

Lead Bank Scheme needs to contextualise recent changes instead of tinkering

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When the Reserve Bank of India (RBI) released the new (draft) circular for the lead-bank scheme (LBS), several newspapers carried reports about the proposal to closely monitor credit/deposit (C/D) ratios in rural branches. However, a bit of digging into the past indicates that these are not new concerns but were part of the master circular issued in April last year.

The concerns articulated in the RBI circular do not have any fundamental changes; they continue to be:

- Expanding banks' presence in unbanked rural areas, making banking service universally accessible;
- Better deployment of credit based on a block-level identification of opportunities;
- Coordination with states and its developmental imperatives.

Apart from tinkering with the coordination mechanism by introducing multiple subcommittees, the draft circular was not newsworthy. Now that the circular is in the news, it is worth our while to examine the relevance of the LBS in current times. The previous review was in August 2009, when a high-powered committee chaired by Usha Thorat examined the issue. The conditions have significantly changed since. The growth of the microfinance sector has made loans available to women across geographies, to the extent that we have pockets of crisis due to over-lending. The branch licensing policy, which mandates 25 per cent of new branches should be in unbanked locations, has helped expand the physical outreach; the Jan Dhan Yojana has brought households to banks; new small-finance banks (SFBs) have been licensed; and the banking sector, including private banks, has consistently achieved the targets in priority-sector lending (PSL).

The circular talks of two objectives of the LBS:

- The first objective of “enhancing the flow of credit to priority sectors for achieving inclusive growth” is adequately addressed;
- The second objective — “deepening financial inclusion through improved access and usage of financial services” — needs attention.

The draft circular makes changes in the coordination structure, with subcommittees for inclusion and literacy; agriculture; micro, small, and medium enterprises (MSMEs); and payment systems. Even here, the tone of the circular focuses on the planning and dispensation of credit rather than addressing the changed ecosystem.

The contextual framework of the LBS was rooted in pushing credit to excluded sections of society and needed district-level credit committees and preparing annual block- and district-level credit plans. Banks also had a clear service area. Most of these have been breached.

- The concept of a service area no longer exists, and with interconnected banking, even the concept of a home branch is becoming irrelevant;
- Many players in the credit market –microfinance institutions, gold-loan companies, and non-banking finance companies (NBFCs) — are dispensing credit while not being authorised to take deposits.
- The changes in the PSL architecture have incentivised lending to underserved areas by giving additional weights to underbanked districts, and with the tradability of PSL obligations through PSL certificates, there is a discovery of the opportunity sets.
- The RBI has reduced priority-sector obligations for SFBs from 75 per cent to 60 per cent of adjusted net bank credit. It has also reduced the threshold for qualifying assets to 60 per cent for NBFC-MFIs (microfinance institutions). Both these indicate the RBI's movement away from hard regulation to respecting the market forces.

In this context, the lead bank continuing to look at credit plans and monitor C/D ratios of banks makes little sense. MFIs and other players have been lending in districts where the C/D ratio is low with no permission to take deposits.

The priorities of financial inclusion in the current context are different.

First, there is a need to focus on savings-led inclusion. With the Jan Dhan Yojana and the architecture of business correspondents, there is near universalisation of bank accounts. But, there has been no campaign to get the poor to save money in safe places with a menu of options. There is a strong belief that the poor do not or cannot save. Savings is just a matter of managing cash flows, which the poor do much better than a sophisticated fund manager.

Second, the draft circular talks about payments and we see app-based payments visible ubiquitously. However, the account is linked to a device. The focus here should be to get each holder of a bank account an agency to digitally transact with her or his own personal device.

Third, and the most important aspect, would be consumer protection. For some reason financial literacy is always clubbed with inclusion. The framework should move towards customer rights, customer protection, and customer education. There is no point in teaching how to compound interest rates when people do not have choices.

The nomenclature of a “lead bank” is passe. In the changed circumstances the structure of the state-level bankers’ committee needs to be reimagined, and the data of the financial sector needs to be integrated with a larger and broader coordination mechanism. Given that the RBI is trying to get a common regulatory framework for all regulated entities, it is important that it looks at the financial sector (encompassing banks, NBFCs and various subclassifications, payment systems, and others) in an integrated manner for purposes of evaluating the extent of inclusion and data analysis. The current circular is only a small incremental change with a large part of the legacy behind it.

Institutions like cooperatives, chit funds, pawnbrokers, and moneylenders — all regulated by state legislation — need to be integrated into this framework and they should come within the coordination ambit. The RBI should work with state governments to establish state-level financial-sector development and regulatory authorities that are empowered to insist on registration, and which collect data and regulate them in coordination with the central bank. This mechanism has worked well for urban cooperative banks. It has to be expanded to include other state-level initiatives for coordination on the developmental agenda.

There is a need for a high-powered committee with a new set of terms of reference that recognise the developments in the past 15 years and contextualise the changes. We have had enough tinkering.

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