Developments in Co-operative Banking

Chapter IV

1. Introduction

4.1 Co-operative banks, with their extensive branch network and localised operational base, play a key role in the development process, in general and credit delivery and deposit mobilisation, in particular. Different segments of the co-operative banking sector address specific credit needs of diverse sections of the population, both in terms of location as well as tenor (Chart IV.1). While co-operatives enlarge the reach of banking, both geographically and socio-economically, their conduct of banking business often poses a number of challenges, especially in terms of high levels of loan delinquency. Their large number also poses a challenge to regulation. This is compounded further by regulatory overlaps among several supervisors, including the Reserve Bank, the State Governments and the National Bank for Agriculture and Rural Development (NABARD).

Chart IV.1: Organisational Structure of Co-operative Credit Institutions

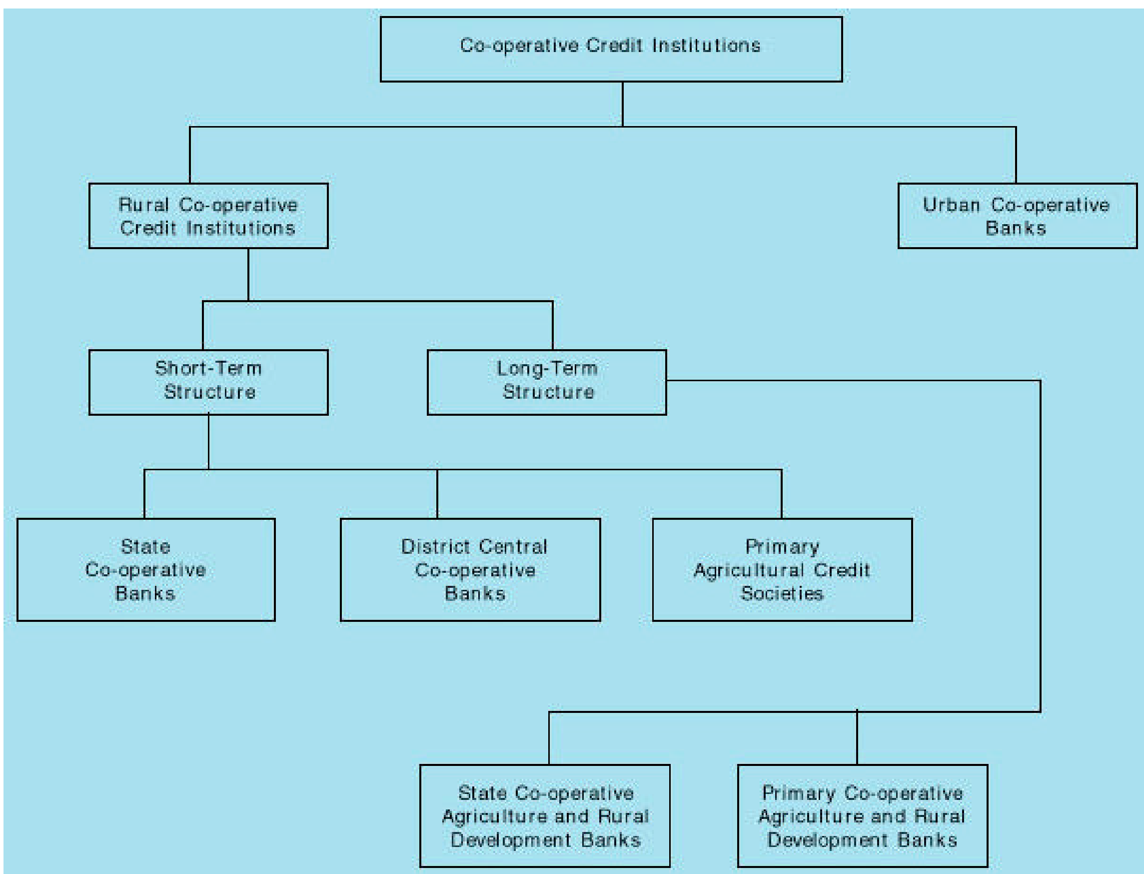


Table IV.1: Spread of Urban Co-operative Banks - State-wise
(as on March 31, 2003)

State	No. of banks	State	No. of banks

1	2	3	4	5	6
1.	Andhra Pradesh	169	16.	Manipur	5
2.	Assam	13	17.	Meghalaya	3
3.	Bihar	9	18.	Mizoram	1
4.	Chhatisgarh	14	19.	Nagaland	1
5.	Delhi	19	20.	Orissa	19
6.	Goa	7	21.	Pondicherry	1
7.	Gujarat	362	22.	Punjab	5
8.	Haryana	8	23.	Rajasthan	44
9.	Himachal Pradesh	5	24.	Tamil Nadu	136
10.	Jammu & Kashmir	4	25.	Tripura	1
11.	Jharkhand	1	26.	Uttar Pradesh	78
12.	Karnataka	324	27.	Uttaranchal	7
13.	Kerala	65	28.	West Bengal	55
14.	Madhya Pradesh	77	29.	Sikkim	1
15.	Maharashtra	670	30.	**Total**	**2,104**

4.2 The Reserve Bank continued to strengthen the co-operative bank supervisory framework during 2002-03. The Reserve Bank's initiatives in respect of UCBs included the institution of a system of off-site surveillance for scheduled UCBs, greater balance sheet disclosure norms and enhancement of governance principles. This was reinforced by several initiatives by the State Governments and NABARD as well.

4.3 Co-operative banks continued to grow during 2002-03 (Appendix Table IV.1). The profitability of co-operative banking, nevertheless, remained unsatisfactory, largely reflecting a narrowing of spreads. At the same time, however, some improvement in their asset quality was discernible.

2. Urban Co-operative Banks

4.4 UCBs are registered under the Cooperative Societies Acts of the respective State Governments. UCBs having a multi-state presence are registered under the Multi-state Cooperative Societies Act and regulated by the Central Government. Besides, the Reserve Bank also has regulatory and supervisory authority for bank-related operations under certain provisions of the Banking Regulation Act, 1949 (As Applicable to Co-operative Societies). UCBs are included in the Second Schedule of the Reserve Bank of India Act, 1934, provided their net demand and time liabilities are at least Rs.100 crore and subject to certain other related criteria.

4.5 The number of UCBs increased to 2,104 as at end-March 2003, which included 89 salary earners' banks and 133 *Mahila* banks. Of these, 163 were under liquidation as at end-March 2003. The spatial pattern of UCBs remains highly skewed - largely concentrated in few States, such as, Andhra Pradesh, Gujarat, Karnataka, Maharashtra and Tamil Nadu (Table IV.1). Apart from a few large banks, most of the UCBs are very small in size, often with a single branch (Table IV.2).

4.6 The number of scheduled UCBs climbed to 57, after the inclusion of four during 2002-03 and one in April 2003, accounting for about 35 per cent of total UCB deposits. Of these, 39 were located in Maharashtra, 11 in Gujarat, 3 in Andhra Pradesh, 2 in Goa and one each in Karnataka and Uttar Pradesh. Two banks were subsequently descheduled.

Table IV.2: Size-distribution of Urban Co-operative Banks – Deposit-wise
(as on March 31, 2003)

Deposit size	No. of banks
1	2
Less than Rs.10 crore	846
Rs.10-25 crore	459
Rs.25-50 crore	226
Rs.50-100 crore	205
Rs.100-250 crore	137
Rs.250-500 crore	42
Rs.500-1,000 crore	17
Above Rs.1,000 crore	9
Total	**1,941 #**

Excluding 163 banks under liquidation.

Regulation and Supervision of UCBs

4.7 The regulation and supervision of UCBs is performed by the Urban Banks Department (UBD) of the Reserve Bank in co-ordination with the Registrars of Co-operative Societies of the State Governments and the Central Registrar of Co-operative Societies. As UCBs are primarily co-operative societies, they are subject to dual control - on the one hand by the State Government under the Co-operative Societies Act of the respective State, and on the other, by the Reserve Bank under the Banking Regulation Act, 1949 (As Applicable to Co-operative Societies). While the registration, administration, amalgamation and liquidation of UCBs are governed by the provisions of the State Cooperative Societies Acts, the Reserve Bank exercises regulation and supervision over their banking- related functions, by virtue of the powers conferred on it by the Banking Regulation Act, 1949 (As Applicable to Co-operative Societies).

4.8 In the Monetary and Credit Policy of 2001-02, the Reserve Bank had mooted a proposal for setting up a separate supervisory body for UCBs, to take over the entire function of inspection/ supervision of UCBs in view of the adverse consequences of the present multiplicity of authorities involved in supervising UCBs. The apex body could be under the control of a separate high-level supervisory board consisting of representatives of the Central Government, State Governments and the Reserve Bank as well as independent experts and could be accorded the responsibility of inspection and supervision of UCBs to ensure their conformity with prudential, capital adequacy and management norms laid down by the Reserve Bank. The Reserve Bank has discussed the issues with the Central Government and the response of the Central Government is awaited.

4.9 UCBs have been going through a difficult phase since early 2001 with intermittent cases of irregularities. With a view to examining their problems and suggesting solutions, a Committee was constituted under the chairmanship of Shri Anant G. Geete, the then Minister of State for Finance, Government of India. In formulating its recommendations, keeping in view the need for protecting the interest of depositors and the integrity of the country's payment system, the Committee was guided by two considerations: (a) removing the avoidable irritants facing the sector, and (b) bringing UCBs under a robust regulatory framework. Based on the recommendations of the Committee, the Reserve Bank undertook several measures during 2002-03 (Box IV.1).

Licensing of New Banks

4.10 The number of UCBs has been rising rapidly in recent years. The Reserve Bank has constituted a Screening Committee of eminent external experts to examine not only the background and credentials of promoters but also to consider the environment / business projections submitted by the promoters and other factors influencing the viability of the proposed bank.

During the year under review, the Committee considered 90 proposals for the organisation of new banks, and granted 'in principle' approval in two cases. In addition, 22 proposals were closed, as the promoters of the proposed banks failed to comply with the stipulated eligibility requirements. During the period under review, 131 licences were issued for opening new branches.

