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Implementation of Minimum Balance Rule for Savings Bank Accounts in India – The Fault Lines

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Abstract

The objective of this note is to highlight the true features of a significant regulation put in place by RBI on levy of penal charges for non-maintenance of minimum balance in savings bank accounts. Banks have been given freedom to prescribe their minimum balance requirements in normal savings bank accounts. However, there are certain far reaching guidelines that banks need to follow when it comes to levy of charges for non-maintenance of the same. While arriving at the charges for non-maintenance of minimum balance, banks are required to ensure that (i) the penal charges are a fixed percentage levied on the shortfall, and (ii) the penal charges are reasonable and not out of line with the average cost of providing the services.

This note shows that banks have set their penal charges in violation to the spirit behind the regulation by not framing the charges as a fixed percentage of shortfalls. It is observed that most of the banks have set some slab structure in a manner that vitiates the fundamental principle of charges being a fixed percentage of the shortfall. Furthermore, for most of the banks, the charges when considered as a percentage of shortfalls work out to an average rate of 6.5% of every month's shortfall, which is equivalent to a penal rate of 78% per annum. This high rate of penalty appears to have no correlation with the costs for arranging such funds at, say, the call money market rate. The present charges for the cost of shortfall funds are camouflaged in a manner which doesn't look exploitative but are actually so.

This note is expected to facilitate the regulator and the banks to come out with meaningful supervisory steps and corrections, while taking forward normal savings bank accounts in the right perspective and thus supporting the country's financial inclusion drive.

Key words: Fixed percentage, Penal charges, Proportionate model, Slab structure

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1. The Regulation and the non-compliance

Effective April 1, 2015, Reserve Bank of India (RBI) introduced focused guidelines on levy of penal charges for non-maintenance of minimum balance in savings bank accounts. Prior to this there were no such guidelines on identification of charges in relative terms, when there is a breach in the required minimum balances in the account. After the new regulation came into being, the banks have been prescribing penal charges

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for non-maintenance of minimum balance by taking into consideration the cost involved in maintaining and servicing such accounts due to such shortfalls. Over the past three years, banks, based on their interpretation of the RBI guidelines, have been levying specific charges, if minimum balance is not maintained. This report looks into the fault lines that exist in the implementation of a well-crafted regulation by RBI. The non-compliance of the regulation in violation to the spirit guiding the minimum balance rule has hurt the vast customer base of banks in a discriminatory fashion.

Of the six-point RBI guideline on levy of charges for non-maintenance of minimum balance in savings bank account, we focus on two of them, i.e. regulations A and B, as below.

- *A: (a) The penal charges should be directly proportionate to the extent of shortfall observed. (b) In other words, the charges should be a fixed percentage levied on the amount of difference between the actual balance maintained and the minimum balance as agreed upon at the time of opening of account. (c) A suitable slab structure for recovery of charges may be finalized.*
- *B: It should be ensured that such penal charges are reasonable and not out of line with the average cost of providing the services.*

Although RBI deserves credit for designing the above guidelines, even after passage of three years, the guidelines have not got implemented in proper spirit. One of the reasons for this is the lack of banks' zeal to comply with RBI's basic direction that this **six-point guideline,** should be brought to the notice of all customers apart from being disclosed on the banks' website. Had that been in place, it would have helped in reducing the current customer inattention towards the extant guidelines that give them certain rights on the manner in which banks can impose penal charges for shortfalls in maintaining bank prescribed minimum balance. Only such an awareness building move, as envisaged by RBI, can bring customer attention and reduce possible scenarios where banks may be taking undue advantage of improper levy of such penal charges. The other major reason for inadequate implementation of the guidelines is possible lack in effective supervision and enforcement towards it. As a consequence, till date not only many banks remain non-compliant in levying the correct service charges for non-maintenance of minimum balance, but the public at large are also kept uninformed, by the banks, of the precise guidelines.

2. What non-compliance are we talking about?

Banks have set multiple slabs of shortfalls and overall the charges are **not a fixed percentage** of the shortfall. In fact, the percentage usually decreases with increase in shortfall. It is a different matter that the charges set by banks may be reasonable in absolute terms but surely they are not reasonable in relative terms, given that RBI has clearly defined what, in relative terms, is reasonable. In other words, banks have introduced slabs in a manner that vitiates the fundamental principle of charges being a fixed percentage of shortfall (under the proportionality rule of RBI).

