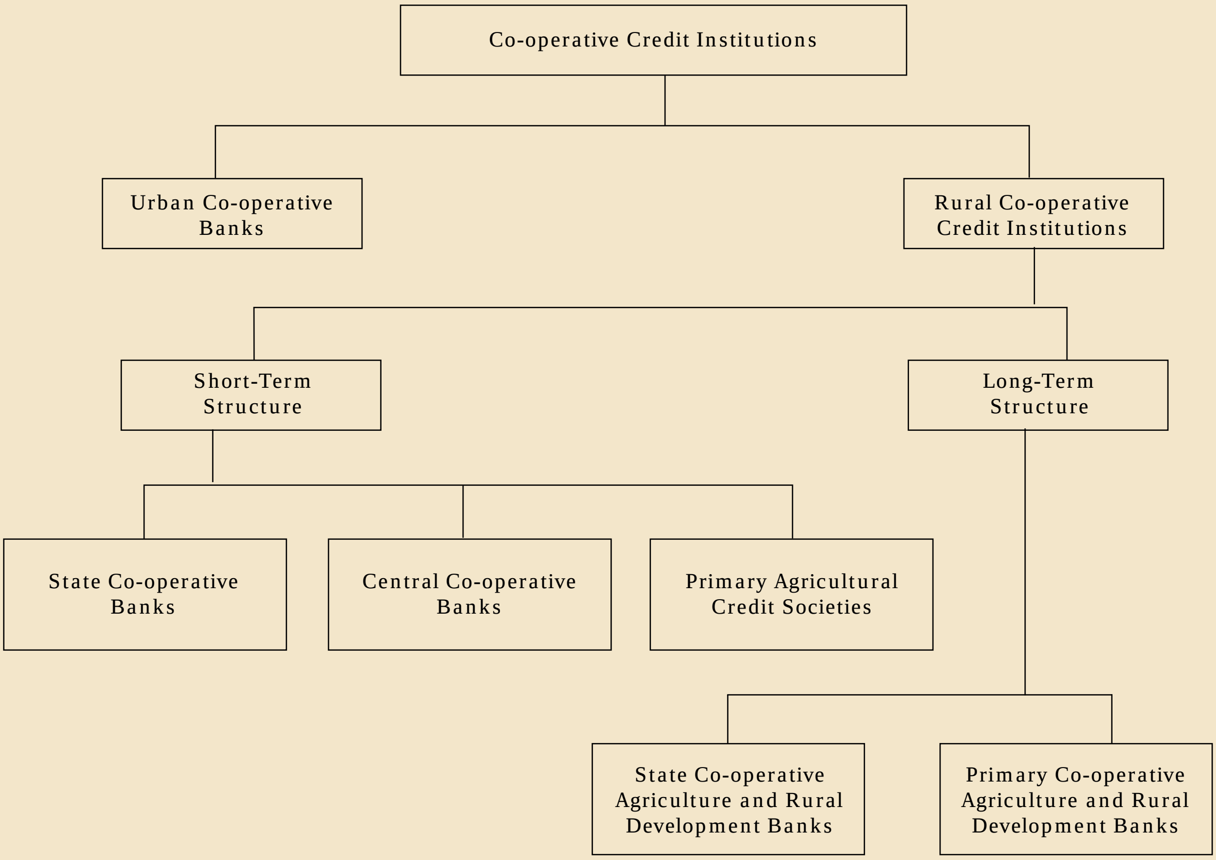
Chapter IV

Developments in Co-operative Banking

4.1 The co-operative banking system, with two broad segments of urban and rural co-operatives, forms an integral part of the Indian financial system. With a wide network and extensive coverage, these institutions have played an important developmental role in enlarging the ambit of institutional credit by way of inculcating banking habits among the poor and those in remote areas. In recent times, co-operative banks have tried to improve credit delivery through some financial innovations.