Box IV.1: Action taken by the Reserve Bank in response to the Recommendations of Anant Geete Committee

- The norms of classifying UCBs as 'weak' and 'sick' were modified with effect from March 31, 2002. A new system of grading of banks based on their level of CRAR, level of net NPAs, record of losses and compliance with certain regulatory requirements has been introduced.
- Non-scheduled UCBs have since been allowed to place their surplus funds with strong scheduled UCBs, subject to certain conditions.
- The ceiling on unsecured advances granted to any single borrower / connected group has been enhanced for sound UCBs. The revised limits are Rs. 50,000 for non-scheduled UCBs with demand and time liabilities (DTL) of less than Rs. 10 crore, Rs. 1 lakh for non-scheduled UCBs with DTL of more than Rs. 10 crore and Rs. 2 lakh for scheduled UCBs.
- As announced in the Monetary and Credit Policy for 2003-04, both 'gold' loans and small loans up to Rs. 1 lakh shall continue to be governed by the 180-day norm for recognition of loan impairment.
- UCBs will be eligible to apply for opening extension counters in residential colonies. The condition of having accounts of at least 500 direct beneficiaries for extension counters has been withdrawn.

Inspections

4.11 The on-site financial inspection carried out by the Reserve Bank continues to be one of the main instruments of supervision over UCBs. During 2002-03, the Reserve Bank carried out statutory inspections of 944 UCBs as against 847 UCBs conducted during the previous year.

Off-site surveillance

4.12 The Reserve Bank has been gradually reinforcing the traditional practice of on-site supervision with off-site supervision. With a view to strengthening the system of supervision of UCBs, the Reserve Bank has introduced, to begin with, a system of off-site surveillance for scheduled UCBs (Box IV.2).

Supervision of newly licensed UCBs

4.13 Some of the newly licensed UCBs have been reported to be facing financial problems including default in repayment of deposits. In order to step up supervisory control over such banks, Regional Offices of the Reserve Bank were advised to take the following measures:

- Submission of statutory returns by newly licensed UCBs to be closely watched and scrutinised on priority basis.
- Continuous defaults in submission of returns / maintenance of CRR/SLR by UCBs to be brought to the notice of the Reserve Bank for prompt corrective action.
- Registered notices to such banks in the event of non-submission of the returns after one month from their due date to be sent.
- Special scrutiny of books of accounts of banks defaulting in maintenance of CRR/ SLR for more than three months to be conducted by Regional Offices of the Reserve Bank.

Box IV.2: Off-Site Surveillance of Urban Co-operative Banks

The Reserve Bank set up a Prudential Supervisory Reporting System (PSRS) for off-site surveillance (OSS) of urban cooperative banks (UCBs) as part of the new supervisory strategy piloted by the Board for Financial Supervision. While the main objective of the PSRS is to provide relevant information to the Reserve Bank on areas of prudential interest, the OSS returns have also been designed to address the management information needs and to strengthen the Management Information System (MIS) capabilities within the reporting institutions. This is in consonance with the collateral objective of sensitising bank managements to the prudential concerns of the supervisory authority, and thereby facilitating self-regulation. The PSRS comprises a set of eight returns designed to monitor regulatory compliance and obtain information from UCBs on areas of prudential interest. Prudential concerns monitored through these returns relate to solvency, liquidity, capital adequacy, asset quality/portfolio risk profile, concentration of exposures, and connected or related lendings of the supervised institutions.

A beginning towards off-site surveillance of UCBs was made in April 2001 with the introduction of a set of 10 OSS returns for all (then 52) scheduled UCBs. These UCBs submit OSS returns to respective Regional Offices of the Reserve Bank to enter into the database.

The Joint Parliamentary Committee has directed that all UCBs with deposits over Rs.100 crore should be brought under the ambit of off-site surveillance of the Reserve Bank. Presently, the PSRS covers all scheduled UCBs. The application package being developed as part of the computerisation project would be made available to the existing 55 scheduled UCBs before the end of 2003. Upon successful implementation in scheduled UCBs, the coverage would be gradually extended to all banks with a deposit size of over Rs. 100 crore, followed by banks with deposits of over Rs.50 crore and the smaller banks.

Unlike similar off-site surveillance systems elsewhere, the database of the Urban Banks

Department (UBD) of the Reserve Bank, in addition to the OSS returns, would also have on-site inspection data (including rating models), as well as data in respect of all other regulatory and supervisory returns submitted by the banks. Together with OSS data, it would provide a comprehensive account of bank / bank groups.

In order to capture data at source, *i.e.*, at the UCBs, the Reserve Bank is also developing software for the UCBs to assist in preparation and submission of all supervisory and regulatory returns (including OSS returns) electronically. The returns, submitted by UCBs to the respective Regional Offices of UBD, would be automatically uploaded to the database at the Regional Office after checking for consistency and accuracy of the data. This data would then be replicated to the Central Office server on a daily basis. The facility for replication of data to the Central Office already exists in respect of 14 out of the 17 Regional Offices of UBD and OSS data from these Regional Offices are regularly transmitted to the Central Office.

- New banks to be visited by respective regional heads of UBD to have an 'on the spot' feel of their working.

Interactive mechanism for supervision

4.14 In its meetings with the Reserve Bank and the Board for Financial Supervision, in context of the irregularities in recent securities transactions of certain UCBs, the Public Accounts Committee (PAC) of Parliament had stressed that the supervisory focus should be on prevention of irregularities rather than taking *post facto* penal action. It was felt that, to meet this end, there was a need to evolve an interactive mechanism for supervision of UCBs. Accordingly, it was decided by the Reserve Bank that:

- The system of market intelligence would be further strengthened to pick up early warning signals from the sector and initiate prompt corrective action.
- A code of responsibilities for auditors of UCBs, especially chartered accountants, would be prepared.
- Regional Offices of the Reserve Bank would address the need for training auditors of UCBs and hold discussions with the Association of Chartered Accountants / leading firms of chartered accountants.
- There would be a revision of the guidelines of statutory audit rating system.
- The Reserve Bank would write to State Governments for appointment of professional chartered accountants, from a panel prepared by the Comptroller and Auditor General, for undertaking statutory audit of UCBs.

Weak banks

4.15 Based on the new classification, the number of UCBs classified under the class II / III / IV category as on March 31, 2003 stood at 944. During the period under review, 142 weak banks could not comply with the stipulated minimum capital requirements.

Prudential norms and ALM Guidelines for UCBs

4.16 The Reserve Bank continued with its efforts to enhance the financial health of UCBs. In pursuance, certain policy changes were made in regard to prudential norms on capital adequacy, income recognition, asset classification and provisioning in respect of UCBs.

4.17 Capital adequacy requirements for UCBs are, at present, lower than those prescribed for commercial banks. By March 31, 2005, all UCBs would have to fall in line with the discipline applicable to commercial banks. Accordingly, they are required to adhere to capital adequacy standards in a phased manner over a period of three years (Table IV.3).

4.18 The Reserve Bank has also prescribed asset-liability management norms to scheduled UCBs, effective July 1, 2002. These norms are to be extended to non-scheduled UCBs in due course, in a phased manner.

Extension of 90-day NPA norms

4.19 The Reserve Bank has been tightening prudential norms in line with the best international practices in recent years. Accordingly, to ensure greater transparency, the time period for reckoning an advance as non-performing would be reduced from the existing norm of 180 days to 90 days, with effect from March 31, 2004. In this connection, banks were instructed to move over to charging of interest at monthly rests, with effect from April 1, 2002. However, 'gold' loans and small loans up to Rs. 1 lakh will continue to be covered by the 180-day norm for recognition of loan impairment.

Asset Classification

4.20 In accordance with the recommendations of the Committee on Banking Sector Reforms (Chairman: Shri M. Narsimham), an asset, which has remained in the sub-standard category for 12 months will be treated as 'doubtful' with effect from March 31, 2005. UCBs are permitted to phase the consequent additional provisioning, over a four-year period commencing from the year ending March 31, 2005, with a minimum of 20 per cent each year.

Table IV.3: CRAR for Urban Co-operative Banks

(per cent of risk-weighted assets)

As on March 31	CRAR for scheduled UCBs	CRAR for non-scheduled UCBs	*Memo:* CRAR for Commercial Banks
1	2	3	4
2002	8	6	9
2003	9	7	9
2004	As applicable to commercial banks	9	9
2005	As applicable to commercial banks	As applicable to commercial banks	

Investment portfolio of UCBs: Investment in Government and Other Approved Securities

4.21 In the light of developments in the urban co-operative banking sector in 2001, to safeguard the interest of depositors, it was made mandatory for UCBs to hold a proportion of their SLR assets in the form of Government and other approved securities. UCBs have also been advised to effect purchase / sale transactions in Government securities necessarily through the SGL account with the Reserve Bank or Constituent SGL accounts with the designated agencies or dematerialised accounts with other banks/depositories. They are required to route such transactions through the NDS / CCIL system. They are also required to make fresh investments in permitted instruments such as PSU bonds, bonds / equity of specified All-India Financial Institutions, infrastructure bonds issued by Financial Institutions, and units of UTI only in dematerialised form. UCBs have been prohibited from dealing with brokers as counter-parties, and advised to have their transactions in Government securities subjected to concurrent audit every quarter, and confirm to the Reserve Bank that the investments as reported by the UCB, are, in fact, owned by it.

4.22 On the recommendations of the Anant Geete Committee, the non-scheduled UCBs have been allowed to place their surplus funds with strong scheduled UCBs. UCBs have also been advised to limit their call money borrowings to 2 per cent of their aggregate deposits as at end-March of the previous financial year. UCBs have, however, been permitted to lend freely in the call money market without any limit. They have been advised not to issue banker's cheques / pay orders/demand drafts against instruments presented for clearing unless the proceeds thereof are collected and credited to the account of the parties concerned. Urban banks have also been advised not to issue such instruments by debit to cash credit / overdraft accounts which are already overdrawn beyond the limit sanctioned or likely to be overdrawn with the issue of such instruments.

