, the BSBDAs come bundled with a RuPay debit card (persons having Kisan Credit Cards will receive a RuPay ATM card), and an accident insurance facility of Rs 1 lakh; these additional facilities make the product more meaningful to the account-holders.

Basic accounts are be opened with simple KYC norms, and in case of banks already using eKYC systems, electronic verification linked to the Aadhaar number or the e-ID Aadhaar application number. Bank accounts will be seeded with the Aadhaar number to enable DBT payment credits. The government is also in favour of paying a 2% commission for DBT transfers, to be shared between banks and BCs.

Challenges: Account opening has seen accelerated progress since the PMJDY's launch and by end of November, more than 8 crore PMJDY accounts are reported to have been opened. However, a number of issues have emerged that need attention. To begin with, the aggregate numerical target can be misleading. The incentive of the insurance cover and the future overdraft facility led to a mass scramble by the 'already banked' sections to open new PMJDY accounts, including multiple accounts per individual at different banks. This rush to open accounts may have ignored the intent of enabling two adult accounts per household. Also, the no-frills-accounts opened in earlier drives are being converted into PMJDY accounts. Banks will need to coordinate and ensure de-duplication of PMJDY accounts and declare the number of persons covered instead of the number of accounts opened. Surveys are now being arranged by banks to check the coverage per household, thereby duplicating efforts.

The problem of duplication of accounts could have been avoided if eKYC using Aadhaar had been used for account opening. However, given the urgency to meet the targets, banks have not insisted on eKYC for account opening, in many cases this was because of the lack of infrastructure at bank branches. Moreover, while Aadhaar is the best tool for account opening and mapping across databases, it cannot be made mandatory until legislation is passed to this effect. Also, coverage had been flagging earlier this year and is only being speeded up now.

While the PMJDY emphasizes linking of these accounts to the Direct Benefits Transfers (DBT) schemes, there are two issues of concern here. Firstly, while the Finance Ministry has agreed to a 2% commission on DBT payments, at the state government level, there is no uniformity. Further, in many districts/villages that are difficult to access, 2% may not be adequate commission for DBT delivery- both banks and agents will find it difficult to sustain business here. Given the challenges here, the DFS should coordinate across regions and set up uniform guidelines on the commission for DBT payments across central and state schemes, as well as ensure equitable terms of sharing the commissions between banks and BCs. The level of commissions should also take into account the special requirements of pockets/ regions that are difficult to access. On the operational side, banks and BC agents are still not certain about the reimbursement process for DBT commissions. Here, the DFS should clarify the process and turnaround time for reimbursing DBT commissions so that the payment flows can be planned to the last mile efficiently. As BCs bear the load of service delivery at the last mile, banks should provide credit limits for BCs against commissions accrued; this will make the chain stronger and commercially viable.

Another major issue concerns the free accident insurance cover of Rs 1,00,000 per card. The PMJDY document is silent on these details, other than that the NPCI will be bearing the costs of the same. To begin with, it is unclear whether the cover will be only for the first year, and who will pay the premium for such cover. The amounts involved are staggering. The annual premium for a pure cover of Rs 1 lakh ranges from Rs 200 to Rs 400. Given the bulk coverage of 100 million accounts, the premium can be significantly lower. However, even with a 75% reduction, the annual outlay can be Rs 1000 crore per year. To expect NPCI to recover these costs through transaction fees seems infeasible, given the small unit charges for transactions. Even if the NPCI were to charge Rs 0.50 per transaction, it needs to handle 20 billion transactions a year from the 100 million accounts, or 50 transactions per account holder. Given the negligible volume of IMPS transactions today, this seems unattainable. Therefore, it must be expected that the premia will continue to be subsidized or will be eventually passed on to account holders for the insurance to be valid. The PMJDY needs to be transparent and upfront about the duration and expiry date of its 'free insurance' cover in order to avoid a loss of consumer confidence, which can erode all the benefits being targeted.