4.2 The structure of co-operative banking[1] that has evolved over more than fifty years highlights the dual role of members as lenders and borrowers. The co-operative credit structure in the country can be divided into two broad segments: the urban co-operative banks and the rural co-operative credit institutions (Chart IV.1). While the urban co-operative banking system has a single tier comprising the Primary Co-operative Banks (commonly known as urban co-operative banks – UCBs), the rural co-operative credit system is

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



[1] Under the Banking Regulation Act, 1949 only Urban Co-operative Banks (UCBs), State Co-operative Banks (StCBs) and 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. Data on scheduled urban co-operative banks relate to 2003-04, while those for others pertain to 2002-03.

divided into long-term and short-term co-operative credit institutions which have a multi-tier structure. The short-term co-operative credit institutions have a three-tier structure comprising State Co-operative Banks (StCBs), Central Co-operative Banks (CCBs), and Primary Agricultural Credit Societies (PACSs) which are not banks but only societies. The long-term co-operative credit institutions have generally a two tier structure comprising the State Co-operative Agriculture and Rural Development Banks (SCARDBs) and the Primary Co-operative Agriculture and Rural Development Banks (PCARDBs). Long-term co-operative credit institutions have a unitary structure in some States, while in other States they have a mixed structure (unitary and two-tier). The States not having long-term co-operative credit entities are served by the State Co-operative Banks apart from being serviced by the branches of Regional Rural Banks (RRBs) and the rural/semi-urban branches of commercial banks. However, in the State of Andhra Pradesh, the co-operative structure is integrated combining both short-term and long-term structures.

4.3 The regulation and supervision of co-operative banks poses several challenges in view of the large number of such banks, as also the multiple controls by supervisors, including the Reserve Bank, the State Governments and NABARD. The co-operatives are at present under the control of State Governments in all matters relating to registration, membership, election, financial assistance, loaning powers, business operations, loan recovery and audit. Some aspects relating to banking activities are regulated and supervised by the Reserve Bank of India/NABARD. While urban co-operative banks come under the supervisory jurisdiction of the Reserve Bank, rural co-operatives are regulated by the NABARD. There is thus no clear demarcation of regulatory powers, which at times has resulted in cross directives from the controlling agencies, thereby undermining the working of co-operatives.

4.4 Despite several years of operational experience, financial performance of a number of co-operative banks is still below their potential (Appendix Table IV.1). The infusion of elements of good corporate governance, sound investment policy, appropriate internal control systems, better credit risk management, commitment to better customer service, and focus on newly-emerging business areas like micro finance, is expected to strengthen the co-operative banks The Reserve Bank is in favour of a consultative approach to developing a regulatory framework and a revival plan in order to ensure a vibrant future for the co-operative sector, and thus encouraging systemic stability of the overall financial sector.

2. Urban Co-operative Banks

4.5 Urban Co-operative Banks (UCBs) play an important role as financial intermediaries in urban and semi-urban areas catering to the needs of the non-agricultural sector, particularly small borrowers. In the context of the current economic scenario and problems faced by the co-operative banking sector, several initiatives were taken in consultation with the federations and associations of co-operative banks. These include: deferring the application of 90 day NPA norm for small loans and gold loans up to Rs.1 lakh by two years, giving additional time for meeting the prescribed provisioning requirements for assets classified in doubtful category and permission to transfer Government and other approved securities up to 25 per cent to held to maturity (HTM) category. The Reserve Bank has taken several initiatives to address the procedural and regulatory issues. The consultative process has already been put in place with respect to the UCBs in the form of a Standing Advisory Committee. As stated in the mid-term Review of annual policy 2004-05, a vision document for the future role of UCBs is being evolved to ensure depositors' interests and avoid contagion, while providing useful service to local communities. In regard to structural issues, the Reserve Bank would be encouraging growth of strong and viable entities within the sector through consolidation. Further, the Reserve Bank would continue to pursue with the State and Central Governments regarding the issues that arise in their jurisdiction.