Bank Finance against Shares and Debentures

4.23 From October 2001, UCBs are permitted to lend to individuals only with a per-party-limit of Rs.5 lakh (physical security) and Rs.10 lakh (in demat form). A return has been prescribed to monitor compliance in this regard.

Advances against Security of Real Estate

4.24 UCBs have been cautioned to desist from indiscriminate financing against the security of real estate and advised to strictly follow the policy guidelines issued by the Reserve Bank in this regard.

Unsecured Advances

4.25 On the recommendation of the Geete Committee, the ceiling on unsecured advances granted by UCBs to any single borrower / connected group has been enhanced, but only for sound UCBs[2] .

Prohibition on loans to Directors

4.26 The overall ceiling on loans and advances (both secured and unsecured) to all directors of UCBs, their relatives and concerns in which they are interested was brought down from the earlier ceiling of 10 per cent of the bank's demand and time liabilities (DTL) to 5 per cent.

Following recommendations of the Joint Parliamentary Committee and with a view to preventing certain irregularities which surfaced in the case of some UCBs, a total ban has been imposed, with effect from October 1, 2003, on grant of loans and advances to directors of UCBs, their relatives and concerns in which they have interest.

Interest rates on Advances

4.27 In April 2002, the stipulation of Minimum Lending Rate (MLR) was withdrawn for UCBs. However, in the current environment of low inflation, unreasonably high or low rates on lending could adversely affect the earning and overall quality of their credit portfolio. UCBs have, therefore, been encouraged to review both their minimum and maximum interest rates charged on advances and align these rates within reasonable limits. They are also required to publish and prominently display the rates in every branch.

Guidelines for Recovery of Dues Relating to NPAs

4.28 The Reserve Bank has issued guidelines to all UCBs on sale of financial assets to securitisation companies (SC) / reconstruction companies (RC) created under the Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest (SARFAESI) Act, 2002.

4.29 In view of the increasing trend in NPAs of UCBs, the Reserve Bank has issued guidelines to the State Governments for one-time settlement applicable to all NPAs which have become 'doubtful' or 'loss' as on March 31, 2000 with outstanding balances of Rs.10 crore and below on the cut-off date, and NPAs classified as 'sub-standard' as on March 31, 2000 which have subsequently turned 'doubtful' or 'loss'.

4.30 The guidelines will also cover cases in which UCBs have initiated action under the SARFAESI Act, 2002, as also those pending before courts / Board for Industrial and Financial Restructuring (BIFR), subject to a 'consent' decree being obtained from the Court / BIFR. The scheme is to be notified by the respective State Governments and approved by the Board of Directors of the banks concerned within the provisions of the Co-operative Societies Act / rules / notifications / administrative guidelines issued by the Registrar of Co-operative Societies concerned. A Settlement Advisory Committee (SAC) should be constituted by the UCBs to review all applications received and to recommend eligible cases to the Competent Authority for sanction.

Frauds and filing of Police Complaints

4.31 UCBs have been advised that, as a general rule, all cases of frauds on banks, whether committed by outsiders on their own or with connivance of bank officials, or committed by banks' officials themselves, should invariably be reported to the investigating agencies. Criminal cases, where appropriate, should be filed with the courts, immediately after the bank has concluded that a fraud has been perpetrated. Taking into account recent domestic and international developments in the area of financial frauds, related to money laundering and terrorist activities, detailed instructions have been issued to all UCBs, reiterating and consolidating existing instructions on “Know Your Customer” (KYC) norms and cash transactions.

Professionalisation of Management

4.32 The requirement regarding the appointment of at least two directors on the boards of newly constituted UCBs, with suitable banking experience or with chartered accountancy qualifications with bank audit experience, has now been extended to all existing UCBs. All UCBs have been advised to amend their by-laws to incorporate the above requirement.

4.33 UCBs have also been advised that the Audit Committee of their Board of Directors should review the internal audit / statutory audit / the Reserve Bank inspection reports and monitor the action taken to rectify the deficiencies pointed out in such reports. Based on the observations of the Joint Parliamentary Committee, all the UCBs have been directed to implement concurrent audit.

Electronic Data Processing (EDP) – Audit System

4.34 It has been decided to introduce an EDP audit system for UCBs which have fully / partially computerised their operations. Detailed guidelines have been issued to them in this regard. Accordingly, an EDP Audit Cell is to be immediately constituted in banks which have an independent Inspection and Audit Department. As for other banks, they are required to create a dedicated group of persons who, when required, can perform functions of EDP auditors.

Technical Assistance Programme for Strengthening MIS in Co-operative Banks

4.35 The Reserve Bank has set in motion a Technical Assistance Programme to strengthen the Management Information System in cooperative banks. The programme, which has been put into operation on the direction of the Board for Financial Supervision, is being implemented in association with the National Institute of Bank Management, Pune and the College of Agricultural Banking, Pune. The programme is being largely funded by the Reserve Bank, with a nominal contribution by the beneficiary institutions.

Inspection under Section 35 of the Banking Regulation Act, 1949 (As Applicable to Co-operative Societies)

4.36 It has been decided to give UCBs a maximum period up to 4 months from the date of the inspection report, to remove the irregularities pointed out in the inspection report. A certificate signed by the Chief Executive Officer of the bank or the Compliance Officer duly countersigned by the Chief Executive Officer and supported by board resolution, to the effect that all irregularities / violations of the Reserve Bank directions / guidelines / deficiencies pointed out in the inspection report have been fully rectified / complied with, should be furnished by the cooperative bank to the Regional Office concerned within four months from the date of the inspection report. In case of non-compliance, the Reserve Bank will invoke penal provisions contained in the Banking Regulation Act, 1949 (As Applicable to Co-operative Societies).

Introduction of Grading System

4.37 UCBs and their associations represented to the Reserve Bank for a review of the norms and for a change in the nomenclatures of weak and sick due to possible stigma attached to these terms. Accordingly, it has been decided to introduce a system of rating of UCBs into four grades and implement a system of 'corrective action', depending on the grade assigned to the bank, so as to arrest further deterioration in the financial position of these banks. The system of classifying UCBs as 'weak' or 'sick', which was introduced with effect from March 31, 2002 has, thus, been replaced by a new system of grading of banks based on their level of CRAR, net NPAs, record of losses and compliance with liquidity requirements. A corresponding framework of supervisory action has also been put in place.

Supervisory Rating System

4.38 A system of supervisory rating for UCBs, under the Capital Adequacy, Asset Quality, Management, Earnings, Liquidity and Systems (CAMELS) model, has been introduced. The rating system is initially being implemented for scheduled UCBs commencing from the year ending March 31, 2003. A simplified rating system will be made applicable to non-scheduled UCBs with effect from March 31, 2004.

4.39 With a view to enhancing transparency in the disclosures made in the balance sheets, all UCBs with deposits of Rs. 100 crore and above have been advised to disclose, with effect from the year ending March 31, 2003, specified information on CRAR, investments, advances against real estate/shares and debentures, advances made to directors / their relatives / firms or companies in which the directors have interest, cost of deposits, level of non-performing assets, profitability and movement of provision against NPAs as "notes on accounts" to balance sheets. They are also required to indicate their record of payment of deposit insurance premium to the Deposit Insurance and Credit Guarantee Corporation (DICGC) (Box IV.3).

Financial Performance

4.40 The growth in the UCB sector decelerated during 2002-03, reflecting in part the effect of past irregularities (Table IV.4). Notwithstanding the pick-up in credit demand in the economy, the UCBs' credit-deposit ratio recorded a fall during 2002-03. Lead information for large UCBs, based on the reporting system set up by the Working Group on Money Supply (Chairman: Dr. Y.V. Reddy), suggests that deposits declined marginally by Rs. 30 crore during 2003-04 (up to August), while credit offtake declined by 5.6 per cent.

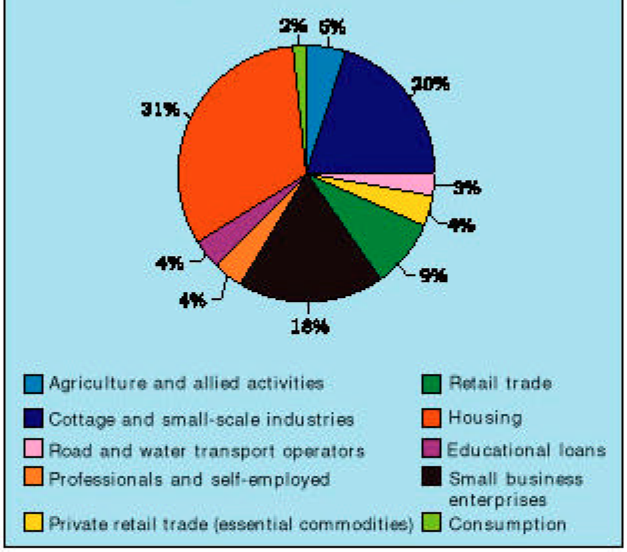
Refinance Facilities

4.41 The Reserve Bank continued to extend refinance facilities under various provisions of the Reserve Bank of India Act, 1934 in respect of advances granted by UCBs to tiny / cottage industrial units, covered under 22 broad groups of industries.

Priority Sector Lending

4.42 As at end-March 2002, 1,817 UCBs achieved the stipulated target of allocating 60 per cent of their total advances to priority sector and 1,407 banks accomplished the required level of 15 per cent of total advances to weaker sections in the priority sector. Of the then existing 51 scheduled UCBs, 28 banks achieved the required priority sector lending target of 60 per cent of the total advances, and 11 banks met the prescribed level of lending to weaker sections. In terms of composition of priority sector lending, there was a shift away from lending to small business enterprises and cottage and small-scale industries to housing (Chart IV.2).