Phase I Pillar 3- Financial Literacy and Credit Counseling

There are lessons to be learnt from the high 'dormancy' of basic bank accounts in rural areas. Besides access issues, the lack of financial literacy is the main cause of low usage. The PMJDY proposes to create financial literacy centres in all rural branches to provide training on operating an ATM card, and explain the benefits of and importance of building a satisfactory credit history. This is planned to be done through the National Centre for Financial Education, and monitored by NABARD.

Challenges: While financial literacy is critical for financial inclusion, resources have been way short of the need in the past. The PMJDY document is once again short on details, but states that the RBI's Depositor Education and Awareness Fund Scheme, created out of unclaimed funds of depositors, will fund the pillar. Creating mass awareness to access and transact from bank accounts, mobile devises and understand credit will call for massive deployment of field campaigns and mass media electronic campaigns at a national level. This cannot be funded at the level of banks or even from the funds in the RBI's scheme, which has only set up 700 centres so far. The involvement of mass electronic media and the internet will be critical to mount an effective public campaign for financial inclusion. This will also necessitate commandeering under-utilized funds in other schemes in the banking sector, such as the Technology Deployment Fund, which had a corpus of over Rs. 5000 crore.

Phase II Pillar 4 - Credit Guarantee Fund

Credit is one of the four components of banking and financial services. Yet, credit penetration remains rather low in India and of the nearly 250 million basic account holders, less than 6 million availed any over draft credit. The PMJDY's proposal to provide up to Rs 5000 overdraft to every account holder (after six months of opening, based on record of transactions) seeks to target the exigent credit needs of the lower-income groups at reasonable interest rates. Separating the 120 million Kisan Credit Card holders, there are over 130 million potential demanders of the overdraft facility, which translates into a huge lending corpus of Rs 65,000 crore. The PMJDY estimates around two-thirds of them will access the overdraft, or a borrowing of Rs 42,000 crore. To cover default risks, PMJDY seeks to create a Credit Guarantee Fund with an initial corpus of Rs 1000 crore, which will be increased to Rs 4000 crore eventually, out of NABARD's Financial Inclusion Fund.

Challenges: The idea of a Credit Guarantee Fund sends out a mixed signal, in that it presupposes default, which is against the very fundamentals of banking. While banks will be assured by the indemnification provided by the Credit Guarantee Fund, it should not in any way result in a lax monitoring regime of the credit issued under the PMJDY. Secondly, the Fund only covers eventual default. However, Basel norms require banks to provision adequately for liabilities outstanding at any point of time. Taking the PMJDY's own estimate, banks will be lending over Rs 40,0000 crores, which is far beyond the present outstanding credit of Rs 1600 crores in all basic accounts (see Table 1). This will call for capital and deposit mobilization well beyond the Rs 1000 core or Rs 4000 crores set aside to compensate for eventual defaults.

On the other hand, if banks follow the safe approach of denying credit or reducing the credit limits on an ad-hoc manner, this can once again erode confidence in the PMJDY. Therefore, the operational requirements will need to be spelt out unambiguously to credit aspirants, and banks should set aside and clarify the available limits for PMJDY overdraft within their overall lending operations at any time, so that there is complete information transparency. Currently, customers have the misconception that the overdraft facility will be given to all account holders for free; thus the eligibility and pricing of the credit overdraft facility need to be spelt out clearly and communicated to the customers, branch level staff as well as agents. Leaving these operational issues to the discretion of the bank/ branch manager can impair the sustainability of this facility.

Phase II Pillar 5- Micro Insurance

The IRDA has created a special regulation for micro-insurance policies (both life and general insurance) with a sum assured of Rs 50,000 or less, which can cover health insurance, cattle, personal assets and equipment, and life.

Challenges: There is nothing additional that the PMJDY brings to the table on micro-insurance, other than to include it in the scope of operations for BCs. There is no financial or other form of contribution from the government's side.