4.6 The number of UCBs increased to 2,105 including 179 banks under liquidation at end-June 2004 compared with 1,106 in 1966 – the year in which the UCBs were brought under the purview of Banking Regulation Act 1949 (As Applicable to Co-operative Societies (AACS)). These include 80 salary earners banks, 112 Mahila banks and 25 SC/ST banks. State-wise

Table IV.1: Distribution of Urban Co-operative Banks : State-wise
(As at end-March 2004)

Sr. No.	Name of the State	No. of banks	No. of branches including Head Office cum-branch	Extension Counters
1	2	3	4	5
1	Andhra Pradesh	133	299	10
2	Assam/Manipur/Meghalaya/Sikkim/ Nagaland/Tripura/Arunachal Pradesh	19	26	0
3	Bihar/Jharkhand	5	5	1
4	Gujarat	328	1,091	3
5	Jammu & Kashmir	4	17	4
6	Karnataka	300	1,052	18
7	Kerala	63	344	0
8	Madhya Pradesh	81	108	4
9	Maharashtra & Goa	639	4,333	23
10	New Delhi	16	60	2
11	Orissa	13	50	4
12	Punjab/Haryana/Himachal Pradesh	17	48	1
13	Rajasthan	42	161	7
14	Tamil Nadu & Pondicherry	134	180	2
15	Uttar Pradesh & Uttaranchal	80	306	14
16	West Bengal	52	86	2
	TOTAL	**1,926**	**8,166**	**95**

distribution of branches shows that around 80 per cent of the UCBs are concentrated in five States *viz*., Maharashtra, Gujarat, Karnataka, Andhra Pradesh and Tamil Nadu (Table IV.1). Only nine UCBs had a deposit size of more than Rs.1,000 crore, while most of the UCBs (about 60 per cent) had a deposit size of less than Rs.25 crore (Table IV.2)

4.7 Of the 8,166 branches of UCBs, 883 were unit banks *i.e.*, banks which function as Head Office-cum-Branches. The Centre-wise distribution shows that Ahmedabad, Bangalore, Hyderabad and Nagpur had the highest number of unit banks (Table IV.3).

Table IV.2: Distribution of Urban Co-operative Banks : Deposit size-wise
(As on March 31, 2004)

Deposit size	No. of banks
1	2
Less than Rs.10 crore	544
Rs.10-25 crore	401
Rs.25-50 crore	225
Rs.50-100 crore	177
Rs.100-250 crore	127
Rs.250-500 crore	38
Rs.500-1,000 crore	18
Above Rs.1,000 crore	9
Total	**1,539 #**

Data in respect of 387 banks not available.

Table IV.3: Distribution of Unit Banks: Centre-wise
(As at end-March 2004)

Sr. No.	Regional Office	Unit Banks
1	2	3
1	Ahmedabad	170
2	Bangalore	168
3	Bhopal	60
4	Bhubaneswar	4
5	Chandigarh	10
6	Chennai	60
7	Guwahati	15
8	Hyderabad	107
9	Jaipur	20
10	Jammu	1
11	Kolkata	32
12	Lucknow	53
13	Mumbai	51
14	Nagpur	110
15	New Delhi	0
16	Patna	4
17	Thiruvananthapuram	18
	Total	**883**

4.8 The minimum demand and time liabilities that a co-operative bank should have, to qualify for inclusion in Second Schedule has been enhanced to Rs.250 crore from Rs.100 crore through the Government of India Notification dated October 30, 2003. During 2003-04 (July-June), one UCB *viz*., Pravara Sahakari Co-operative Bank Limited, Loni, Dist. Ahmednagar was included in the Second Schedule, while two UCBs from Gujarat *viz*., Charotar Nagarik Sahakari Bank Limited, Anand and Visnagar Nagarik Sahakari Bank Limited, Visnagar, Gujarat were excluded consequent upon their liquidation. As a result, at end-March 2004, there were 55 scheduled UCBs spread over Andhra Pradesh, Goa, Gujarat, Karnataka, Maharashtra and Uttar Pradesh.