Chart IV.2: Distribution of Priority Sector Lending by UCBs (end-March 2002)



Box IV.3: Deposit Insurance and Co-operative Banks

In terms of section 5 (ccvi) of the Banking Regulation Act, 1949 (As Applicable to Co-operative Societies), a primary credit society is permitted to undertake banking business. The primary credit societies are also permitted to accept deposits from the public withdrawable by cheques. However, such primary co-operative societies with paid up capital and reserves of more than Rs. one lakh are automatically defined as primary co-operative banks and, therefore, come under the purview of Banking Regulation Act, 1949 (As Applicable to Co-operative Societies) and are registered with the DICGC.

In terms of section 2(gg) of the DICGC Act 1961, in order to be an "eligible co-operative bank" for the deposit insurance cover, the law governing the UCBs entails the following provisions:

- An order for winding up, or an order sanctioning a scheme of compromise, or amalgamation, or reconstruction of the bank may be made only with the prior sanction in writing of the Reserve Bank.
- An order for the winding up of the bank shall be made if so required by the Reserve Bank in circumstances referred to in section 13 D of the DICGC Act.
- If so required, by the Reserve Bank in the public interest, an order shall be made for the supersession of the Committee of Management of the bank and the appointment of an administrator.

Presently, the Co-operative Societies Acts of four States (Meghalaya, Mizoram, Nagaland, and Arunachal Pradesh) and four Union Teritories (Lakshadweep, Chandigarh, Andaman & Nicobar Islands, and Dadra Nagar Haveli) do not have enabling provisions as required under section 2(gg) of the DICGC Act. The matter has been pursued with the respective State Governments to promote suitable legislative amendments in their co-operative acts, so that the banks, governed, by these acts, could also be brought under the purview of the DICGC.

Some of the State Governments like Madhya Pradesh and Karnataka have enacted a parallel legislation for cooperative societies, primarily to give a greater degree of autonomy to the unaided societies (*e.g.*, Madhya Pradesh Swayatta Adhiniyam, 1999 and Karnataka Souharda Sahakari Act, 1997). These enactments do not have the provisions as required by the DICGC Act. The matter has been taken up with the respective State Governments to initiate appropriate amendments to the State Acts. Further, in accordance with the National Policy on Co-operatives, the Co-operative Societies Acts of many States are being amended and recently the new Multi-State Co-operative Societies Act has been enacted to give effect to the new policy. This Act also does not meet all the requirements of the DICGC Act.

An institutional arrangement has been put in place for receiving from DICGC the names of banks which have defaulted in payment of deposit insurance premium and to follow up the matter with the banks concerned to try and ensure that no UCB operates without the DICGC cover at any point of time. The Regional Offices of the Reserve Bank have been advised to closely monitor the position of non-payment of DICGC premium with the concerned banks to ensure prompt payment of the premium.

The Inspecting Officers of the Reserve Bank have also been advised to incorporate the deficiencies observed in compilation / submission of DICGC returns, payment of premium *etc.*, in the Inspection Reports and furnish an extract of the same to DICGC.

UCBs have been advised to indicate the position of payment of DICGC premium in the Directors' Report attached to their annual reports.

Table IV.4: Major Aggregates of Urban Co-operative Banks

(growth rates in per cent)

Indicator	2000-01	2001-02 P	2002-03 P
1	2	3	4
Deposits	13.6	15.1	9.1
Borrowings	40.3	N.A.	N.A.
Loans Outstanding	18.2	14.1	4.5
Credit-Deposit Ratio	67.3	66.7	63.9

P: Provisional.
N.A. : Not Available.

Table IV.5: Gross Non-Performing Assets of Urban Co-operative Banks

(Amount in Rs. crore)

Date	No of	Gross	Gross NPA

(March 31)	Reporting UCBs	NPAs (Rs.crore)	as a percentage of total Advances
1	2	3	4
1999	1,474	3,306	11.7
2000	1,748	4,535	12.2
2001	1,942	9,245	16.1
2002	1,937	13,706	21.9
2003	1,941	13,647	21.0

Non-Performing Assets

4.43 The asset quality of UCBs, with gross non-performing assets (NPAs) of banks at 21.0 per cent of their aggregate advances as at end-March 2003, continues to be a cause of concern (Table IV.5). The level of NPAs of UCBs had jumped during 2001-02 because of difficulties faced by a few banks in Gujarat.

Liquidation

4.44 The Reserve Bank continues to maintain a constant vigil over the performance of UCBs. Due to their financial position, licences have been cancelled / licence applications have been rejected and the Registrars of Co-operative Societies were asked to initiate liquidation proceedings in respect of total 23 banks (Tables IV.6 and IV.7).

Financial Performance of Scheduled UCBs

4.45 The combined size of scheduled UCBs continued to expand during 2002-03 reflecting both the expansion of the existing banks as well as the entry of new scheduled banks (Table IV.8).

4.46 The composition of liabilities continued to undergo a shift with the share of deposits coming down (Table IV.9). The asset side also witnessed a change with the share of investments increasing while the share of bank credit has been declining. Scheduled UCB deposit growth decelerated to 3.3 per cent during the first half of 2003-04 from 10.6 per cent during the comparable half of the previous year. Credit growth, in tandem, declined by 6.1 per cent in sharp contrast to an increase of 2.8 per cent last year. The sharp increase in scheduled UCB deposits last year, reflected in part, the addition of new banks. During 2003-04 so far, while a bank has been added, two others have been descheduled.

4.47 Scheduled UCBs continued to record a net loss for the third year in succession (Table IV.10 and Appendix Table IV.2). Interest income declined as a proportion of total income as interest rates continued to soften and the share of the loan portfolio continued to shrink. Although interest expended also declined, the reduction was much less pronounced leading to a further narrowing of spreads (Table IV.11).

Table IV.6: Banks Under Liquidation - Cancellation of Licence

Bank	Date of speaking order	State
1	2	3
Armoor Co-op. Urban Bank Ltd., Armoor	August 26,2002	Andhra Pradesh
First City Co-op. Urban Bank Ltd., Hyderabad	April 5, 2002	Andhra Pradesh

Jawahar Co-op. Urban Bank Ltd., Hyderabad	May 8, 2002	Andhra Pradesh
Megacity Co-op. Urban Bank Ltd., Hyderabad	August 3, 2002	Andhra Pradesh
Mother Teresa Co-op. Urban Bank Ltd., Hyderabad	October 14, 2002	Andhra Pradesh
Praja Co-op. Urban Bank Ltd., Hyderabad	July 2, 2002	Andhra Pradesh
Datia Nagarik Sahakari Bank Ltd., Datia	May 14, 2002	Madhya Pradesh
The Peoples Co-op. Bank Ltd., Muzaffarpur	April 22, 2002	Bihar
The Begusarai Urban Dev. Co-op. Bank Ltd., Begusarai	April 22, 2002	Bihar
The Madhepura Urban Dev. Co-op. Bank Ltd., Madhepura	April 22, 2002	Bihar
Shree Adinath Sahakari Bank Ltd., Pune	June 25, 2002	Maharashtra
Shree Labh Co-op. Bank Ltd., Mumbai	July 31,2002	Maharashtra
Kalwa Belapur Sahakari Bank Ltd., Navi Mumbai	August 10, 2002	Maharashtra
Maa Sharda Mahila Nagari Sahakari Bank Ltd., Akola	August 10, 2002	Maharashtra
Independence Co-op. Bank Ltd., Deolali Camp	October 30, 2002	Maharashtra

Table IV.7: Rejection of Application for issue of Licence for Urban Co-operative Banks

Bank	Date	State
1	2	3
Shri Jamnagar Nagarik Sahakari Bank Ltd., Jamnagar	December 27, 2002	Gujarat
Rajampet Urban Co-op. Bank Ltd., Hyderabad	July 3, 2002	Andhra Pradesh
Yamunanagar UCB, Yamunanagar	August 6, 2002	Chandigarh
Theni Urban Co-op. Bank Ltd., Chennai	May 23, 2002	Tamil Nadu
Thiruvanaikovil Co-op. Urban Bank Ltd., Chennai	May 20, 2002	Tamil Nadu
The Nalanda Urban Dev. Co-op. Bank Ltd., Biharsharif	May 23, 2002	Bihar
The Shillong Co-op. Urban Bank Ltd., Meghalaya	May 23, 2002	Meghalaya
The Shillong Co-op. UBD Ltd., Shillong	October 26, 2002	Meghalaya

3. Rural Co-operatives

4.48 There is now a three-tier pyramidal cooperative credit structure in the rural cooperative banking sector with the state cooperative bank (StCB) at the apex (state) level, district central co-operative bank (DCCB) at the intermediate (district) level and primary agricultural co-operative society (PACS) at the grassroots (village) level, essentially to ensure flows of short-term credit for production purposes. Similarly, to provide long-term investment credit, both federal and unitary systems of land development banks were put in place depending on the suitability of the structure for the State in question. Thus, at the State level, state co-operative agricultural and rural development banks (SCARDB) and at the primary level, primary co-operative agricultural and rural development banks (PCARDB) or the branches of SCARDBs were established to facilitate augmentation of capital formation in agriculture.

Table IV.8: Scheduled Urban Co-operative Banks – Summary Statistics

(Amount in Rs. crore)

Particular	March 31, 2002	March 31, 2003
1	2	3
No. of scheduled UCBs	52	56
Share Capital	545	627
Reserves	1,931	2,195
Deposits	35,215	36,380
Borrowings	678	542
Loans and Advances	23,308	23,943
Investment in Government		

and other approved securities	8,630	10,487
Investments (Non-SLR)	4,973	3,161

Note : Based on UCB returns. Reserves include statutory reserves and other free reserves and provisions not in the nature of outside liabilities.

