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Technical Assistance (Non-lending) for Financial Inclusion Initiative - Government of Meghalaya (P150093)

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A. Background and Context for Inclusion in Meghalaya

		Meghalaya	India
GSDP	bill USD	3.5	1745.5
Population	mill nos	2.97	1210.8
Per capita GSDP	USD	1182	1442
Working age population	2011 Census	55%	60%
Population BPL	Tendulkar 2011	11.9%	21.9%
Literacy Rate	2011 Census	75.5%	74.0%
Gender Gap - Literacy	2011 Census	3.4%	16.7%
Gini Coefficient - Urban	2010	0.24	0.37
Gini Coefficient - Rural	2010	0.17	0.28
Infant Mortality Rate	SRS 2013	47	40
Access to safe drinking water	2011	44.7%	85.5%
Aggregate Bank Deposits	bill USD	2.1	999.8
Per capita Bank Deposits	USD	698.3	825.8
Aggregate Bank Credit	bill USD	0.6	736.1
Per capita Bank Credit	USD	195.9	608.0
CRISIL Inclusix Score		29.2	40.1
Inclusix Score - South Garo Hills		7.7	
Inclusix Score - East Khasi Hills		48.9	

INR:USD=60
Inclusix Score <25 Low, 25- 40 Below Average, 40 - 55 Above Average, > 55 High
GSDP at current prices FY14 (P), 2004-05 series; Planning Commission database

1. **Lack of access to finance is a critical issue in the Indian state of Meghalaya, particularly in rural and tribal areas:** Meghalaya is situated in the North East Region (NER) in India which remains the most financially excluded region in the country. An estimated 63% of the population is financially excluded in Meghalaya, particularly in rural and tribal areas. Bank branches are distributed at the rate of only 16 branches per 1,000km2, compared with the national average of 30.4 branches per 1,000km2, and financial services are largely concentrated in Shillong (capital city). Also, the distribution of bank branches is highly uneven, with bank branches per 1,000km2 ranging from 58 in East Khasi Hills to about 4 in South Garo Hills. Similarly, in South Garo Hills, on an average, one bank branch covers a population of over 20,000 as compared to 5,000 in East Khasi Hills. The number of deposit accounts per 100 adults is 41 (national average: 59.3), and the loan accounts is 8.3 (national average: 13.3). Therefore not only is outreach of financial services significantly lower than the national average, within the state variations exist (see Table 1). The reasons are difficult terrain, low population density in many parts of the state, poor infrastructure and a mix of demand and supply side factors (discussed further below). On the supply side, financial institutions have been constrained due to relatively low risk appetite, internal capacity constraints to manage risks or design products suited to local needs, as also poor

network connectivity and inadequate physical infrastructure that hinders effective delivery of services. It was noted by the mission team during the field visits as well as through earlier studies that loan origination has been poor on account of low levels of financial awareness, even though there is willingness and interest among the people to learn how to manage finances Also, for low value transactions, often the costs of owning and operating an account outweigh the benefits. For instance, technology and connectivity failure leads to poor customer experience, more so when customers have to travel a substantial distance at a cost to reach the nearest bank branch and transaction completion is uncertain.

Table 1: Access to Finance in districts of Meghalaya

	Bank Branches	Bank branches per 1000 sq km	Persons covered per bank branch	CD Ratio	% of households availing banking services
East Garo Hills	25	9.6	12,717	64%	31%
East Khasi Hills	160	58.2	5,162	40%	64%
Jaintia Hills	58	15.2	6,812	47%	48%
Ri-Bhoi	34	13.9	7,613	73%	51%
South Garo Hills	7	3.7	20,333	31%	27%
West Garo Hills	47	12.8	13,687	39%	43%
West Khasi Hills	28	5.3	13,695	36%	37%
Meghalaya	**359**	**16.0**	**8,264**	**43%**	**48%**
India	**102,343**	**30.4***	**11,825***	**77%**	**59%**

Source: Agenda cum Background Paper, SLBC, Meghalaya (March 2014); RBI; Census (2011); Department of Financial Services Website.

*Based on number of branches as on March 31, 2013

2. **Viability of the Banking Correspondent (BC)-Customer Service Point (CSP) model, set up to overcome these challenges, is at best uncertain** and the experience has been uneven. Of the over 5700 villages allotted under the financial inclusion plan, 930 are covered by itinerant BCs who make weekly visits. It is observed that households access multiple channels to meet their financial needs. It is typical for a micro entrepreneur or household to access post offices for remittance, Self Help Groups for small savings and short term personal loans, and formal bank channels for Kisan Credit Card [KCC] based agricultural loans. Microfinance institutions in Meghalaya are mostly focused on East Khasi Hills and Ri-Bhoi districts and have been exploring

the possibility of expanding their outreach and product basket.