4.9 During 2003-04, scheduled UCBs witnessed several positive developments pertaining to balance sheet, profit and income, and asset quality (Table IV.4). The deposits and advances of scheduled UCBs continued to grow during 2003-04. The policy induced changes in the composition of assets of UCBs, especially, the growth of investments in Government securities, led to a significant improvement in both the asset quality and profitability of scheduled UCBs. The net profit of the scheduled UCBs showed a substantial growth of 40.4 per cent, while the net loss of UCBs declined by 69.1 per cent. Tier I capital of scheduled UCBs as a group increased considerably to Rs.297 crore in 2003-04 from a negative Rs.10 crore in 2002-03. It may be noted that the negative Tier I capital shown for the year ended March 2003 was on account of the combined effect of negative Tier I capital in respect of (i) Madhavpura Mercantile Co-operative Bank Ltd., (ii) Charminar Co-operative Urban Bank Ltd., (iii) Vasavi Co-operative Urban Bank Ltd., (iv) Bombay Mercantile Co-operative Bank Ltd., (v) Janata Sahakari Bank Ltd., (vi) Mapusa Urban Co-operative Bank Ltd. and (vii) Rupee Co-operative Bank Ltd. on the aggregate position. Tier II capital also recorded a modest increase of 21.7 per cent. Non-performing assets declined both in absolute as well as percentage terms. The decline in net NPAs was higher due to increased provisioning.

Regulation and Supervision of UCBs

4.10 UCBs are registered as societies under the Co-operative Societies Act of the respective State Governments, and UCBs that have a multi State presence are registered under the Multi State Co-operative Societies Act administered by the Government of India. While registration, administration, amalgamation and liquidation of UCBs are governed by the provisions of the

Table IV.4: Key Financial Indicators of Scheduled UCBs
(As at end-March)

(Amount in Rs. crore)

Items	2003	2004	Variation (in per cent)
1	2	3	4
Number of Scheduled UCBs	56	55	–
Paid up capital	608	707	16.2
Reserves (excluding loan loss provisions)	2,195	2,488	13.4
Tier I capital	-10	297	–
Tier II capital	434	529	21.7
Deposits	36,024	39,305	9.1
Investment in Government and other approved securities	10,806	13,954	29.1
Loans and Advances	22,941	23,962	4.5
Gross NPAs	6,927	6,892	-0.5
Net NPAs	3,827	3,509	-8.3
Net Profit	354	497	40.4
Net Loss	326	101	-69.1
Accumulated Losses	2,276	2,320	1.9

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

State Co-operative Societies Acts, banking related functions are governed by the provisions of Banking Regulation Act, 1949 (AACS).

4.11 An Ordinance to amend the Banking Regulation Act, 1949 and DICGC Act, 1961 was promulgated on September 24, 2004 to enable the Reserve Bank to issue licence to Multi State Co-operative Societies to carry on banking business. This was in response to developments following the Supreme Court judgement dated October 29, 2003 that the Reserve Bank could not issue banking licences to a society registered under the Multi State Co-operative Societies Act (MSCS Act), 2002. The Supreme Court ruling raised doubts about the legality of the licences issued to the existing multi State UCBs by the Reserve Bank under the Banking Regulation Act, 1949. This amendment would enable the Reserve Bank to issue licences to co-operative societies registered under the Multi State Co-operative Societies Act, 2002. The multi State co-operative banks have also become 'eligible banks' under Section 2(gg) of the DICGC Act so that their deposits can be insured by the Deposit Insurance Credit Guarantee Corporation in the interest of the small depositors.

4.12 The Reserve Bank since 2000-01 has sought to align the regulatory regime for the UCBs with that of commercial banks by introducing several measures relating to prudential norms, capital adequacy, asset classification, provisioning norms, individual and group exposure norms, ALM framework, *etc.*

4.13 The Reserve Bank constituted a Screening Committee of eminent external experts in June 2001 to examine the various factors influencing the viability of proposed banks including the background and credit-worthiness of promoters of proposed new UCBs, and the environment/business projections submitted by the promoters. During 2003-04, 118 proposals for setting up of new UCBs were placed before the Committee for consideration. Three UCBs, which were granted 'in principle' approval during 2002-03, were issued banking licences during 2003-04. However, the Committee recommended that for all newly proposed UCBs, it should be made mandatory to come into being through a process of graduation on the strength of demonstrated and verifiable track record. Subsequently, it has been decided to consider issuance of fresh licences only after a comprehensive policy on UCBs is put in place.