Table IV.9: Liabilities and Assets of Scheduled Urban Co-operative Banks

(As on March 31)

(Amount in Rs. crore)

Item	2002		2003*	
	Amount	Share (Per cent)	Amount	Share (Per cent)
1	2	3	4	5
Liabilities				
1. Capital	531	1.1	627	1.2
2. Reserves	5,940	12.6	7,534	14.4
3. Deposits	34,285	72.4	36,683	70.0
4. Borrowings	637	1.3	571	1.1
5. Other Liabilities	5,946	12.6	7,022	13.3
Total Liabilities	**47,340**	**100.0**	**52,437**	**100.0**
Assets				
1. Cash	2,266	4.8	2,578	4.9
2. Balances with Banks	1,897	4.0	1,740	3.3
3. Money at call and short notice	318	0.7	303	0.6
4. Investments	12,997	27.4	14,524	27.7
5. Loans and Advances	22,468	47.5	23,726	45.2
6. Other Assets	7,393	15.6	9,566	18.3
Total Assets	**47,340**	**100.0**	**52,437**	**100.0**

* Data comprises of 49 audited banks and 8 unaudited banks including one UCB scheduled in April 2003.

Source: Balance sheet of respective banks.

4.49 Over the years, co-operatives have grown substantially in terms of network, coverage and outreach - as at end-March 2002, there were 30 StCBs (847 branches), 368 DCCBs (12,652 branches) and about 99,000 PACS. As at end-March 2002, there were 20 SCARDBs and 768 PCARDBs. While co-operatives form the major component of rural credit system in India, of late, UCBs have been also providing agricultural credit in their area of operations.

Table IV.10: Financial Performance of Scheduled Urban Co-operative Banks

(Amount in Rs. crore)

Item	2001-02	2002-03*	Variation	
			Absolute	Percentage
1	2	3	4	5
A. Income (i+ii)	**5,069 (100.0)**	**5,139 (100.0)**	**70**	**1.4**
i) Interest Income	4,449 (87.8)	4,498 (87.5)	49	1.1
ii) Other Income	620 (12.2)	641 (12.5)	21	3.3

B.	**Expenditure (i+ii+iii)**	**5,485 (100.0)**	**5,735 (100.0)**	**251**	**4.6**
	i) Interest Expended	3,404 (62.1)	3,415 (59.6)	12	0.4
	ii) Provisions and Contingencies	1,136 (20.7)	1,317 (23.0)	181	15.9
	iii) Operating Expenses	945 (17.2)	1,003 (17.5)	58	6.1
	of which : Wage Bill	537 (9.8)	564 (9.8)	26	4.9
C.	**Profit**				
	i) Operating Profit	720	721	-1	0.1
	ii) Net Profit	-416	-596	-181	—
D.	**Total Assets**	**47,340**	**52,437**	**5,097**	**10.8**

* Data comprises of 49 audited banks and 8 unaudited banks including one UCB, scheduled effective April 2003.

Notes:

1. For details see notes to Appendix Table III.2.
2. Figures in brackets are percentage shares to the respective total.

Source: Balance sheet of respective banks.

State Co-operative Banks (StCBs)

4.50 The composition of the liabilities of the state co-operative banks (StCBs) in terms of major constituents (*viz*., capital, reserves, deposits, borrowings and other liabilities) remained broadly unaltered between end-March 2001 and end-March 2002 (Table IV.12). Scheduled state cooperative banks recorded an increase of 1.9 per cent during the first half of 2003-04 in sharp contrast to a decline of 7.8 per cent during the comparable period of the previous year. The seasonal decline in credit offtake, at 2.4 per cent, was also lower than that of 5.0 per cent last year.

Table IV.11: Select Financial Ratios of Co-operative Banks*

(per cent of assets)

Item	Scheduled UCBs		StCBs		CCBs	
	2001-02	2002-03	2000-01	2001-02	2000-01	2001-02
1	2	3	4	5	6	7
Operating Profit	1.52	1.34	1.70	2.08	1.73	1.90
Net Profit	-0.88	-1.14	0.39	0.31	0.06	-0.03
Income	10.71	9.80	10.27	10.14	10.75	10.74
Interest Income	9.40	8.58	9.90	9.62	10.17	10.14
Other Income	1.31	1.22	0.37	0.52	0.58	0.60
Expenditure	11.59	10.94	9.88	9.83	10.69	10.76
Interest Expended	7.19	6.51	7.85	7.33	7.19	7.14
Operating Expenses	2.00	1.91	0.71	0.73	1.83	1.70
Wage Bill	1.13	1.07	0.53	0.53	1.42	1.31
Provisions and Contingencies	2.40	2.51	1.32	1.77	1.67	1.93
Spread (Net Interest Income)	2.21	2.06	2.04	2.29	2.98	3.00

* As ratio to total assets.

Table IV.12: Liabilities and Assets of State Co-operative Banks

(As on March 31)

(Amount in Rs. crore)

Item	2001		2002 P	
	Amount	Share (Per cent)	Amount	Share (Per cent)
1	2	3	4	5
Liabilities				
Capital	695	1.3	807	1.4
Reserves	5,144	9.8	5,516	9.6
Deposits	32,626	62.2	35,500	61.8
Borrowings	11,693	22.3	11,550	20.1
Other Liabilities	2,318	4.4	4,105	7.1
Total Liabilities	**52,476**	**100.0**	**57,478**	**100.0**
Assets				
Cash and Bank Balance	2,313	4.4	3,492	6.1
Investments	16,156	30.8	16,436	28.6
Loans and Advances	29,861	56.9	32,111	55.9
Other Assets	4,146	7.9	5,439	9.5
Total Assets	**52,476**	**100.0**	**57,478**	**100.0**

P: Provisional.

4.51 The recovery performance of StCBs as a proportion of demand[3] at the all-India level declined from 84 per cent in 2000-01 to 81 per cent in 2001-02. Among the various States / Union Territories, the recovery performance improved considerably in Chandigarh, Andaman & Nicobar, Jammu & Kashmir, Nagaland, Tripura, Mizoram and West Bengal while it deteriorated significantly in Bihar, Assam and Pondicherry. States/Union Territories where StCBs achieved more than 90 per cent recovery during 2001-02 include Haryana, Madhya Pradesh, Tamil Nadu, Karnataka, Kerala, Punjab, Chattisgarh and Gujarat (Appendix Table IV.3).

Financial Performance of StCBs

4.52 Despite an increase in the spread (net interest income), higher expenses for provisions and contingencies led to a decline in the net profit for the StCBs. Out of 30 StCBs, 23 have made profits aggregating to Rs. 270 crore, while 7 made losses amounting to Rs. 93 crore (Table IV.13).

Central Co-operative Banks

4.53 The composition of the liabilities of CCBs remained broadly unaltered between end-March 2001 and end-March 2002 (Table IV.14). Deposits continued to account for over 60 per cent of the total liabilities while reserves recorded a strong growth of 17.8 per cent.

4.54 At the all-India level, the recovery performance of CCBs as a proportion of demand, more or less, remained the same. A few States, such as, Bihar, Chhattisgarh, Jammu and Kashmir, Madhya Pradesh, Punjab and West Bengal registered marked improvement in recovery performance while the recovery performance in Maharashtra and Karnataka deteriorated. Punjab, Tamil Nadu and Uttaranchal were the only States, which achieved more than 80 per cent recovery during 2001-02.

Financial Performance of CCBs

4.55 CCBs registered a marginal loss in 2001-02 as compared with a marginal profit during the previous year (Table IV.15). Interest income continued to account for nearly 95 per cent of the total income, while interest expenditure accounted for nearly two-thirds of total expenditure. During 2001-02, 258 CCBs made profits amounting to Rs. 698 crore, while 110 CCBs made losses to the tune of Rs.719 crore. The deterioration in the overall profitability of CCBs could be attributed to higher expense for provisions and contingencies.

Primary Agricultural Credit Societies (PACS)

4.56 Primary agricultural credit societies (PACS), the grass-root level arm of short-term co-operative credit, mediate directly with individual borrowers, grant short to medium-term loans and also undertake distribution and marketing functions. There were 98,247 PACS as on March 31, 2002 with about 10 crore members. A large number of PACS, however, face severe financial problems primarily due to significant erosion of own funds, deposits and low recovery rates. Various policies have been adopted to improve the financial health of the PACS. NABARD has been extending funds to develop the infrastructure for PACS.

Table IV.13: Financial Performance of State Co-operative Banks

(Amount in Rs. crore)

	Item	2000-01	2001-02(P)	Variation	
				Absolute	Percentage
	1	2	3	4	5
A.	**Income (i+ii)**	**5,389**	**5,809**	**420**	**7.8**
		(100.0)	**(100.0)**		
	i) Interest Income	5,194	5,508	314	6.0
		(96.4)	(94.8)		
	ii) Other Income	195	301	107	54.4
		(3.6)	(5.2)		
B.	**Expenditure (i+ii+iii)**	**5,185**	**5,632**	**447**	**8.6**
		(100.0)	**(100.0)**		
	i) Interest Expended	4,121	4,192	70	1.7
		(79.5)	(74.4)		
	ii) Provisions and Contingencies	690	1,024	334	48.4
		(13.3)	(18.2)		
	iii) Operating Expenses	373	416	43	11.5
		(7.2)	(7.4)		
	Of which : Wage Bill	280	304	24	8.6
		(5.4)	(5.4)		
C.	**Profit**				
	i) Operating Profit	**894**	**1,201**	**307**	**34.3**
	ii) Net Profit	**204**	**177**	**-27**	**-13.2**
D.	**Total Assets**	**52,476**	**57,478**	**5,002**	**9.5**

P : Provisional.

Notes :

Figures in brackets are percentage shares to the respective total.

Source : NABARD.

Table IV.14: Composition of Liabilities and Assets of Central Co-operative Banks

(Amount in Rs. crore)

Item	2001		2002(P)	
	Amount	Share (Per cent)	Amount	Share (Per cent)
1	2	3	4	5
Liabilities				
Capital	3,128	3.2	3,425	3.2
Reserves	9,105	9.4	10,723	10.0
Deposits	61,813	64.0	68,090	63.3
Borrowings	16,937	17.5	18,818	17.5
Other Liabilities	5,704	5.9	6,529	6.1
Total Liabilities	**96,687**	**100.0**	**1,07,585**	**100.0**
Assets				
Cash and Bank Balance	5,853	6.1	7,169	6.7
Investments	27,616	28.6	28,905	26.9
Loans and Advances	52,512	54.3	59,269	55.1
Other Assets	10,706	11.0	12,242	11.4
Total Assets	**96,687**	**100.0**	**1,07,585**	**100.0**

P. Provisional.

Long-term Co-operative Credit

4.57 The long-term co-operative credit structure comprises State Co-operative Agriculture and Rural Development Banks (SCARDBs) in 20 States/Union Territories with 768 Primary Co-operative Agriculture and Rural Development Banks (PCARDBs). The banks in the long-term co-operative credit structure have been displaying several weaknesses, which inhibit their ability to effectively compete with the commercial banks in the emerging liberalised economic environment.