3. **Institutional appetite and capacity for credit is low** as well. Risk perception on credit amongst banks and other lenders in Meghalaya is high because of the low recovery rates, even though part of the problem is with limited appraisal and lax monitoring on the part of banks themselves. Credit culture issues also appear to have impacted recovery rates where borrowers even with good credit history of payments have at times chosen not to repay, or delayed repayment in anticipation of a debt waiver scheme. In this context, there is a case for strengthening product design, credit appraisal and risk management competencies of banks and identification of appropriate delivery and monitoring channels, while ensuring credit risks are priced and allocated in a manner that best reflects the capacity to absorb them. Willingness to lend on the part of banks is evidently low unless loans are guaranteed by the Credit Guarantee Fund Trust for Micro & Small enterprises (CGTSME) or an equivalent entity that allows banks to secure their exposure[1]. The GoM views the absence of credit histories [for micro borrowers] as a contributor to credit market failure and one that needs to be addressed on priority.

4. **The problem of access to financial services is compounded by lack of financial capability among the low income population**. Studies indicate that there is a preference for utilizing own savings and informal sources to fund occupational activity. General cultural factors and attitude towards monetary savings and formal credit have hindered penetration of financial services. Traditionally, society has focused on meeting subsistence needs and links with micro-enterprises and local livelihood requirements have been weak: It is observed that most livelihoods are carried out on subsistence scale and not oriented towards the market. Limited surpluses from such low scale operations therefore limits access to finance from both a demand and supply side perspective, rendering livelihoods risky.

5. **Financially excluded sections of the population are also more vulnerable to risks** of crop loss or sudden job loss, as has been the case post the coal mining ban in Meghalaya. Since their savings are often are not monetized, it further curtails their capacity to access formal financial services. Awareness about availability of financial products is low as well. According to the survey conducted by PwC in 2012, less than 50% are aware of non-saving and non-loan products which leads to involuntary exclusion. It is also noteworthy that majority of the survey respondents (at least 65-70%) who borrowed for starting their own business lie in the 25-49 age categories. This reveals an inherent desire for enterprise amongst the young and middle age people in Meghalaya.

[1] As conveyed by State Bank of India, Convenor, State Level Bankers Committee

6. **In terms of gender, the survey revealed that women are active savers but are less willing than men to use financial intermediaries** to deposit their savings and instead prefer to keep their savings at home. Majority of females fund their investment (66%) through savings and therefore, demand for loans is lower among them.[2] Women and young people are, thus, the priority target groups for this program in Meghalaya. **Meghalaya's demographic profile supports the gender focus given its favorable literacy rate and lowest gender gap for literacy in India**. Responses from field missions have also been encouraging in terms of the potential for positive development outcomes from gender focused interventions.

B. Intervention

7. The Government of Meghalaya (GoM) is keen to enhance financial inclusion to support its flagship Integrated Basin Development and Livelihood Program (IBDLP) by facilitating financial education and institutional capacity. To better understand the baseline situation IFC commissioned a statewide assessment of access to finance in Meghalaya in 2012. The findings from the supply side (across banks, NBFCs, MFIs, others) and demand side surveys (across farmers and enterprises) in the state were used to develop a DFID funded World Bank executed Non-lending Technical Assistance (NLTA).

8. The objective of the NLTA (worth USD 315,000) was to support the financial inclusion initiative of the Government of Meghalaya (GoM), **through piloting financial awareness, providing capacity building to select financial institutions, and designing a roadmap for responsible finance in the state**. The focus regions for activities under this NLTA include ones where concentration of poverty is likely higher and therefore expected to be more excluded.

9. The NLTA aims to **take early steps in implementation** to address the inclusion challenge in Meghalaya. These **build on a range of diagnostic work** already carried out in the area of Financial Inclusion and identified issues in varying degrees of granularity for households, firms and institutions in Meghalaya. The knowledge takeaways from this TA provide among the first empirical cases of work in this area including in some measure on technical specifications on intervention design that could be useful in other LIS/NER.

