CAFRAL
CENTRE FOR ADVANCED FINANCIAL RESEARCH AND LEARNING
Promoted by Reserve Bank of India

Customer Protection and Financial Literacy to Support Financial Inclusion

December 2015

As the world makes a concerted effort towards bringing hitherto financially excluded people into the fold of the formal financial sector, financial literacy, or rather the lack of it, is proving to be a major hindrance. In this context, it is important to understand whether financial literacy actually results in increased usage of formal financial products, and how to deliver this literacy in an effective manner.

Increasingly, evidence from across the world is suggesting that, when delivered in a potent manner, financial literacy does lead to elevated consumption of financial products. Worldwide, ACCIONS' experience suggests that a third of the financial literacy clients become active savers. While a third of them save for the first time, another third become more regular about their savings. The Mann Deshi Mahila Sahakari Bank has also witnessed savings increasing by three times after a financial literacy course was offered to their existing and potential clients. Knowledge about specific products has been found to be most effective, when it is embedded in the products, and is offered at a time when the client most needs the products.

However, for financial literacy to be productive, it needs to go beyond imparting knowledge about the products on offer in a mechanical manner. It has to be focussed on creating financial capabilities, in terms of imparting an understanding of how to use technology to one's advantage (e.g. how to access bank balance through mobile phone, how to transfer money to another bank account, the various uses of a debit/ATM card etc). Many people don't understand different financial concepts like income and cash flows. Some of them don't comprehend the impact of taking multiple loans on their future cash flows. Some try to game the system, without grasping the long term implications on their finances, repayment capacity and ultimately on their credit scores. Most have to rely on loans as they don't grasp the impact of savings and insurance products on their future borrowing needs. Financial literacy models that create awareness around these issues, are likely to achieve desired results.

It is important to extend the financial literacy campaigns beyond existing customers. Not only does it enable customer acquisition, it may also result in higher comprehension of the bank's products among its existing customers, as the better educated among the audience might later help others with the details.

There are a growing number of instances where banks and other organisations have found a sustainable business model in financial literacy programs. In Latin America, many for-profit banks are undertaking financial education by themselves without any regulatory requirement, because they feel it makes business sense for them. Banco Pichincha, the largest bank in Ecuador, turned around its entire marketing campaign to focus on benefits from savings to the customer. It increased its deposits by 40% as a result. RevolutionCredit, a USA based company, has found a unique business model in designing financial literacy videos, that teach concepts to users, and simultaneously accesses their credit worthiness. The credit scores from these videos are then sold to their lender partners, who price the loans to these users based on these scores. This helps the users to get access to financial services at a reasonable rate, while helping the lenders price the loans appropriately.

However, it is not just the consumers that need financial literacy. It is increasingly being felt that the service providers too need to be enlightened. The bank agents need to be regularly trained and tested about their grasp of the product features. Banks are often not able to offer the right products to prospective clients due to a lack of recognition of their cash flows and their needs. For example, in a recent survey in India, a number of people expressed that the time taken to undertake a banking transaction discourages them from regularly transacting.

Finamérica is one Columbian financial institution that has included all these factors in its financial literacy program. It educates and encourages its customers to save concurrently with their loan repayments. The customers set their own savings goals, and if they achieve them, get better rates on the credit. The customers are imparted knowledge about benefits of savings and other products at "teachable moments", and are prompted to use alternate channels. This knowledge is imparted by a differently trained and incentivised sales force and customer service staff, which is motivated to increase deposits, and not just number of accounts opened. All their marketing material are embedded with financial education messages.

Most importantly, currently financial literacy is being handled as a one-size-fits-all approach. It needs to be segmented and separately targeted at school children, women, agricultural labourers, unemployed youth, and small and marginal farmers as disparate groups in order to be more effective.

With an increasingly large number of Banking Correspondents acting and offering financial services on behalf of banks and MFIs, with the number likely to shoot up as Payment Banks and Small Banks start operating, Customer Protection needs a heightened focus from all players. Ensuring customer protection with respect to bank agents is especially challenging, as they are neither a bank's employee, nor do they operate on a bank's premises. Till now, surprise agent visits have served the purpose well in countries like Mexico, which has a high number of good quality agents. Countries like Kenya are starting to look at agent supervision more seriously, with banks now allowed to hire telecom agents. Mystery shopping is a recently employed tool in this area.

While surprise visits and mystery shopping can prove to be productive tools for agent supervision, an attitudinal change can serve the purpose well. It needs to be recognised that financial literacy and customer protection are closely linked. Customers need to be made aware of their rights and of the services they can expect from a bank agent. This knowledge, when combined with an opportunity to air their grievances in a non-threatening atmosphere, can contribute greatly to customer protection. At the same time, it is imperative to educate the bank agent regarding his responsibilities. Bank staff should be encouraged and rewarded to collect customer feedback. Technology can play a vital role, e.g. use of voice-enabled machines in customer-facing transactions. The machine emits different sounds for different types of transactions, and depending on the sound being emitted, even illiterate clients can understand whether their deposit has been completed, or a withdrawal has been made, etc.

Customer protection cannot be fully ensured without the supervisor's active intervention. One specific area is potential conflict of interest in case of interoperable bank agents. Different regulators approach the issue in different manners – some do not allow agents to open accounts and standardise all other costs, some make it compulsory for information about all banks' products to be displayed in an equitable way, and some expressly prohibit agents from actively lobbying for a specific bank's products. The approach most productive, yet practical and enforceable would need to be chosen by the regulator.

Self-Regulatory Organisations (SROs) can play an active part in this area. While many customers fear sharing their grievances with the bank's/MFI's representative for the possibility of losing the existing benefits, many of them open up in front of independent observants like the SRO's agent. SROs could conduct their own customer surveys and cross-check their members' claims on settlement of grievances.

Continuity of services is a crucial aspect of customer protection. Providers of financial services need to ensure viability and sustainability of the agent. Lack of a viable model leads to the agent abandoning the area, resulting in service disruption and loss of end-user's trust in the product.

The provider, deliverer and the regulator, hence need to work in a coordinated and cohesive manner to ensure effective delivery of financial literacy and customer protection.

This document was authored by Nidhi Prabhu (Program Officer, CAFRAL). For any queries, please contact on nidhi.cafral@rbi.org.in