4.14 During 2003-04, 104 licences were issued for opening new branches to 86 UCBs. According to the detailed guidelines issued by the Reserve Bank to UCBs on opening of Extension Counters (ECs), only those UCBs which are not classified as Grade III/IV can open ECs within the premises of educational institutions, big offices, factories and hospitals, of which the UCB is the principal banker provided the nearest branch of the bank is beyond 10 kms from the concerned institution. The eligibility for opening ECs for UCBs in Grade I/II requires that the own funds should not be less than the minimum required for opening of new branch at the place where the proposed EC is to be opened, and also subject to compliance with CRR/SLR, priority sector lending targets, other provisions of Banking Regulation Act, 1949 (AACS) and other instructions issued by the Reserve Bank. Further, only those UCBs that show net profits for the last three years and have net NPAs below 7 per cent can offer safe deposit locker facility subject to provisions of adequate security arrangements. While scheduled UCBs, which satisfy the eligibility criteria have been permitted to open ECs and obtain *post facto* approval from the Reserve Bank, non-scheduled UCBs require prior permission of the Reserve Bank for opening an EC.

4.15 The Board for Financial Supervision (BFS) of the Reserve Bank has been playing a critical role in enhancing the quality of regulation of urban co-operative banks on the basis of its deliberations and guidance while considering the inspection summaries of scheduled UCBs placed before the Board as well as other matters referred to it (Box IV.1).

Know Your Customer Guidelines

4.16 UCBs have also been subjected to 'Know Your Customer' (KYC) norms. These guidelines relate to identification of depositors, and require the banks to put in place systems and procedures to help control financial frauds, identify money laundering and suspicious activities, and scrutiny/monitoring of large value cash transactions. UCBs were advised that the information collected from customers as part of KYC guidelines was confidential and not to be used for cross selling of services of various products by the banks. UCBs desirous of collecting information about customers for

Box IV.1: The Role of BFS in the Regulation of Co-operative Banks

The Board for Financial Supervision (BFS) suggested in March 2004 that till such time that appropriate regulatory/legislative framework be put in place, no fresh licences for setting up of UCBs should be issued. The suggestion was accepted and incorporated in the annual policy Statement 2004-05 announced on May 18, 2004.

Apart from this, the BFS has proposed a graded response to the issue of granting banking licences to existing unlicensed banks based on their eligibility criteria. Further BFS directed that only financially strong scheduled UCBs should be allowed to keep the deposits of non-scheduled UCBs to avoid contagion effect of failure of one UCB on other UCBs. The need for framing a 'Prompt Corrective Action' mechanism based on certain financial trigger points was also underscored by the Board, and as directed by the Board, a paper on Escalatory Framework of Supervisory Action is under preparation. In case of several scheduled UCBs whose financials were weak, the Board directed that the concerned State Governments be advised to infuse capital in the banks to the extent required to meet the prescribed CRAR level. If capital funds are not infused within the prescribed time, the banks which had placed deposits with these banks (having solvency problem) would require to treat these deposits as NPAs.

Supervisory ratings based on CAMELS ratings, as applicable to commercial banks was introduced, initially for the scheduled UCBs with effect from March 2003, on an experimental basis. Simplified rating model for large non-scheduled urban co-operative banks based on CAEL parameters has been introduced from March 2004.

purposes other than KYC requirements could do so separately by obtaining customers' approval for making use of such information.

Priority Sector Lending

4.17 According to the targets prescribed, the UCBs are required to extend 60 per cent of total loans and advances for lending to the priority sector and of the total priority sector advances, at least 25 per cent (or 15 per cent of the total loans and advances) should be extended to weaker sections. In order to ensure that credit is available to all segments of the Small-Scale Industry (SSI) sector, (classified on the basis of investment in plant and machinery), certain sub-targets have also been specified (Table IV.5).