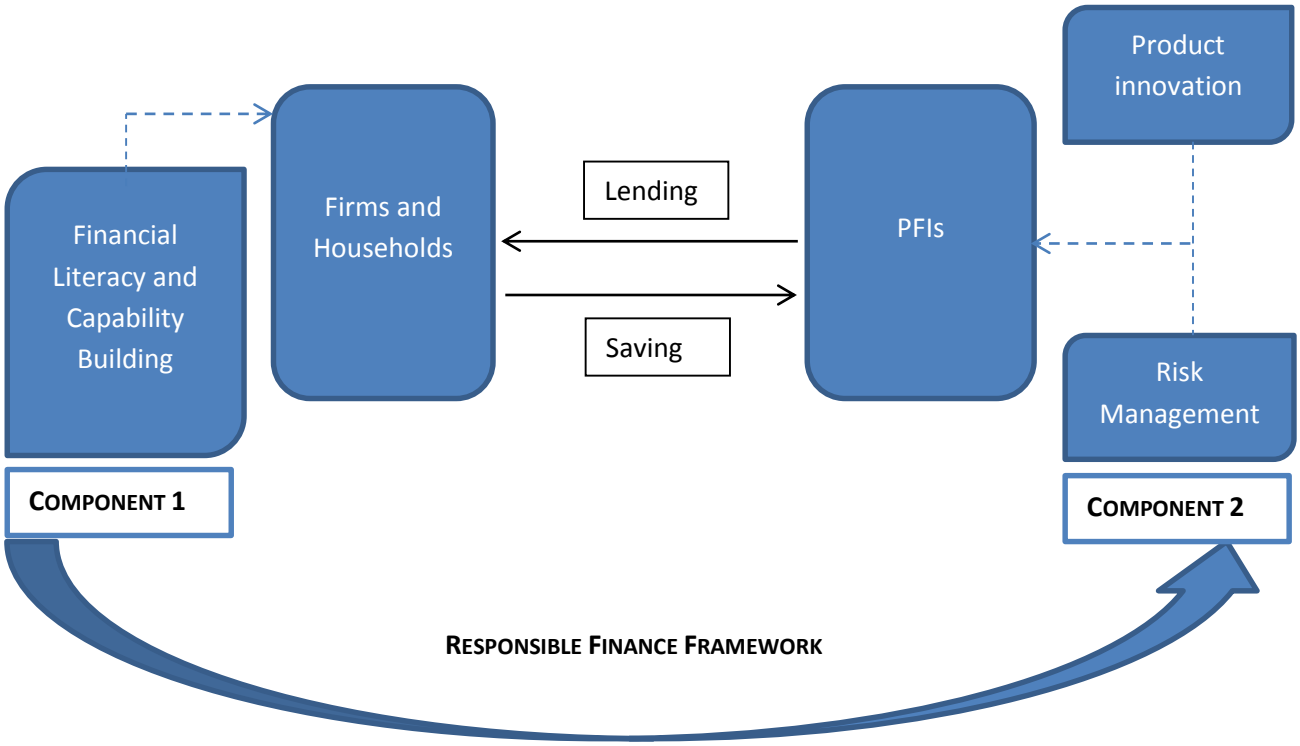
10. The NLTA was organized around two core activities: (i) financial awareness component to support designing and piloting the roll-out of financial awareness and

[2] Designing an Access to Finance Programme in Meghalaya, IFC-PwC Demand side survey report, October 2012 and IFC-PwC Strategy Report, January 2013.

literacy campaign, targeting several districts which cover the Khasi / Garo / Jaintia tribes; and (ii) capacity building component for selected Partner Financial Institutions (PFIs), with the aim to strengthen risk management capacity of the PFIs, develop customized financial products to meet the needs of the underserved population, and design a framework for responsible finance.

11. The activities under the program support the state of Meghalaya in meeting its growth target of 11 per cent under the Government of India's XII Plan (2012-17) with thrust on reducing poverty; ensuring better livelihood opportunities for its citizens and creating necessary infrastructure for long term sustainable development. The NLTA is aimed at strengthening micro entrepreneurship / livelihoods in the state so as to encourage a move towards market based solutions and reducing dependence on state subsidies in this regard. It addresses these through synchronized demand and supply side interventions as demonstrated below. The project design is expected to enable GoM scale up the demand and supply side interventions subsequently.

OUTPUT



C. Alignment with India Country Partnership Strategy (CPS) 2013 – 2017

12. The activity supports pillar 3 of the CPS (Inclusion), calling for improved access to services to excluded segment of population. Increasing access to financial services is one of the key focus areas under the pillar. The activity is also integral to the CPS in that it focuses on a LIS, that too in the especially backward north eastern region (NER) of the country. In addition, the activities are also aligned with the CPS's gender focus as women are the key beneficiaries of the activities.

D. Details of activities under the NLTA

The Financial Inclusion NLTA-Meghalaya is delivered on the following fronts:

Component 1: Financial Awareness

13. The scope of work under this subcomponent is to help evolve financial literacy content , through pilot roll-outs in different districts and among the more excluded tribes and regions [Khasi, Jaintia, Garo] , which contributes to increasing awareness on financial products and improving capability in daily financial planning. The activities completed under this component are summarized below:

14. **Preparation of financial literacy curriculum customized for Meghalaya to reflect local profiles and financial priorities**. Financial literacy material tailored for Meghalaya was designed by the World Bank drawing from Parinaam Foundation's literacy curriculum, the World Bank's Indonesia project on financial education and with inputs from the local trainers and GoM. The modules covered aspects of 1) Financial Planning and basic numeracy skills, 2) Understanding the importance of saving, 3) How to borrow within one's capacity to repay and 4) Preparing a simple business plan and simple record keeping. The training used creative comic strip for story-telling, a workshop format and unique incentives (such as free calculator, savings box, financial diary and certificates). [Reports enclosed in Annex 1] Since many villagers were shy to approach a bank branch and speak to a bank official, staff from the nearest bank branch was invited to distribute the certificates at the completion of the 4-week training and have an open dialogue with the

Picture 1: Questions round with the Bank official during the training in Khasi Hills

participants. The perception barriers which inhibited the rural people from approaching a bank are likely to be reduced by means of such informal interaction with the bank officials held in the village setting.

15. **Trainer training and building local capacity for scale through involvement of local staff.** A week long training was conducted by the Parinaam foundation for 9 trainers and 20 Enterprise Resource Personnel (ERPs)[3]. The trainers chosen were persons with local language competence in the three regions of the state. The feedback from the training was used to further refine the financial literacy material.