One could have cared less if the banks' approach had not been on penalising more, in percentage terms, the accounts with smaller shortfalls than the ones with larger shortfalls, thereby leading to accounts with smaller shortfalls cross-subsidising the accounts having larger shortfalls. The efficacy of the discrepancy on penal rates attaches significance, since banks give a fixed percentage rate of interest on balances in their savings account.

Banks usually violate regulations A(a) and A(b) but get possibly protected due to regulation A(c). There is a tendency on part of some banks to express somewhat like "… our slab structure provides for less penalty (in rupee terms) in the lower slabs and higher penalty for the higher slabs". Such a response gives an impression as if RBI could not make the country understand the meaning of 'proportionality' or 'fixed percentage'.

Banks' purportedly taking shelter under regulation A(c), implies as if regulations A(a) and A(b) have no relevance. It also signifies as if banks could have had logic to do otherwise (i.e., doing something different from a slab structure, in Rupees, not providing for lower penalty in the lower shortfall slabs and higher penalty for the higher shortfall slabs) had RBI come out with only regulation A(c) and not A(a) and A(b). In other words, what one may infer by such a stance taken by banks is that RBI has put redundant regulations A(a) and A(b) when A(c) alone would have sufficed. However, that could not be the case since RBI, even in the preamble of the said regulation, refers to the essence as *"the penal charges levied should be in proportion to the shortfall observed"*, and attributes the same to the Damodaran committee.

Notwithstanding the above, a careful reading will clearly show that regulation A(c) talks about allowing banks to finalise suitable slab structure (if they so desire) only *for recovery* of charges. Therefore, the banks' suitable slab structure *for recovery* of charges comes into being only after the bank has put in place their charges as per regulations A(a) and A(b). Regulations A(a) and A(b) explicitly lays down the rule of how to set, or arrive at, the charges. The *recovery* of such charges (and how to *suitably* do so) is secondary. The banks tend to completely ignore regulation A(a), which in fact gets reiterated by RBI under regulation A(b).

So, what exactly is RBI trying to convey while giving freedom to banks on the formation of suitable slab structure only for recovery of charges? The spirit and suitability of a slab structure hinges on RBI's fundamental policy, wherein it tried to judiciously link methods like (a) banks paying interest, in percentage terms, on the amount held under deposits, (b) banks charging interest, in percentage terms, on loan balances in accounts, and (c) savings deposit account holders paying a penal fee for non-maintenance of minimum balance, in percentage terms, on the shortfall amount. A vital question that arises is – what exactly are such slab structures set by banks, which are not only devoid of the spirit as set in the RBI guidelines but are also detrimental to depositors' interest?

It is pertinent to mention that banks should transparently declare a '*constant of proportionality*', which it might have adopted while arriving at the charges in line with regulations A(a) and A(b) for non-maintenance of their prescribed minimum balance in savings account. For most of the banks, the best fit of the their current charges to the proportionality model gives a value of around 0.065 for the constant of proportionality. That means the charges have been fixed at an average rate of 6.5% of every month's shortfall, which is equivalent to a penal rate of 78% per annum. This high rate of penalty appears to have no correlation with the costs for arranging such funds at, say, the call money market rate. Thus, it raises question on the efficacy of regulation B.

When RBI says "*banks should ensure that such penal charges are reasonable and not out of line with the average cost of providing the services*", the vital question that arises is whether RBI has built any capacity (in terms of a methodology) to judge compliance of the regulation. As such there is no item-wise scientific costing in banks since most of the operational expenses relate to bank as a whole. It may not be feasible to calculate precise costing for a particular type of account. The broader costs of deposit products are covered by the net interest margin.

3. Assessment of banks

We focus on eleven select banks for assessing their take on the regulation. These banks are SBI, OBC, IOB, Axis Bank, HDFC Bank, Kotak Mahindra Bank, Yes Bank, IndusInd Bank, ICICI Bank, Citibank, and Standard Chartered Bank. To understand their interpretation of regulation A, we formally engaged with three banks apart from the Indian Banks' Association (IBA). However, the banks fumble in their attempt to respond.

Most of the banks have set two, three or four slabs of shortfalls and within each slab the charges are constant in rupee terms, i.e., the charges are **not a fixed percentage** of the shortfall even within each slab. Moreover, though between slabs the charges vary, with respect to the slab means the charges are **not a fixed percentage**. In fact, the percentage usually decreases with increase in mean shortfall implying that they are resorting to unwarranted cross subsidisation. To summarise, under no circumstance do these banks ensure that the charges are a fixed percentage of the shortfall. Table-A provides bank-wise slab summary for metro/urban regions.