4.18 As at end-March 2003[2], UCBs had extended Rs 42,633 crore to the priority sector constituting 62.1 per cent of total loans and advances (Table IV.6). Segment-wise break up shows that the highest percentage of priority sector advances was extended to cottage and small-scale industries followed by housing, and small business enterprises.

Refinance Facilities

4.19 During 2003-04 (April-March), four UCBs were sanctioned refinance to the tune of Rs.466.89 lakh under Section 17(2)(bb) read with Section 17(4)(C) of the Reserve Bank of India Act, 1934.

Entering into Insurance Business

4.20 Scheduled UCBs having a minimum net worth of Rs.100 crore and complying with exposure norms and connected lending have been allowed to act as corporate agents to undertake insurance business without risk participation after obtaining the approval of the Reserve Bank.

Standing Advisory Committee on Urban Co-operative Banks

4.21 The Standing Advisory Committee on UCBs constituted by the Reserve Bank is a high

Table IV.5: Sub-targets for Priority Sector Lending by UCBs

Sr. No.	Category	Investment in plant and machinery	Per cent to total SSI advances
1	2	3	4
1.	Cottage industries, khadi & village industries, artisans and tiny industries	Upto Rs. 5 lakh	40
2.	Cottage industries, khadi & village industries, artisans and tiny industries	Between Rs. 5 lakh and Rs. 25 lakh	20
3.	Other SSI units	Between Rs. 25 lakh and Rs. 100 lakh	40

[2] The data on priority sector advances of UCBs are available upto end-March 2003.

Table IV.6: Priority Sector and Weaker Section Advances: Segment-wise
(As on March 31, 2003)

(Amount in Rs. crore)

Segments	Priority Sector Advances	Weaker Section Advances
1	2	3
1. Agriculture and Allied Activities	2,143 (5.0)	668 (6.3)
2. Cottage and SSI	9,252 (21.7)	1,373 (12.8)
3. Road and Water Transport Operators	2,876 (6.8)	614 (5.7)
4. Private Retail Trade (Essential Commodities)	3,444 (8.1)	866 (8.1)
5. Retail Trade (others)	3,702 (8.7)	1,108 (10.4)
6. Small Business Enterprises	6,043 (14.2)	1,441 (13.5)
7. Professional & Self Employed	5,134 (12.0)	1,605 (15.0)
8. Educational Loans	1,228 (2.9)	403 (3.8)
9. Housing Loans	6,835 (16.0)	2,287 (21.4)
10. Consumption Loans	1,975 (4.6)	326 (3.1)
Total	**42,633** (100.0)	**10,690** (100.0)
Percentage to total advances	**62.1**	**15.6**

Note: Figures in brackets are percentages to respective advances.

powered body chaired by a Deputy Governor and comprising members from Central and State Governments, IBA, DICGC, NABARD and federations of UCBs to give expert advice on policy matters pertaining to UCBs. The Committee had recommended in December 2002, that there should be representation of non-member depositors on the Board of UCBs so as to protect the interests of such depositors, as the proportion of non-member deposits to total deposits is very high in the UCBs. Accordingly, State Governments have been requested to consider amending their respective State Co-operative Societies Act so as to give representation to the non-member depositors on the Board of UCBs. With a view to reinforcing the consultative process in a more constructive manner, to address the structural/ regulatory and supervisory issues relating to UCBs and facilitating the process of formulating future approaches for this sector, it has been decided that the Committee would meet on a quarterly basis in future.

Ban on Loans to Directors and Interested Companies

4.22 The overall ceiling on loans to directors, their relatives, and concerns in which they are interested was brought down to five per cent of bank's demand and time liabilities in December 2002. A few instances, however, of an undue concentration of advances in the hands of a few borrowers, including directors and their relatives, were brought to the notice of the Reserve Bank. The Joint Parliamentary Committee (JPC), which probed the 'stock market scam and matters relating thereto' recommended that a complete ban be imposed on granting of loans and advances to the directors and their relatives or the concerns in which they are interested. Accordingly, a complete ban on sanction of loans and advances by UCBs to their directors and their relatives and the firms/ concerns in which they are interested has been imposed effective October 1, 2003.