16. **Delivering the training at the last mile.** The pilot trainings were conducted from April 27-June 3, 2015 in a representative sample of villages in each district identified as per agreed criteria[4] to ensure adequate participation from the target population,. Baseline data of the selected villages was captured in a format provided by the World Bank Team. The financial literacy training imparted under the program was given at a neutral location in the village, in the local language and at a time suitable for the villagers (e.g. early morning or late evenings when most people are not at work). Stories, group exercises, games, etc., kept the class engaged and made the training fun for the participants. This ensured better attendance and interest in the program. The training was attended by 1780 participants in 45 villages spread across the three tribal regions; Khasi, Jaintia and Garo Hills. [5]Women constituted about 67% of the total trainees and the average age of the trainees was 32.8 years. Most participants were involved in agriculture or piggery activities. (Refer to Figure 2). In order to prepare a video guide for future trainers and document the learnings, GoM requested filming of the sessions being conducted in select villages covering all the three regions. Consequently, a GoM appointed media team, facilitated by the World Bank covered the videographing of all modules including reactions of select participants and the trainers. A shorter video will be used to showcase the program to various stakeholders while a longer video will serve as a practical guide for delivery of the training by future trainers.

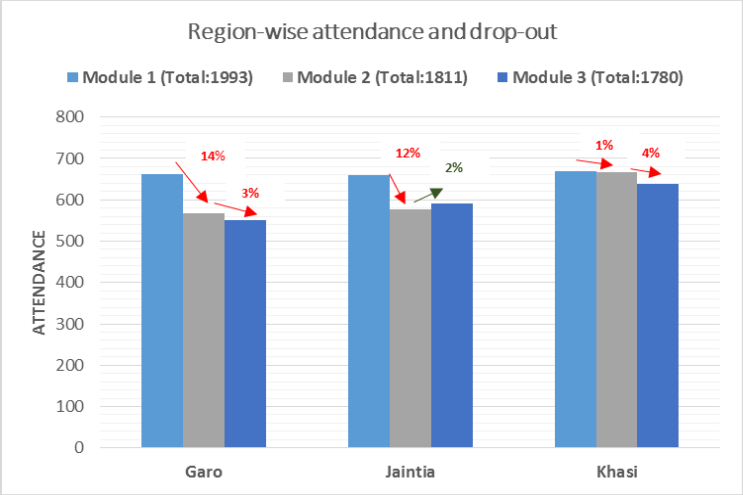
[3] Enterprise Facilitation Centres (EFCs) are set up in all 39 blocks of the state to act as a single window public interface agency under the IBDLP programme at the grass root level. EFCs coordinate with different agencies to facilitate the inception and growth of enterprises. The EFCs are manned by two enterprise resource persons (ERPs) and one enterprise support person (ESP).

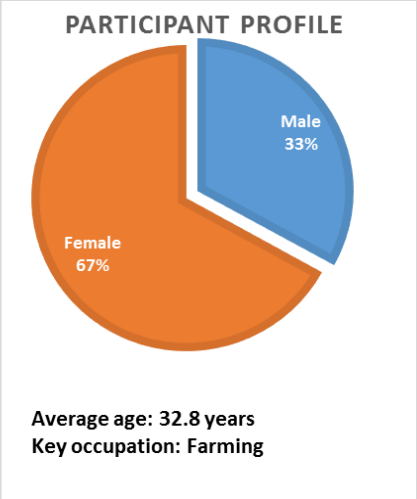
[4] Primary criteria for selection of villages: a) villages with more than 100 house holds, b) less than 5km bank access and Secondary criteria are: a) preferred Enterprise Facilitation Centres and LIFCOM linkage, b)villages/blocks that have expressed interest in literacy training.

[5] Based on Week 3 of the 4- week module

Picture 2: Group exercises and games ensured that the participants have fun as they learn

Figure 2: 1780 participants completed the 3 modules and women constituted a bulk of participants





Source: MIS collected during the roll-outs

17. **Production of an entertaining educational video.** An entertaining film containing financial literacy messages was shot in Meghalaya using local actors.[6]The idea was to produce an educational film which resonates with the audience in rural Meghalaya where characters are believable and reflect the lives of the targets. The creative team worked with the World Bank team and the GoM to craft an appropriate storyline. The half an hour film contains a narrative story as well as animation to convey educational messages. A shorter primer video and radio content will also be developed with the film.

[6] The video is currently under final stages of editing

Box 1: Case of village Saka Boldamgre, West Garo Hills

There is visible excitement in one classroom of the village primary school even though school hours are over. About 45 adults eagerly await their teacher while curious bystanders peek through the windows. Willingstone Mara who had come to attend the third week of the training describes his experience "This is the first training program in the village! I have learnt how to save for the future even if it is Rs.10 or Rs.15. I can give advice to my children now on managing money. I have learnt how to tackle emergency situations." However, he says that the modules are not always easy for the participants, many of whom have only studied upto class 5; but the desire to learn is palpable in the classroom. As another participant proudly shares" I sat all night with the calculator to practice calculations. Now I know how to calculate!"

Key observations

18. Based on target profiles and range of subjects that needed coverage, designing appropriate content and identifying suitable interventions was thought critical to implementation success of the sub-component. **The pedagogy adopted combined content and format in an innovative manner to address gaps in knowledge, skills, attitudes and behavior.** A classroom based training format using highly interactive methods which had been widely tested and found more effective relative to traditional teaching methods was used in training the villagers.