Phase II Pillar 6 - Unorganized Sector Pension Scheme

Of the 400 million people working in the unorganized sector, less than 2 million have any pension coverage. The PMJDY seeks to create a pension scheme – Swavalamban – for the unorganized sector, under which the government of India shall contribute Rs 1000 per annum, against a subscriber's contribution ranging from Rs 1000 to 12,000 maximum per year. The scheme is to be offered through aggregators and BCs.

Challenges: Although the intent is to encourage and incentivize people to contribute towards a pension, the government's contribution is presently guaranteed only until 2016-17.

The Way Forward

To the credit of the government, the product as envisaged by the PMJDY has, for the first time, all services as defined under financial inclusion-savings, credit, insurance and pension. Ever since financial inclusion came into focus as an explicit objective for the government and the RBI, this is the first time there is a demand from customers for the product, and banks are seeing significant traction. Yet, this rush from the consumers has led to several issues that need to be addressed at the implementation level.

For instance, in meeting this huge demand, several fault lines in the bank-BC relationship from the past are being exposed, and as these are critical for the success of the PMJDY, they must be fixed at the earliest. While Business Correspondents are the backbone of the programme, the face in the field, they have not been included as stakeholders in the consultative processes, and remain unrepresented in major decision-making events. At the very least, the Business Correspondent Federation of India should work with the IBA and be included in the SLBC review meetings. While banks are looking at viability over a longer gestation period of two-three years, BCs are straining to achieve operational viability. From the BC point of view, there should be directives from the RBI/DFS such that commissions are paid on time and appropriately. In fact, for sustainability, the terms of BC remuneration should be harmonized across banks so as to create a uniform engagement and customer service quality at the last mile. In any case, the RBI/DFS must track the actual number of accounts being opened, the number activated, the transaction activity in these accounts at the agent level and the payment flows to the last mile to ensure that the targets are met in the true sense and that the agent on the ground receives his dues on time.

There are conflicting directions at banks about using Aadhaar for KYC, and this is more to do with the lack of infrastructure at bank branches. At the same time, there is need to reduce duplication of accounts; here use of Aadhaar would be the best tool. While Aadhaar is the best tool for account opening and mapping, legislation on Aadhaar and coverage must be speeded up. Yet, given current constraints on connectivity, use of OTP must be allowed as an option to biometrics for DBT payouts.

When it comes to DBT payouts, while the Finance Ministry has agreed to a 2% commission on DBT payments, there is no uniformity across states for government transfers. Also, 2% may not be adequate commission for DBT delivery in many districts/villages that are difficult to access where both banks and agents find it difficult to sustain business. Given the challenges here, the DFS should coordinate across states and set up uniform guidelines on the DBT commission across central and state schemes, as well as ensure equitable terms of sharing the commissions between banks and BCs. The level of commissions should also take into account the special requirements of pockets/ regions that are difficult to access. On the operational side, the DFS should clarify the process and turnaround time for reimbursing DBT commissions so that the payment flows can be planned to the last mile efficiently. As BCs bear the load of service delivery at the last mile, banks should provide credit limits for BCs against commissions accrued; this will make the chain stronger and commercially viable.

The government also needs to clarify many points of detail, especially on costing. For instance, there is still considerable lack of clarity on who bears the cost of the initiation benefits of the programme. The eligibility and pricing of the overdraft is unclear to many, not just the customers, but also within the bank management chain. Further, assumptions and costs of operating the Credit Guarantee fund are not clear, especially whether the default risk cover is to be borne by the customer, and how to avoid mass defaults.

Going ahead, it is important for the government to work with all those in the operational chain - RBI, IBA, BCFI, TRAI, DOT, NPCI, IRDA, NABARD and others- to sort out the operational details and convey these within the banking channels to the branch managers and BC agents. Putting in a strong foundation at the very beginning is crucial to ensure that the entire edifice of new accounts opened stays firm and will bring value to the unbanked.