State Co-operative Agriculture and Rural Development Banks (SCARDBs)

4.58 The profitability of SCARDBs showed a downward trend during 2001-02 as compared with 2000-01. NPAs formed 18.5 per cent of total loans outstanding as at end-March 2002, lower than 20.5 per cent as at end-March 2001. The recovery performance, at 55 per cent of demand, as at end-June 2002, however, deteriorated from 62 per cent as at end-June 2000. The recovery performance of the SCARDBs varied widely across the States during 2001-02.

Table IV.15: Financial Performance of Central Co-operative Banks

(Amount in Rs. crore)

	Item	2000-01	2001-02 P	Variation	
				Absolute	Percentage
	1	2	3	4	5
A.	**Income (i+ii)**	**10,393** (**100.0**)	**11,543** (**100.0**)	**1,150**	**11.1**
	i) Interest Income	9,829 (94.6)	10,903 (94.5)	1,074	10.9

ii) Other Income	565	641	76	13.5
	(5.4)	(5.6)		
B. Expenditure (i+ii+iii)	**10,332**	**11,564**	**1,233**	**11.9**
	(100.0)	**(100.0)**		
i) Interest Expended	6,950	7,685	735	10.6
	(67.3)	(66.5)		
ii) Provisions and Contingencies	1,611	2,057	446	27.7
	(15.6)	(17.8)		
iii) Operating Expenses	1,770	1,822	52	2.9
	(17.1)	(15.8)		
Of which : Wage Bill	1,369	1,406	37	2.7
	(13.3)	(12.2)		
C. Profit				
i) Operating Profit	**1,672**	**2,036**	**363**	**21.7**
ii) Net Profit	**62**	**- 21**	**- 83**	**—**
D. Total Assets	**96,687**	**1,07,585**	**10,898**	**11.2**

P : Provisional.

Note: Figures in brackets are percentage to share to the respective total.

Primary Co-operative Agriculture and Rural Development Banks (PCARDBs)

4.59 The credit extended by PCARDBs declined by 10.5 per cent during 2002-03 in sharp contrast to an increase of 20.7 per cent clocked during 2001-02. The profitability of PCARDBs also showed a downward trend during 2001-02 as compared with 2000-01. NPAs formed 30.4 per cent of total loans outstanding as at end-March 2002, a jump from 20.2 per cent as at end-March 2000. In tandem, the recovery performance deteriorated to 46 per cent of demand.

Health Status of Rural Co-operatives

4.60 The non-performing assets of rural cooperative banks remains high. The asset quality of the higher tier, *i.e.*, StCBs is, however, relatively better than that of the lower tier, *i.e.*, CCBs (Table IV.16).

Table IV.16: Composition of Gross NPAs
(As on March 31, 2002)

(Rs. crore)

Asset Quality	StCBs	CCBs
1	2	3
Substandard Assets	2,403	6,325
Doubtful Assets	1,821	4,245
Loss Assets	261	1,268
Total NPAs	4,485	11,838
Percentage of NPAs to loans Outstanding	13.4	19.7

4.61 The growing area of concern in the case of co-operative credit structure is the poor recovery performance. The repayment performance was much better in case of short-term co-operative credit structure. However, during 2001-02, both the short-term and long-term institutions have witnessed a fall in the ratio of recovery performance.

4.62 Various measures have been initiated to address the large NPA problems being faced by the rural credit co-operatives. First, NABARD has finalised guidelines on the lines of the onetime settlement scheme for NPAs of commercial banks, in consultation with the Reserve Bank. The cut-off date for NPAs has been fixed at March 31,1998 and the cut-off level amount at Rs. 5 lakh. The scheme was initially made operative up to March 31, 2002 and subsequently extended up to September 30, 2002 and settlement under the scheme was to be completed by December 31, 2002. Secondly, in consultation with the Central Government and the Reserve Bank, it has been decided to give one more opportunity to the borrowers to come forward for settlement of their outstanding dues. Hence, revised guidelines are now issued which provide for a simplified non-discretionary and non-discriminatory mechanism for compromise settlement of chronic NPAs of Rs.l0 lakh and below for individual borrowers, and Rs.10 crore and below in respect of institutions under all categories of loans and advances. The scheme will remain operative till end-September 2003 and settlement under the scheme is to be completed by end-March 2004. Thirdly, rural credit co-operatives have been instructed to follow the guidelines uniformly without any discrimination, as also to immediately pass on the recovered amounts to higher financing institutions. It is also clarified that for implementing the scheme, credit co-operatives would not receive financial support from the Government, the Reserve Bank or NABARD. Finally, banks have been given discretion to formulate One-Time Settlement scheme for amounts of NPAs beyond the above cut-off level and date with the approval of board of directors and the Registrars of Co-operative Societies.

4. NABARD and the Co-operative Sector

4.63 NABARD is the apex institution entrusted with a pivotal role in the sphere of policy planning and providing refinancing facilities to rural financial institutions to augment their resource base. In order to strengthen the effectiveness of NABARD, as also to enable it to effectively leverage its equity and mobilise additional resources for refinancing operations, the Government and the Reserve Bank have been contributing annually Rs.100 crore and Rs.400 crore, respectively, since 1996-97. With these contributions, the effective capital base of NABARD as at end-March 2002, rose to Rs.2000 crore. NABARD has also been permitted to issue capital gains tax exemption bonds since 2000-01.

Policy Initiatives by NABARD

Development Action Plans (DAPs)/ Memoranda of Understanding (MoUs)

4.64 The mechanism of preparation of institution-specific DAPs by co-operative banks introduced in 1994-95 as a measure of institutional strengthening was continued during 2002-03. A second phase of base-level MoUs has been introduced for the three years (2000-03). At the instance of NABARD, based on the past experience, the rural co-operative banks adopted the system of drawing up annual DAPs since 1997. MoUs were executed between NABARD and co-operative banks to obtain commitment for achieving the business targets envisaged in DAPs. The implementation of DAPs and compliance to MoU covenants were monitored by the Reserve Bank and NABARD along with the State Government representatives through the mechanism of monitoring review committees set up at the State and district levels.

Expert Committee on Rural Credit

4.65 An Expert Committee on Rural Credit (Chairman: Prof. V.S. Vyas), constituted by NABARD submitted its report in August 2001. In pursuance of its recommendations, NABARD has initiated action on some of the related areas, such as, financing asset-less poor, small farmers/tenants, dry land agriculture, agriculture sub-sectors, private capital formation and rural non-farm activities, initiating steps to strengthen RRBs and cooperatives, opening of DDM Offices and follow up of the recommendations made by the Task Force to study the fuctions of Co-operative Credit System and to Suggest Measures for its Strengthening (Chairman : Shri Jagdish Capoor).

Revitalisation of Co-operative Credit Structure

4.66 The Capoor Committee, set up by the Government, to study the co-operative credit structure had suggested various measures for strengthening and revitalising the co-operative credit structure in its report submitted in July 2000. During 2001, an Inter-Ministerial Joint Committee under the Chairmanship of Shri Balasaheb Vikhe Patil, reviewed the recommendations, particularly those relating to the funding mechanism and sharing pattern of revitalisation assistance amongst the Government of India, States and Co-operatives. Based on these recommendations, NABARD placed its scheme before the Government in October 2002. The scheme, which envisaged linking of revitalisation assistance to co-operative banks to certain reforms to be carried out by the State Governments, included the following measures:

- adoption of essential features of Model Co-operative Societies Act, particularly removal of duality of control by State Governments and the Reserve Bank / NABARD;
- autonomy to co-operative credit institutions;
- audit of SCBs/DCCBs/SCARDBs by Chartered Accountants and freedom to PACS for this purpose;
- professionalisation of management;
- adoption of transparent HRD policies;
- abolition of common cadre system of PACS secretaries.

Resources of NABARD

4.67 The flow of resources to NABARD, including RIDF deposits, decelerated by 7.9 per cent during 2002-03 (Table IV.17). Market borrowings through the issue of bonds and debentures increased substantially in 2002-03. There was a large accretion to deposits under the Rural Infrastructure Development Fund (RIDF).

4.68 The Reserve Bank has also been assisting NABARD in providing refinance support to the rural sector by making available funds under the two General Lines of Credit (GLC-I and GLC-II). These limits have been enhanced periodically, and as at end-March 2002-03, the limit sanctioned under GLC-I and GLC-II stood at Rs.5,650 crore and Rs. 850 crore, respectively.

Table IV.17: Net Accretion in the Resources of NABARD (April-March)

(Rs. crore)

Type of Resource	2001-02	2002-03 P

1	2	3
Capital	0	0
Reserves and Surplus	655	693
NRC (LTO) Fund	531	222
NRC (Stabilisation) Fund	6	222
Deposits	-252	-21
Bonds and Debentures	2,465	2,624
Borrowings from Central Government	-65	-243
Borrowings from RBI	-100	-708
Foreign Currency Loans	9	51
Other Borrowings	—	—
RIDF Deposits*	2,474	2,434
Other Liabilities	451	444
Other Funds	111	67
Total	**6,283**	**5,786**

P Provisional.
* RIDF deposits raised from banks.
Source: NABARD.