19. Criteria for selecting trainees ensured that women were adequately represented, since exclusion indicators for women were found to be more adverse. 'Teachable moments' were factored in through selection of trainees who were either embarking on or considering scaling up micro enterprises and therefore more receptive to investments in financial capacity. In designing the financial literacy modules, the Bank Team built on Parinaam Foundation's core modules which had been tested and well received, and added fresh content (particularly the sections on savings and small business finance) from other Bank projects where financial literacy interventions have been designed, duly adapted to reflect local profiles and financial priorities. The participants were provided with diaries to record their financial dealings to enable them keep track of their finances. The diary recordings were reviewed by trainers from the second module onwards. The literacy material was further fine-tuned to reflect socio-economic and cultural nuances of different districts of Meghalaya in which the literacy trainings were administered. Finally, to complement the classroom sessions the entertainment video

was designed to reinforce valuable information and messaging on financial literacy through a narrative that makes the characters and situation credible in a Meghalaya context, thereby helping create favorable attitudes and possibly change overt behavior.[7]

20. The trainings were closely monitored by the implementation firm, Basix Consulting and independent field visits were conducted by Parinaam Foundation and the World Bank team with close participation of GoM. Adequate coverage of geography and participation was achieved. The trainers were found to be fully conversant with the modules and proficient in delivering the training. The GoM also indicated interest in customization of the prepared material for inclusion in the school syllabus, either as part of the text book or as a classroom exercise or a co-curricular activity. However, several challenges (as also envisaged during the conception of the TA) were faced during the implementation due to the need for careful coordination among the components and a tight timeline. Key observations and learnings from the pilots are summarized below.

21. **The initial level of financial awareness varied among the regions which affected the uptake and absorption of the training. The financial priorities among the regions also differed depending on their level of financial access and awareness**. This suggests need to further customize content to the local context for financial literacy initiatives. For example, participants in the remote areas felt that the modules on savings and financial planning were most useful. The session on business planning was found to be too advanced for a class where most participants were illiterate and therefore, class duration had to be extended. Thus, selection of the participants has to be carefully done to ensure that the training is relevant and interesting for them. Since the selection is routed through the village headman, biases may creep in and various sensitivities need to be managed. Where most participants are illiterate, the pace of teaching should be slowed down to enable better understanding.

22. **Finding locally-based, educated trainers who are willing to travel to rural areas of the state was difficult.** We saw a drop-out even as the recruitment process was going on. While selecting candidates for such assignments, it is necessary to build in redundancies to take care of possible attrition and have some additional persons identified. The ERPs who received the training and complemented the trainer's role during the pilots were found to be very effective for running the program. The program also gave an opportunity to the ERPs to visit the villages in their blocks and interact

[7] A World Bank Policy Research Paper (Lisa Xu and Bilal Zia, 2012) indicates that it is especially important to tailor both content and format of education program to their target audience. The FinScope surveys demonstrate that lack of awareness of financial products and institutions is likely a major barrier to the take-up of financial products, particularly insurance. Moreover, Carpena et al. (2011) indicates that it may be easier to design interventions to improve financial awareness and attitudes than traditional numeracy skills

with the community. Using the pool of ERPs for conducting the financial literacy sessions is seen to be a good idea and should be explored in future.

23. **The law and order disruptions affected the continuity of the trainings.** It also led to several logistical rearrangements at the last minute causing further delays. In addition, the safety concerns prevented the bank officials from making visits to the villages in remote areas of Garo Hills. Given the difficult terrain, limited infrastructure, different local languages, and the law and order situation, extensive coordination is required for running the program. Dedicated resources that are locally-based should be recruited to ensure seamless implementation.

24. The last session with the bank branch official helped the participants overcome their inhibitions in approaching the bank. However, field reports reveal that bank staff is not always well-trained to facilitate such interactions and in such cases, this could lead to a possible loss of confidence in the bank. There is also a risk of the bank officials using this platform for marketing purposes, which needs to be contained. Prior discussion with bank staff by the project implementation team will likely enable them to deal with customer interactions better.

25. Feedback and early indications suggest that the intervention has i) been effective at engaging the audience (validation being the fairly robust attendance record despite challenging on-ground conditions), ii) provided useful feedback on differential appetite for financial products viz. some regions like to use formal channels for savings, G2P while others may have a greater need for credit, iii) identified that **financial capacity varies with exposure to the ecosystem of financial services** and therefore warrants a localized yet dynamic approach to literacy enhancement efforts iv) found good potential for technology led delivery channels (especially recommended for testing are **mobile enabled channels**) which can help improve awareness and access and thereby help bridge intra-state disparities; this becomes particularly relevant for conflict prone areas which is a key challenge that Meghalaya encounters.

26. Supporting initiatives by GoM in upgrading connectivity are in progress, an area the state government views as strategic and is therefore fully committed to. Where mobile connectivity is a challenge such as in the remoter parts of Meghalaya like the Garo Hills region, provision of reliable financial services in a comprehensive manner using mobile technology would be feasible once GoM's initiatives to upgrade connectivity in such areas succeed.

