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SAVINGS WITH A BONUS — FINANCIAL PEACE OF MIND

Relevant for: Indian Economy | Topic: Issues relating to Growth & Development - Banking, NPAs and RBI

The confidence that ordinary Indian savers repose in guaranteed return products has been subjected to hard knocks of late. First there was the scare about public sector banks being placed under prompt corrective action by the Reserve Bank of India (RBI). Then there were the defaults by AAA-rated non-banks. Recently, the RBI's strictures on Punjab & Maharashtra Co-operative Bank Limited (PMC) have opened a can of worms on the safety of co-operative banks, and the gaps in the working of deposit insurance.

But whenever Indian savers complain of the lack of safe investments, they are usually told to observe more due diligence as far as their investments are concerned or embrace market risks through vehicles such as mutual funds. While this advice may be appropriate for affluent urban savers, it is quite impossible to follow for a majority of households in India which have a subsistence level of income and scant access to financial literacy.

The average Indian earned a per capita income of 1.26 lakh in FY19. A Global Wealth report from Credit Suisse (October 2019) found that the median wealth of an Indian adult was $3,042 (2.1 lakh). A survey on financial literacy among Indian savers by the Tarun Ramadorai committee in 2015, found that over 30% of savers did not grasp the concept of compound interest.

This highlights the crying need for Indian savers to have access to simple fixed return products that offer complete safety of capital without their having to dig into balance sheets. The small savings schemes (also called national savings schemes) from India Post fit this description to a tee.

Given that these schemes make up part of Central government borrowings, they are sovereign-guaranteed. The Indian Government in any case ends up borrowing 6-7 lakh crore from the public markets every year to fund its fiscal deficit. Today, it is mainly institutional investors who get to participate in Government of India securities (G-sec) auctions. There is no reason why this opportunity cannot be opened up to more small savers instead.

But if savers are in search of safe options and post office schemes fit the bill, why are they so under-the-radar? Numbers from the RBI show that by the end of FY19, while commercial banks were sitting pretty on deposits of 126 lakh crore, small savings schemes managed just 8.9 lakh crore. It is bemusing to note that HDFC, a private sector non-bank, has managed to garner the same volume of deposits (1.2 lakh crore) as post office time deposits with their massive outreach.

There is immense scope for reviving the popularity of the post office schemes, if the Central government can make five design changes that tailor them to better meet the needs of small savers.

A few years ago, in a bid to wean savers away from administered interest rates, post office schemes were transitioned to floating rates by pegging their interest rates to government securities with comparable maturity. Over time though, the quarterly rate changes have acquired a life of their own, bearing limited correlation to market rate movements.

There is nothing wrong, really, in the Central government offering small savers with special needs a premium over prevailing market interest rates. But to make such rate moves transparent, it is best that the Government specifies and sticks to a fixed spread over G-sec rates for each scheme.

The banking lobby is bound to be up in arms against "high" rates on small savings impeding transmission. But the caps on individual investments in the more popular schemes (1.5 lakh for Public Provident Fund, 15 lakh for Senior Citizens Savings Scheme (SCSS), 4.5 lakh for Monthly Income Account) restrict the sums that savers can park in these schemes. Such caps can be extended to all schemes with high spreads. This apart, the very intent of re-designing post office schemes is to attract bottom-of the-pyramid savers who are not considered lucrative by banks.

Indian savers have felt a need for 10-year or 20-year fixed return instruments to park their long-term money. Presently though, a majority of debt options available to them are in the one to five-year bucket. Even among the post office schemes, six of the nine available ones cater to savings needs for one to five years only. Investors who would like a longer-term option have just two choices — the Public Provident Fund (PPF, 15 years) and Kisan Vikas Patra (KVP, 9 years), as the Sukanya Samriddhi Yojana is restricted to those with a girl child.

Re-introducing National Savings Certificates in the 10, 15 and 20-year tenors can meet this need while helping the Central government source long-term funds for capital spending.

While deposits with private entities offer both regular income and cumulative options, with post office schemes it is an "either or" choice. Having both options on the menu can help savers decide whether they want regular cash flows or compounding benefits.

Today, most post office schemes offer tax breaks on the principal invested under Section 80C but their returns are taxed at income tax slab rates (the only exceptions being PPF and Sukanya Samriddhi). Reversing this position may render these schemes more attractive to small savers. For savers whose income levels are likely to be at or below the lowest tax slab, the 80C benefit has limited utility. But an extra percentage point in tax-free returns can mean a great deal.

If the Central Government is loath to extend such tax benefits to all post office schemes, it can restrict them to special-purpose schemes. Taxation on more than three-year small savings products that accumulate interest, needs to be brought on a par with market products and given inflation indexation benefits.

Small savers may like the predictability of a fixed return for the long term. But given their limited savings, they also need early exit options in case they are beset by an emergency. While the time deposits and SCSS offer early exit on fairly simple terms, early withdrawals from the PPF or Sukanya Samriddhi are subject to convoluted conditions. Doing away with bureaucratic rules for investors to get their hands on their own money is critical to make post office schemes more attractive to their target audience.

Finally, the foremost reason savers cite in shying away from post office schemes — despite their safety and reasonable returns — is the woefully poor customer service that they need to deal with. At a time when Indians from every strata have taken to digital transactions like ducks to water, India Post continues to rely on archaic modes of working in dealing with customers.

Its insistence on a paper application process, old-fashioned passbooks, cheque payments and branch visits ensures a process that is time-consuming and arduous for those seeking to invest their money with it. While India Post has been transitioning its record-keeping and backend

operations to the digital mode, it appears that this has yet to percolate to its customer interface. On this aspect, the organisation can take a leaf or two out of the books of non-banks such as HDFC or Sundaram Finance who make deposit investing such a seamless experience for their customers.

If India Post can shed its half-hearted attempts to transform itself into a payments bank and convert itself into a digitally enabled, pure deposit-taking bank, it can render a yeoman service both to the government and small savers of this country.

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