Table IV.18: Deposits Mobilised under RIDF

(Rs.crore)

Year	RIDF-I	RIDF-II	RIDF-III	RIDF-IV	RIDF-V	RIDF-VI	RIDF-VII	RIDF-VIII	Total
1	2	3	4	5	6	7	8	9	10
1995-96	350	—	—	—	—	—	—	—	350
1996-97	842	200	—	—	—	—	—	—	1,042
1997-98	188	670	149	—	—	—	—	—	1,007
1998-99	140	500	498	200	—	—	—	—	1,338
1999-2000	67	539	797	605	300	—	—	—	2,307
2000-01	—	161	412	440	850	790	—	—	2,654
2001-02	—	155	264	—	689	988	1,495	—	3,591
2002-03	—	—	188	168	541	817	731	1,413	3,857
Total	**1,587**	**2,225**	**2,308**	**1,413**	**2,380**	**2,594**	**2,226**	**1,413**	**16,145**

Source: NABARD.

Rural Infrastructure Development Fund

4.69 The RIDF–I was initially set up in 1995-96 with a *corpus* of Rs.2,000 crore with the major objective of providing funds to State governments to enable them to complete ongoing infrastructure projects pertaining to irrigation, flood protection, rural roads and bridges. The *corpus* of RIDF is contributed by scheduled commercial banks to the extent of their shortfall in agricultural lending under the priority sector target subject to a maximum of 1.5 per cent of net bank credit. The RIDF-II to RIDF-VIII were established during the subsequent years up to 2002-03. The Government has announced a *corpus* of Rs.5,500 crore under RIDF-IX (Tables IV.18 and IV.19).

4.70 The interest rate on RIDF loans have been gradually reduced from 13.0 per cent in 1995-96 to 11.5 per cent in 2000-01 and further to 8.5 per cent as announced in the Union Budget 2002-03.

4.71 The scope of RIDF has been progressively widened to allow lending to *Gram Panchayat*s, Self-Help Groups and other eligible organisations for implementing village-level infrastructure projects. Furthermore, the projects eligible for RIDF loans have also been enlarged by including innovative projects, such as, information technology-enabled services and new activities, such as, system improvement and mini-hydel generation under the power sector, construction of primary/ secondary school buildings and primary health centres and rain water harvesting structures.

4.72 The Union Budget for 2002-03 announced that loans from RIDF would be linked to the reforms undertaken by the State Governments. Accordingly, out of the *corpus* of Rs.5,500 crore under RIDF-VIII, Rs.1,100 crore was to be allocated to the State Governments for reforms already taken up/to be taken up in agriculture and the rural sector. States achieving a reform implementation rating of 60 per cent or above were sanctioned the full allocation and those with a rating between 35 per cent and 60 per cent were sanctioned 50 per cent of the reform-linked allocation, while States having a rating of more than 60 per cent were eligible to share the unavailed amount of reform- linked allocations. Fifteen States, *viz.*, Andhra Pradesh, Chhattisgarh, Gujarat, Haryana, Himachal Pradesh, Jammu and Kashmir, Karnataka, Kerala, Madhya Pradesh, Maharashtra, Orissa, Punjab, Rajasthan, Tamil Nadu, and West Bengal achieved a rating of 60 per cent and availed their full allocation. Other five States availed their non-reform linked allocations. Eight States in the North-Eastern Region were exempted from the linkage.

Table IV.19: Loans Sanctioned and Disbursed under RIDF

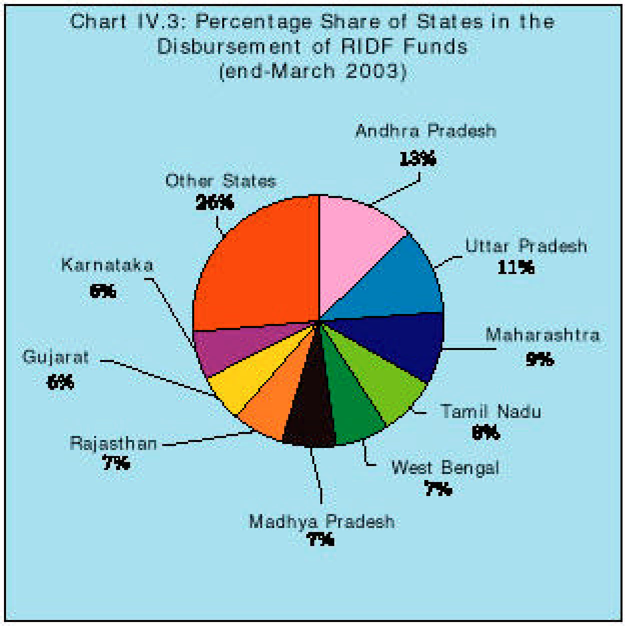
(As on March 31, 2003)

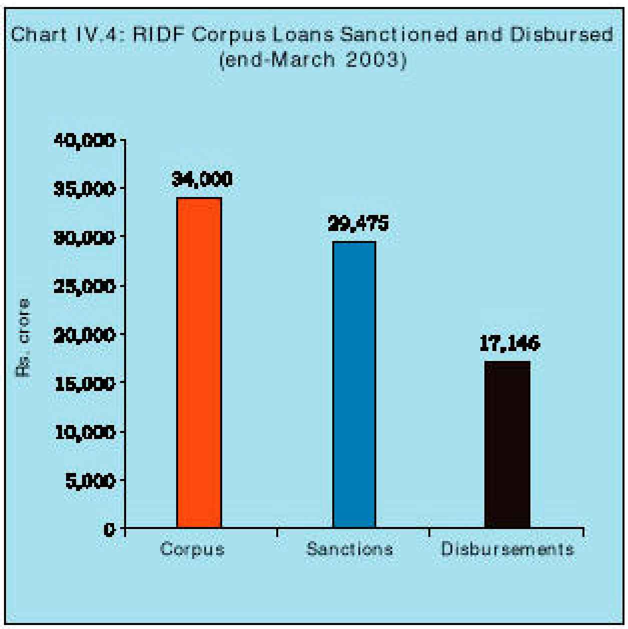
(Amount in Rs.crore)

RIDF	Year	Corpus	Loans Sanctioned	Loans Disbursed	Loan disbursed as percentage of loans sanctioned
1	2	3	4	5	6
I	1995	2,000	1,910.5	1,760.9	92.2
II	1996	2,500	2,627.8	2,373.7	90.3
III	1997	2,500	2,707.8	2,377.0	87.8
IV	1998	3,000	2,976.5	2,160.8	72.6
V	1999	3,500	3,532.5	2,502.2	70.8
VI	2000	4,500	4,579.3	2,788.4	60.9
VII	2001	5,000	5,056.8	2,055.7	40.6
VIII	2002	5,500	6,084.1	1,126.4	18.5
IX	2003	5,500	—	—	—
Total		**34,000**	**29,475.3**	**17,145.1**	**58.2**

Source: NABARD

4.73 Nine States together accounted for about 74 per cent of the total disbursements as at end-March, 2003 (Chart IV.3). However, there exists a huge gap between sanctions and disbursements, (Chart IV.4). Taking all the RIDF *tranches* together, Andhra Pradesh accounted for the largest disbursements followed by Uttar Pradesh, Maharashtra, Tamil Nadu, West Bengal, Madhya Pradesh, Rajasthan, Gujarat and Karnataka.





4.74 The State-wise analysis of ratio of disbursements to sanctions reveals that Sikkim topped the list with 80.5 per cent, followed by Mizoram, Punjab, Tamil Nadu, Rajastan and Uttar Pradesh.

4.75 Loans under RIDF are given for various types of rural infrastructural investments like irrigation projects, flood protection, watershed management, construction of rural roads and bridges. Of the total amount sanctioned under RIDF schemes, about 50 per cent was accounted for by construction of rural roads and bridges and 34 per cent by irrigation projects.

4.76 The utilisation of RIDF funds has been low as compared with sanctions largely due to several factors, such as, lack of budgetary support (where only part funding is envisaged from RIDF), delays in the completion of formalities for drawal of funds and in completing preliminary work in respect of irrigation projects (where land acquisition, and forest environmental clearance, as well as tendering procedures are required).

Credit from NABARD

4.77 The outstanding credit extended by NABARD to StCBs, RRBs and State Governments declined during 2002-03, mainly due to a decline in outstanding credit to State Governments and RRBs (Table IV.20). This was partly offset by higher credit to StCBs during the year. A major part of the outstanding refinance was for short-term purposes. Seasonal agricultural operations (SAO) amounted for bulk of the Rs.1,409 crore credit limit sanctioned to RRBs for short-term purposes. NABARD sanctioned long-term loans to 12 State Governments towards the contribution to the share capital of co-operative credit institutions. The interest rate structure of NABARD for refinance and credit to the ultimate beneficiaries of term loans remained the same during the year (Table IV.21).

Table IV.20: NABARD's Credit to StCBs, State Government and RRBs

(Rs. crore)

Category	2001-02*(July-June)				2002-03* (July-March)			
	Limits	Drawals	Repay-ments	Out-Standings	Limits	Drawals	Repay-ments	Out-standings
1	2	3	4	5	6	7	8	9
1. State Co-operative Banks								
a. Short-term	7,319	9,151	9,073	4,910	7,358	5,450	5,175	5,185
b. Medium-term	854	307	162	443	493	18	106	356
Total (a+b)	**8,173**	**9,459**	**9,235**	**5,353**	**7,851**	**5,468**	**5,281**	**5,540**
2. State Governments								
Long-term	63	50	59	487	61	28	74	441
3. Regional Rural Banks								
a. Short-term	1,381	1,257	1,246	1,201	1,406	858	1,190	869
b. Medium-term	16	9	16	34	3	0.3	10	24
Total (a+b)	**1,397**	**1,266**	**1,262**	**1,235**	**1,409**	**858**	**1,200**	**893**
4. Grand Total (1+2+3)	**9,633**	**10,775**	**10,557**	**7,075**	**9,321**	**6,354**	**6,554**	**6,875**

* Figures are provisional.
Source : NABARD.