Component 2: Capacity Building of Partner Financial Institutions (PFIs)

II A: Risk Management at PFIs

27. The scope of work under this sub component of the TA is to assess gaps in risk management particularly credit appraisal and origination, credit risk monitoring and adequacy of MIS/IT systems to provide support; recommend improvements in risk management processes through a Risk Management work plan; and design and piloting of risk training modules. The risk management framework includes strategy, analytics on identification, response, containment, forecasting and prevention of risks. These have been drawn from field lessons on a range of PFI risk issues including credit origination and market failures in Meghalaya.

28. A situational assessment exercise at MCAB and MRB [Reports enclosed in Annex 2] to identify gaps revealed the need for risk management to be structured as a separate, specialized function and for good risk control practices to be embedded in operational processes. Despite PFI risk management processes being unstructured in their current form, they are effectively practiced in narrow operational areas or silos. The objectives of current state of practice seemed to be compliance with regulations and identifying risks after they have occurred. Both for reasons of greater regulatory preparedness and to manage the envisaged increase in complexity of business, having a dedicated risk management function at PFI's is seen as essential for building robust internal management systems. This is being encouraged by both regulators and the state government who have lent strong support to this TA activity. Consequently, senior management at respective PFI's has been involved in the process of building internal consensus for it.

KEY RISK GAPS: MCAB AND MRB

In general, the lack of diversified economic structure, small sized agricultural holdings and low scale of operations has constrained credit absorption in Meghalaya. MCAB faces significant credit risks [gross non-performing loans at 7.82% in 2013-14] due to its relatively weak credit appraisal, origination and monitoring capacity. These have remained underdeveloped due to a large share of lending absorbed by government schemes or Food Corporation of India [as part of consortium finance] which preclude the need for robust, independent credit appraisals.

MRB faces credit risks [gross non-performing loans in 2013-14 at 4.45% with expected deterioration in 2014-15] from concentrated exposure to businesses like coal trading which have seen major disruption, as well as rapid expansion of its branch network in recent years.

Besides institutional capacity, a significant factor impeding the ability to carry out due diligence at institutions is the unavailability of legitimate financial records and supporting documentation at borrower level due to the exemption on filing of income tax returns in the state of Meghalaya.

At MCAB, staffing is a constraint across levels both on account of attrition and limited ability to replace staff. Branches are unable to adequately monitor or serve customers and at the head office, senior functional positions remain unmanned. These pose operational risks.
At MRB, meeting service delivery needs from the rapid branch expansion entails navigating significant operational risks. This is because a significant number of these branches are in conflict prone areas. Key to containing this is addressing recruitment policy for local staff where the State and Central governments can play a key role. The recent increase in the number of accounts arising from customer enrolments under Jan Dhan Yojana is likely to increase work pressure on already thin staff in branches resulting in increased operational risks.

Related to the issue of weak service delivery is the issue of poor customer orientation in general as reflected in the absence of customized products to meet local needs, or any mechanism to integrate client feedback into product design. This has precluded the need for testing of new product design and delivery capacity.

Both MCAB and MRB are exposed to interest rate risk and run significant risk on short term dynamic liquidity. They do not have active asset liability management systems that track and monitor liquidity in various time buckets. Asset liability committees (ALCO), key in any bank risk architecture are yet to go beyond regulatory guidelines and actually help the banks understand risks. Treasury functions are not separated and well defined as good practice demands segregation of treasury functions viz. into front office [trading], mid office [settlement, monitoring and controls] and back office [accounting]. The lack of segregation results in enhanced risk on the investment portfolio.

Risk Management Framework

29. Based on the study of current risk management practices in the PFIs the consultant team had prepared a risk management framework for both the banks. The framework contains the actions required to be taken by the banks to improve risk management practices in various areas – organizational structure, staffing, systems and processes, MIS and skills of staff. The major recommendations are – i) Risk Committee of the board to be strengthened through improved structuring of its agenda and improving the quality of reporting, ii) setting up a risk management department in the banks under a senior officer and have major initiatives and credit proposals examined through the department iii) Setting up a risk management committee of senior officers that meets frequently to examine cross-functional risks iv) introduction of risk registers to record

risk events, v) improve the analysis of MIS to identify actual and potential risks and develop a early warning system, vi) introduce additional MIS reports on risk-related aspects, vii) Introduce risk rating of branches, viii) improve staff skills in risk management through training and exposure. The document had been discussed with the PFIs and based on their feedback finalized (Annex 3).

Training modules and possible next steps

30. The need for training of senior officials of both the PFIs in risk management, especially to increase their capacity to implement the risk management framework was strongly felt by the banks as also the stakeholders such as RBI, NABARD and GoM. The risk management framework documents were utilized to prepare training modules for the PFIs.

31. Risk training courses were conducted during May 29th – June 4th 2015. The design of modules has been derived from the gap assessment exercise for PFIs carried out earlier in this NLTA and mentioned above. Deploying participant group exercises and case studies, the trainings have been structured around sensitizing the audience to risk concepts, its operational implications, management and early warning mechanisms for control and mitigation.