OBC sets a typical example where one could argue that regulations A(a) and A(b) have been followed by the bank with the penal charges being a fixed 6% of shortfall. However, invoking regulation A(c) thereafter, the bank has finalised a 'suitable' slab structure where there is just one slab of penal charge of Rs 100 for any shortfall from the prescribed minimum balance of Rs 2500. This highlights how a loose end, such as in regulation A(c), can distort the spirit of the regulation. In the present age of core banking solutions, the spirit behind regulation A(c) could at best be used for rounding off the penal charges to the nearest higher Rupee. Making broad slab intervals with constant charges in rupee terms within the interval is not only unsuitable but also distorts the whole rationale of proportionate charges. It also unnecessarily creates significant disconnects in charges between slabs.

Based on the charge structure for the eleven banks, a best fit under the proportionality model allow us to derive the effective annual rate that the banks are charging for the shortfall amount of money. Such a fit also allows us to showcase that SBI, during the 6-month period April-September, 2017, had imposed excessive charges of about Rs. 141 crore to a vast section of depositors by creating a biased slab structure in violation to the proportionality principle set by RBI.[1] Similarly, while looking at other banks for possible violation in the proportionality principle, we have established that most of the banks, in violation to a *rule of unbiasedness* set by RBI, impose a disproportionately higher penal charge in the lower slab of shortfalls than in the higher slab of shortfalls. In this process the banks thrust undue and uncalled for discrimination in form of cross subsidisation at no fault of a vast section of depositors.

[1] See reference [1] for more details.

A shortfall in minimum balance maintenance by a savings account depositor can be considered akin to an overdraft facility availed by a customer. The only difference between overdraft funds and the shortfall money (in the required minimum balance) is the credit risk associated with the overdraft account. Since there is no credit risk in shortfall funds, there is no rationale for its cost to exceed the cost of overdraft funds. The interest rate in overdraft accounts was in the range of 6 to 14% per annum as on March 2016. Since then the interest rates have eased down significantly. Contrastingly, on the other extreme, the loans through credit cards carry a rate of around 40% per annum. If the cost of highly risky credit card based funds is 40% per annum, can the cost of zero risk funds (shortfall in customers' own savings deposit funds) be more than 40% per annum? Ideally, comparison with overdrafts highlights no grounds to charge more than 10% per annum for shortfalls in savings bank accounts.

Through Table-A, it gets highlighted that banks don't seem to correlate cost of shortfall funds with the corresponding cost of the same funds in the call money market. Banks lend to each other in call money market without collateral. The call money market rates on an average have been less than 7% per annum, in the near past. Thus, keeping the alternate month shortfall issue in view and the cost to setup IT based control mechanisms for such type of customers, it is imperative that the cost of shortfall funds cannot exceed 14% per annum. With many banks charging at an average high rate of 78% per annum of the shortfall amount, it makes the whole regulation of 'reasonableness of charges as per cost' quite shallow.

Table-A: Glimpse of the bank charges in terms of annual penal rate on shortfall funds

Name of Bank	Minimum balance (Rs)	Slab Type	Constant of proportionality (*k*)	Monthly rate set by bank (%)	Implicit annual rate set by bank (%)
SBI	3000	Disproportionate 3-slabs	0.0208	2.08	24.96
OBC	2500	Disproportionate 1-slab	0.0597	5.97	71.64
IOB	1000	Disproportionate 3-slabs	0.1329	13.29	159.48
Axis Bank	10000	Disproportionate 3-slabs	0.0685	6.85	82.20
HDFC Bank	10000	Disproportionate 4-slabs	0.0698	6.98	83.76
Kotak Mahindra Bank	10000	Disproportionate 2-slabs	0.0635	6.35	76.20
Yes Bank	5000	Disproportionate 2-slabs	0.0940	9.40	112.80
IndusInd Bank	10000	Disproportionate 2-slabs	0.0563	5.63	67.56
ICICI Bank	10000	Disproportionate 1-slab	0.0649	6.49	77.88
Citibank	100000	Disproportionate 2-slabs	0.0079	0.79	9.48
Standard Chartered Bank	10000	Directly proportionate	0.0500	5.00	60.00