Table IV.21: NABARD's Structure of Interest Rates for Term Loans

(per cent per annum)

Size of Limit	Rate of Interest to ultimate beneficiaries			Rate of Interest on refinance		
	Commercial Banks	RRBs	StCBs/ SCARDBs	Commercial Banks	RRBs/ SCBs/SCARDBs	StCBs/ SLDBs
1	2	3	4	5	6	7
Up to Rs.25,000 *	Rate of Interest to the beneficiaries			6.75	6.75	6.75
Above	Is to be determined by the banks					

Rs.25,000* and up to Rs.2 lakh	Subject to the guidelines laid down By the Reserve Bank of India	7.75	7.75	7.75
Above Rs.2 lakh*#		8.50	8.50	8.50

* 6.75 per cent for minor irrigation, land development, dry land farming, SGSY, SHGs and Wasteland Development

\# 7.75 per cent for cold storages / rural godowns / farm mechanisation /agribusiness centres, 6.75 per cent for agri export zones, as on November 26, 2002, and for North-Eastern Region, Sikkim, Andaman and Nicobar Islands.

Source: NABARD.

5. Issues in Micro Credit

4.78 The role of micro credit as the most suitable and feasible alternative in accomplishing the goals of growth and poverty alleviation is now well recognised. Micro finance embodies the basic democratic ethos of self-development through a participatory approach. The experiment of micro finance in India through the conduit of SHGs has demonstrated considerable democratic functioning and group dynamism. Their adroitness in assessing and appraising the credit needs of members, their business-like functioning and efficiency in recycling the funds often with repayment rates nearing cent per cent have proved that this is among the best alternatives in improving the credit delivery to the poor. Recognising their importance, both the Reserve Bank and NABARD have been spearheading the promotion and linkage of SHGs to the banking system through refinance support and initiating other proactive policies and systems. There are three models of credit linkage of SHGs with the banks, *viz*., as noted earlier,

- SHGs, formed and financed by banks,
- SHGs, formed by formal agencies other than banks, NGOs and others but directly financed by banks,
- SHGs, financed by banks using NGOs and other agencies as financial intermediaries

4.79 A couple of case studies highlight the role played by the many micro-credit institutions in the rural economy (Box IV.4).

Progress of Micro Finance

4.80 The programme of micro finance has made rapid strides in India. The programme, which was heralded in 1992 with a modest pilot project of linking around 500 SHGs with half a dozen banks across the country, has grown to cover 31,000 rural outlets of more than 500 banks, with a loan portfolio of more than Rs.2,000 crore on March 31, 2003 (Table IV.22). The programme has enabled the formal banking system to reach the doorsteps of 116 lakh very poor households through the conduit of 7.17 lakh SHGs.

Box IV.4: Case Studies of Micro-Finance Models:

The Swayam Krishi Sangam (SKS) and the Prathama Bank are two good illustrations of successful models of SHGs. While the SKS model represents an SHG formed by a formal agency, other than the banks but directly financed by banks; the Prathama model, on the other hand, is a specimen of those SHGs formed and financed by the banks. The SKS has emerged as one of the catalytic forces behind the spread of micro-finance movement in Andhra Pradesh. The Prathama Bank, being the first regional rural bank, commands a long-standing experience in the field in the state of Uttar Pradesh.

The SKS and the Prathama Bank target the rural poor women, with the SKS focussing especially on the drought-prone region. The methodology adopted for group formation under the SKS, *inter alia*, includes (a) selection of villages based on the levels of poverty, main economic activities and type of land, and (b) conducting project meetings to create awareness. A group is formed with five members and a *sangam* evolves when eight such groups are constituted. The Prathama Bank, on the other hand, relies on the expertise of the *vikas volunteer vahini*s (VVV) - a club consisting of volunteers, who command local acceptability and goodwill and act as informal ambassadors of the bank to the villages. Village meets, with the help of VVVs, are organized by the bank to impart awareness among the people.

The SKS and Prathama models leverage technology and novelty in the promotion of SHGs. The SKS offers a variety of savings and loan products meant both for consumption and income generating activities and has pioneered smart cards and palm pilots (electronic passbooks). It has developed fully automated and integrated in-house management information systems (MIS), which enable virtual real time access to portfolio, client and staff information in all its branches. It has also developed Microsoft Excel-based financial models for different periodicities to monitor cash management, track financial performance against targets and project operational growth. These new initiatives have proved helpful in lowering the cost of transactions, increasing the productivity, reducing the scope for error and fraud and improvement in the accuracy and timeliness of management information systems.

The Prathama Bank has also taken several initiatives such as setting up of an exclusive Women Development Cell, Micro Credit Innovation Cell, launching of Rural Entrepreneurship Development Programme for training SHG members in various crafts, starting of SHG primary school in each village, launching of novel schemes like *Prathama Swachata* (Sanitation) Yojana and Gas (LPG) Connection Scheme.

Within a short span, both have posted an improved outreach and coverage. As at end-June 2003, the outreach and network of SKS has grown to cover 8 branches encompassing 524 village centres, serving 17,058 customers. As at end-fiscal 2003, with an outstanding credit portfolio of Rs.4.9 crore and savings portfolio of Rs.36 lakh, it has achieved the annual targets, maintaining a repayment rate of 99 per cent. Over 85 per cent of its clients are marginalised members of society. The total loans outstanding at about Rs.0.02 crore in the year 1999 have grown, within four years to Rs.5.12 crore in 2002-03. In the case of the Prathama Bank, as at end-March 2003, more than 4,500 SHGs encompassing 65,000 members were credit-linked with an amount of Rs.12.6 crore, disbursed for various income generating activities comprising dairy, retail shops, *zari* work, and other related activities.

A cost-benefit analysis involving the case studies under review reveal divergent trends, though administrative expenses for administering an outstanding loan of Rs.100 witnessed a decline in both cases in the recent years. While interest earning on an outstanding loan of Rs.100 increased in the case of the SKS, it, however, declined for the Prathama Bank. Furthermore, the gap between income and expenditure widened for SKS, while the Prathama Bank recorded a surplus income continuously over the years. While the SKS depends on foreign donations, the dependence of the Prathama Bank on outside agencies in the form of borrowings has been quite minimal.

Table IV.22: SHG Bank Linkage: Cumulative Progress

(Amount in Rs. crore)

As on March 31	No. of SHGs Financed	Bank Loan Disbursed
1	2	3
1999	32,995	57.07
2000	1,14,775	192.98
2001	2,63,825	480.87
2002	4,61,478	1,026.34
2003	7,17,360	2,048.67

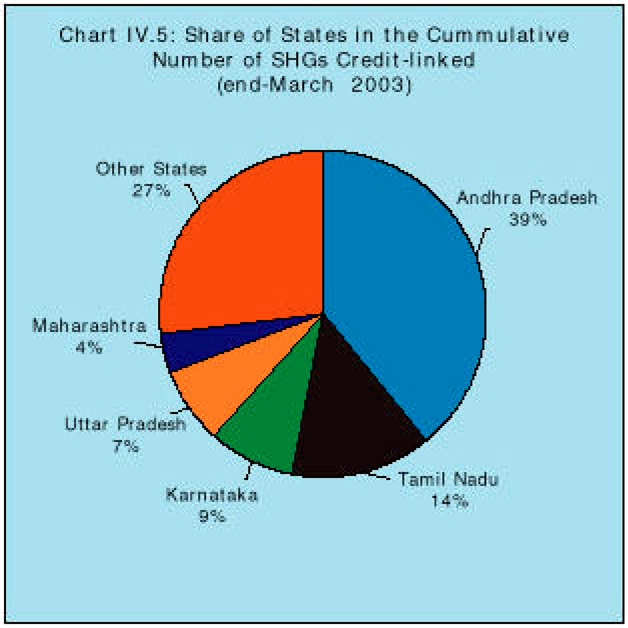
Source: NABARD.

4.81 The significant increase in the number of SHGs linked during the year was possible due to the active involvement of 504 banks, 2,800 NGOs and many other agencies including developmental departments of different State Governments. The credit linkage programme covered 523 districts in 30 States and Union Territories. The notable features are the active participation of women in the programme accounting for 90 per cent of the total SHGs and the strong loan repayment performance of SHGs at more than 95 per cent.

4.82 NABARD has been playing a catalytic role, both in terms of promotional grant support to NGOs and developing capacity building outreach of various partners in formation and nurturing of quality SHGs. The amount of cumulative grant support sanctioned for promotion and linkage of SHGs, as on March 31, 2003, aggregated to Rs.10.4 crore covering 564 NGOs and 78,011 SHGs. However, release of grants, at Rs.4.5 crore, constituted 43.2 per cent of the sanctioned grant, resulting in the promotion of 51,945 SHGs, of which 26,229 SHGs are with credit linkage. NABARD has also been supporting Farmers' Clubs (FCs) and independent volunteers to act as self-help promoting institutions (SHPIs). It is also providing revolving fund assistance to NGOs.

4.83 Thus, the micro finance programme has made significant progress, both in terms of coverage and outreach. However, there are some issues of concern, which deserve attention.

- The coverage of poor families in the SHG movement is yet to gain momentum. Out of 52 million poor families (260 million poor) in the country, only 11.6 million families (58 million poor) or 22.3 per cent of the poor families were covered as on March 31, 2003.
- Another area of major concern is the uneven growth of micro finance. As on March 31, 2003, of the total SHGs credit linked, Andhra Pradesh accounted for 39 per cent followed by Tamil Nadu, Karnataka and Uttar Pradesh. These four States together accounted for 69 per cent of the total SHGs credit-linked and four fifth of the total amount of bank loan as on March 31, 2003 (Chart IV.5).



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1 Under the Banking Regulation Act, 1949 only urban co-operative banks (UCBs), state co-operative banks (StCBs) and district central co-operative banks (CCBs) are qualified to be called as banks in the co-operative sector. The discussion in this Chapter also covers issues relating to other credit co-operatives, *viz.*, primary agricultural credit societies (PACS) and the long-term structure of rural credit co-operatives. In this chapter, data on scheduled co-operative banks relate to 2002-03, while that for others primarily pertain to 2001-02.

2 These guidelines have been discussed in Box IV.1.

3 Demand is amount due as on a particular date. It includes both interest and principal repayment due as on that date.