32. PFI-wise modules are enclosed in Annex 4. Among others, the modules include the recommended organizational structure for Risk Management commensurate with the size and nature of PFI operations; respective responsibilities of Risk Committees, Owners and Managers; understanding various forms of risk that can potentially impact PFI operational segments and measures to mitigate them; understanding the concept and utility of building Risk Registers for an institution; Asset Liability Committees and the use of Asset Liability Management (ALM) tools; and conducting Risk Management Committee meetings.

33. The approach has been to recommend a few steps beyond regulator mandated structures. They derive from the expected trajectory of the operating profile of PFIs, factor in good governance principles and leave open the path to graduate to a more Risk Mature organization. Upgrading capacity of state level Co-operative and Rural Banks by bringing in risk orientation in business processes would allow deployment of more advanced supervisory approaches like Risk Based Internal Audits or Risk Based Supervision at a future date that would contribute to systemic stability.

34. In addition to the role of PFIs in implementation, there is a legitimate role for the state government in helping put in place appropriate mechanisms and incentives to address gaps, which could include policy reform. The state government being a key shareholder

in the PFIs has a fiduciary responsibility towards sustainable PFI operations given the latter's dominant role in rural and development finance, as also ensuring that its investments are well managed and productive.

35. The consultative and collaborative approach adopted for capacity building at PFIs has helped mitigate the risk of resistance to change. The gap assessment and development of the risk management framework was done in partnership with the PFIs. After the draft reports were ready, these were discussed and the inputs from institutions were taken on board. The training modules were prepared in a way that the framework can be seen by banks as an *operational document*. Classroom activities entailed use of banks' data for some of the critical analysis. Further the Registrar of Co-Operatives, Reserve Bank of India and NABARD (regulators) were kept apprised of the progress of work through the period of engagement. The training courses were well appreciated by the staff and respective CEOs of PFIs. The trainees identified a list of priorities and developed a roadmap for implementing risk management practices in their banks towards the end of training. RBI, NABARD and GoM in their roles of regulators, funders and members on the Boards of the PFIs have assured continuing attention to implementation of the framework by the PFIs. That said, the ability of PFIs to streamline data / information flow and build requisite technical and strategic capacity will require sustained effort.

36. The State Level Bankers Committee coordinates financial inclusion efforts and provides the interface of banks with the state government. The formation, governance, roles of different members and review of performance of financial sector has been developed over the years and the SLBC is now a well settled body. The involvement of Reserve Bank of India and other apex development banks makes this body most effective. The learnings from the NLTA will be channeled through RBI and GoM in to the SLBC to ensure that banks become aware of field developments and expectations and adapt the learning to their context.

II B: Product Development at PFIs

37. Scope of work included (i) an assessment of the capacity gap in designing financial products customized for the underserved population of Meghalaya (ii) preparing an action plan (iii) development of two customized financial products (product options could be agriculture or allied sector credit product packaged with an appropriate crop insurance product; savings products through cooperatives as BCs for banks) (iv) designing product methodologies relating to the two new products (v) training staff on the methodologies for product development.

38. Based on an assessment of capacity gaps in PFIs and demand side surveys carried out across 200 customers and potential customers of PFIs, two product prototypes [Product Methodology enclosed in Annex 5] have been developed for piloting and further testing. In summary, key requirements of customers in the target segment are flexibility in loan size and terms in relation to the specific cash flow generation cycle of the activity or enterprise; need for products to cater to marginal farmers including through minimum (secondary) collateral[8] requirements; need for storage and warehousing facilities to protect value of produce and lower market risks; and need for financing agricultural implements for productivity enhancement. Pig rearing was found to be a viable and scalable activity in most parts of Meghalaya whereas preference for dairy production was less broad based even if found strong in some areas.

39. Loans for pig rearing and broiler farming are two products suggested for piloting. These are common economic activities across Meghalaya which makes them amenable to a fair degree of standardization in loan structuring, processing and documentation on the part of PFIs. These help reduce transaction and monitoring costs and processing times, critical attributes of small rural finance. Standard loan products from institutions typically meet part of the financing needs leaving the balance to be accessed from other less formal channels. This by itself could impair viability depending on the levied rate of interest or terms of repayment from less formal channels. If PFI lending criteria allows for higher exposure, with appropriate structuring or perhaps even credit enhancements, outcomes could be more productive, sustainable and welfare enhancing.

40. The proposed products attempt to reduce this credit gap, provide a longer term, flexible repayment structure and minimum margin requirements with a back-ended performance based subsidy structure to address risks of moral hazard. Through such product customization, access to formal financial systems by groups previously without or with limited access, become possible. Monitoring requirements under such structures are more rigorous to ensure asset quality is maintained. The design entails the use of Business Correspondent [BC] services both for delivery and monitoring of credits to address this need in a cost effective manner, subject of course to appropriate oversight mechanisms to contain principal-agent risks being in place. The BC channel would also facilitate small and marginal borrowers to use bank accounts for G2P transactions and other financial products and services viz. savings, micro insurance, NREGA and remittance services. This could contribute both to BC channel viability and building financial buffers for low income households and microenterprises.