4. Cross subsidisation when not required – Enforce control

The specific service provided by the banks is to allow withdrawal of funds even when balances go below the minimum balance prescribed. Accordingly, the penal charges for non-maintenance of the banks' prescribed minimum balance should ideally be commensurate with the actual cost of the shortfall funds. Banks should not thrust as charges the cost of something which should be borne, on an average, by all normal savings bank account holders – like the broader cost of NPA or cost of running BSBDAs or cost of running ATMs, etc. Banks have already been given the freedom to use the savings bank interest rate as an instrument to adjust for their overall expenditure-revenue. Therefore, given that RBI has clearly put in a regulation mandating banks to ensure that the charges are reasonable and as per cost of the specific service, RBI needs to appropriately address whether it is desirable to artificially build cross subsidisation in a selective manner in form of excessive service charges.

A major hurdle is the mixing of the cost of providing a specific service (in this case, cost of funds) by banks and the cost of cross subsidisation. With a view to eliminate discrimination in form of cross subsidisation, a possible way out for banks could be to enforce reasonable changes for a service without cross subsidisation, and that all situations demanding cross subsidisation should be accommodated by adjusting the savings bank interest rate.

Nevertheless, the banking supervisor may like to ensure compliance of its regulatory instructions on minimum balance so that no individual is left discriminated. This may require a clear understanding on whether RBI should allow cross subsidisation to be loaded, while banks workout the service charges based on actual costing.

RBI has formulated the penal charges rule with an objective of bringing in fairness from the customers' angle. Thus, it is time to plug the regulatory and supervisory gaps in a holistic manner and not only formulate clearer guidelines on the formation of slabs but also how to measure reasonableness of charges based on costs of funds.

5. Recommendations

i. Given the extant regulation on minimum balance in savings account, RBI may like to ensure its compliance not only in letter but also in spirit. Though banks are free to decide on the penal charges so long as it is reasonable and as per cost, the charges should have a clear objective of bringing in fairness from the customers' angle. The penal charge rule is not to facilitate adjustments by banks based on their analysis of the distribution of shortfalls and net amount of revenue expected; thereby creating a situation of cross subsidisation.

ii. A loose end, such as in regulation A(c), can distort the spirit of the regulation. In the present age of core banking solutions (CBS), the spirit behind regulation A(c) could at best be used for rounding off the penal charges to the nearest higher Rupee. Making broad slab intervals with constant charges in rupee terms within the interval is not only unsuitable but also distorts the whole rationale of proportionate charges. It also unnecessarily creates significant disconnects in charges between slabs.

iii. So long as the minimum balance regulation is in place and the spirit behind the regulation has not changed, the Enforcement Department (EFD) of RBI, having a focused objective of enforcing regulations keeping in view promotion of public interest and consumer protection, should be pro-active in checking such situations that affects the gullible masses directly.

iv. The Consumer Education and Protection Department (CEPD) of RBI needs to pitch-in to protect the depositors and educate them about the correct regulation since the central bank has already directed the banks that the *RBI guidelines* of November 2014, on levy of charges for non-maintenance of minimum balance in normal savings bank account, should be brought to the notice of all customers apart from being disclosed on the bank's website.

6. Concluding remarks

The details related to this work is available in the IIT Bombay Technical Report. The url for the Report is http://dspace.library.iitb.ac.in/jspui/handle/100/22127

A power point presentation on the subject based on the conference presenation is also avaialble. The url for the same is http://www.math.iitb.ac.in/~ashish/workshop/Fault-LinesPPT.ppsm

Consequent to the late-December release of the Report, SBI, effective April 1, 2018, has significanly revised its charges downwards for shortfall in minimum balances in their normal savings account. For metro and urban regions, SBI, retaining their minimum balance requirement of Rs 3000, revised the charge slabs to Rs 10, Rs 12 and Rs 15 (from their earlier charges of Rs 30, Rs 40 and Rs 50) for respective shortfalls in the ranges Rs 0-1500, Rs 1500-2250 and Rs 2250-3000.

Referring to Table-A, we see that for SBI the monthly rate and the implicit annual rate on the shortfalls in minimum balance are 2.08% and 24.96% respectively. *Ex post* revision of SBI's penal charges, the monthly rate is 0.64% while the implicit annual rate is 7.64%. These rates are quite resonable and in sync with the prevaling call money market rates.

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