Investments in Government Securities

4.23 UCBs have been advised to step up their SLR investments in Government securities and other approved securities. In order to mitigate the risk arising out of dealing in such securities, it has been prescribed that UCBs should build up Investment Fluctuation Reserve (IFR), out of realised gains on sale of investments and subject to available net profit, of a minimum of five per cent of the investment portfolio in available for sale and held to maturity categories within a period of five years.

Non-SLR Investments by UCBs

4.24 Draft guidelines on UCBs' investments in non-SLR debt securities was placed on the website for comments/suggestions from UCBs. Based on the feedback received, final guidelines were issued in April 2004. The guidelines cover investments in bonds issued by public sector undertakings, unsecured redeemable bonds floated by nationalised banks, bonds/shares issued by AIFIs and units of Unit Trust of India (UTI) and apply to both primary market and secondary market. As per the guidelines, UCBs are not permitted to invest in non-SLR debt securities of original maturity of less than one year. The Board of Directors should fix prudential limits in each category of investments and the aggregate investments in non-SLR debt securities including units of UTI should not exceed 10 per cent of the deposits as on March 31 of the previous year. UCBs' investments in units of UTI should not exceed five per cent of the incremental deposits of the previous year.

Bill Discounting

4.25 UCBs have been issued detailed guidelines/safeguards on purchasing/negotiating/discounting/rediscounting of genuine commercial bills. Banks have been advised to clearly lay down a bills discounting policy approved by their Board of Directors, which should be consistent with their policy of sanctioning of working capital limits.

Concurrent Audit

4.26 All the scheduled UCBs and other UCBs that have deposits above Rs.50 crore were advised in December 1996 to introduce systems of concurrent audit. As recommended by the JPC on 'Stock Market Scam and Matters Relating Thereto', concurrent audit has been made mandatory for all the UCBs. UCBs have been advised to report serious irregularities, if any, pointed out by the Concurrent Auditors to the Reserve Bank together with details of the action taken to rectify the same.

90 day NPA Norm

4.27 In line with the international best practices and to ensure greater transparency, the period for recognition of loan impairment has been reduced from 180 days to 90 days with effect from March 31, 2004 except for gold loans and small loans up to Rs.1 lakh, which continue to be governed by 180 day loan impairment norm.

Reduction of NPAs

4.28 In view of representations received from UCBs/Federations, the time period for receiving and processing of applications for settlement of NPAs up to Rs.10 crore under one-time settlement has been extended up to July 2004 and October 2004, respectively. Registrar of Co-operative Societies of all the States have been advised to issue suitable instructions enabling UCBs to take recourse to Securitisation Act for recovery of NPAs.

4.29 In respect of NPAs included in 'doubtful for more than three years' category on or after April 1, 2004, a higher provisioning requirement of 100 per cent in place of 50 per cent earlier has been prescribed with effect from March 1, 2005. On receipt of requests from Federation/Association of UCBs for granting more time to restructure their accounts and meet stricter prudential norms, it has been decided to grant more time to UCBs for: (i) adopting a graded higher provisioning according to the age of NPAs for the NPAs outstanding as on March 31, 2006, and (ii) a provisioning requirement of 100 per cent for NPAs classified as 'doubtful for more than three years' category.

Identification of NPAs and Provision thereagainst

4.30 It was observed that UCBs wait till the end of financial year to make provisions against NPAs which distorts the quantum of net NPAs as on any date other than the date of annual closure of accounts. UCBs have, therefore, been advised that apart from identifying NPAs on an ongoing basis, they should make provisions for the same at the end of each quarter.