Training modules and possible next steps

[8] Primary collateral would be the produce / livestock for which financing is being provided

41. Staff training on product methodologies were administered during May 29th – June 4th 2015 at MCAB and MRB in Shillong [Training presentations are enclosed as Annex 6]. Next steps will hinge upon learnings from piloting the new products and evaluating performance. Measurement of performance is important both from the perspective of increasing 'financial inclusion' at the customer end and meeting desired credit standards for PFIs. Learnings could in the simplest case necessitate adjustments in design of individual products, or result in development of relatively more complex participatory risk sharing structures, or yield an even higher degree of innovation where these learnings combine with new public good like interventions like collating credit histories or mitigating risks through product aggregation, where possible. As explained earlier, the trained senior officer group in both these banks came out with a list of priority actions and a phased roadmap for implementing risk management practices. The CEOs of both PFIs have agreed to take the roadmap further after consultations with the board. The state government would have a large role to take it to the next level of development as would a range of participatory institutions.

II C: Responsible Finance Roadmap Design

42. To support financial sector development at the sub national level, the responsible finance roadmap [Framework enclosed in Annex 7] looks at (a) mechanisms for improved sharing of credit information through credit bureaus and the key role of the state in facilitating this; (b) design of customer information kits to improve transparency; (c) simplified customer cards giving product details, costs, effective interest rates and grievance/complaints referral points with contact information in local languages; (d) inclusion of information on customer protection issues in financial literacy material and complaint resolution process; (e) feasibility of setting up Financial Inclusion Data Center for public access in District Level Consultative Committee of Bankers and/or EFCs; and (f) training of bank staff in local customs and culture to make them competent in customer interactions; (g) conduct of periodic demand and satisfaction surveys; (h) mainstreaming the roll-out of financial literacy training based on the experience of pilots and monitoring mechanism with RBI involvement to review customer protection, grievance handling and responsible practices. SBI, MCAB, MRB and HDFC Bank were consulted and their practices studied, and RBI and NABARD were consulted for developing the responsible finance framework.

43. The public good nature of a responsible finance intervention gives the state government and regulatory authorities' viz. RBI and NABARD legitimate roles in implementation. That said, the specifics of implementation design should be based on (i) a deep understanding of local credit markets, (ii) the likely effects the lending rules will have on lending markets to ensure that well-meant policies do not lead to financial exclusion

or increases in the price of delivered credit, and (iii) the willingness to sustainably invest in financial literacy efforts for the underserved population. Better data on lending markets before and after the rules are introduced and more detailed understanding of consumer behavior would help identify effective regulatory rules and supervisory actions that could ensure more responsible lending while not limiting financial inclusion and the growth of the credit market.

44. Key to consider is the extent to which the regulator has a formal mandate and / or flexibility to set differential disclosure and oversight rules, if needed, at a sub national level. Inter institutional co-ordination may be required if disclosure norms are set in a standardized agreement between credit providers, and may need to be revised in the interest of say consumer protection.

45. Finally, when publishing product comparisons and selection advice, the use of simple framing techniques that draws on behavioral research[9] could help yield beneficial and responsible outcomes.

E. Results

46. Key Results indicators are summarized below:

Table 2: Results Indicators

	Indicator	Result achieved
Output I: Models for Financial awareness and knowledge piloted	Share of beneficiaries that are women	67%
	Number of people/entities receiving financial awareness/literacy session[10]	1780 people across the three tribal regions of the state
	Number of training and workshops conducted for financial awareness/literacy	90
Output II: Capacity of PFIs enhanced	Number of institutions supported through capacity building	2 [covers 45% of rural branches; 35% of priority sector advances in Meghalaya]
	Number of customized financial products developed at PFIs	2

47. This Bank-supported technical work in Meghalaya has yielded very encouraging results, established a rationale and need for sustained scaled up interventions in demand

[9] 'Mind, Society and Behavior' World Development Report 2015, World Bank Group
[10] Based on Week 3 MIS

and supply side inclusion activities and provided a platform for dialogue on related policy and investments for possible further work on financial sector interventions.

48. The work can support GoM evolve an appropriate *financial inclusion strategy*[11] *(including responsible finance components)* through data and diagnostics from baseline data captured through pilots as well as identifying a set of coordinated, prioritized and comprehensive framework for actions that ensures maximum impact within institutional and resource constraints. Further this can help implement a comprehensive package of reforms to encourage financial sector activity and innovation in line with the financial inclusion strategy targets, and setting monitor-able target indicators informed by data and diagnostics.

49. This work can be useful for other states as well, particularly in learnings from demand and supply side interventions on bank account usage post first phase of Pradhan Mantri Jan Dhan Yojana, the Government of India's financial inclusion program. The knowledge takeaways from this TA provide among the first empirical cases of work in this area, including not just broad program recommendations but to some degree technical specifications on intervention design that should be useful in other contexts. The enclosed outputs can be provided to other state governments as well as made freely accessible on the internet.

[11] Potentially drawing on World Bank's Action Framework for Universal Financial Access

Enclosed Annexes (link)

Annex 1: Financial Literacy Manual
Annex 2: Risk Assessment Reports for PFIs
Annex 3: Risk Management Framework
Annex 4: Risk Management Trainings
Annex 5: Product Methodology
Annex 6: Product Training Presentations
Annex 7: Responsible Finance Framework