Off-site Surveillance (OSS) System for UCBs

4.31 A revised set of off-site surveillance returns were prescribed for scheduled UCBs effective from the quarter-ended March 2004 to obtain relevant information on areas of supervisory concern, strengthen MIS systems within the scheduled UCBs and to sensitise their managements about the prudential concerns of the supervisory authority and thereby help in self regulation. The content and structure of OSS returns have been modified to reduce the volume of data submission, while enlarging the breadth and depth of information being obtained from UCBs. The UCBs now have to submit eight returns including one annual return from the quarter ended April 2004.

4.32 The scope of OSS has been extended to cover non-scheduled UCBs with a deposit base of Rs.100 crore and above from the quarter-ended June 2004. The remaining non-scheduled UCBs would be brought under OSS in a phased manner. A revised application software developed by the Reserve Bank has been installed in all the UCBs covered under OSS enabling them to submit all the regulatory and supervisory returns in electronic format. The accuracy of data submission by UCBs is ensured through validation checks built in the application package. The application package also enables Regional Offices to capture the data received from UCBs electronically and the data gets replicated in the server installed in Central Office over the INFINET.

Prompt Corrective Action

4.33 As a framework for initiating prompt corrective action, a system of gradation of UCBs based on critical financial parameters *viz.*, capital adequacy, net non-performing advances and profitability has been introduced. Gradation is communicated to problem banks to enable them to formulate action plans for corrective action (Box IV.2). Only UCBs having strong financials are allowed to declare dividend.

Banks under Directions

4.34 Reserve Bank issues directions under Section 35A in respect of banks, which are in serious financial difficulty. The directions may be issued either as a consequence of findings of the inspection report or due to sudden developments like a run on the bank, *etc.* The directions may include restriction on deposit taking, withdrawal of deposits with or without a ceiling, further expansion of loans, restriction on incurring expenditure other than minimum establishment expenses required for day to day running of the bank, *etc.* The banks placed under directions are monitored and the restrictions may be gradually removed depending upon the ability of banks to rectify the inadequacies (Appendix Table IV.2).

Reconstruction Schemes

4.35 The reconstruction schemes approved by the Reserve Bank in the recent past, in respect of a few UCBs, which landed into financial difficulty, have not been progressing as intended. Accordingly, it has been announced in the annual policy Statement for the year 2004-05 that only such reconstruction schemes would be considered, which envisage recapitalisation by the stakeholders *viz.*, the shareholders/co-operative institutions/ Government to the extent of achieving the prescribed capital adequacy norms, without infusion of liquidity through settlement of insurance claims by DICGC, and schemes that lay a clear road map for reducing the NPA level to a tolerable limit within a stipulated time-frame.

Administration of UCBs under liquidation

4.36 Keeping a constant vigil on the UCBs, the Reserve Bank took measures as cancellation of licences and rejection of licence applications to eliminate financially unviable entities from the urban banking sector. Also, the Registrars of Co-operative Societies (RCS) were asked to initiate liquidation proceedings in a few banks (Appendix Table IV.3). Further, the liquidators appointed by the RCS in a few banks were found to be directly linked with other UCBs in the area. It was also noticed by DICGC that the claim list submitted in respect of UCBs under liquidation contained several inadequacies. In order to overcome such shortcomings, RCS of all the States were requested to frame criteria for appointment of liquidators with suitable qualifications. Further, certification by a Chartered Accountant of the deposit claim list forwarded by UCBs under liquidation/amalgamation/merger/restructure has been introduced.

Other Supervisory Initiatives

4.37 In order to reduce UCBs' exposure to the capital market, the margin requirement on

Box IV.2: Grading of UCBs Based on Critical Financial Parameters

For regulatory purposes, a system of grading has been adopted under which UCBs are being classified into four categories (Grade I/II/III/IV). The criteria for classification is as follows.

Sound banks having no supervisory concerns are classified as Grade I. Banks meeting any one of the following parameters are classified under Grade II (problem banks): (i) CRAR of one per cent below the prescribed norms, or (ii) net NPAs of 10 per cent or more, but below 15 per cent, or (iii) incurred a net loss for the previous financial year, or (iv) defaults in the maintenance of CRR/SLR in the previous financial year and/ or there is more or less a continuous default in maintenance of CRR/SLR during the current year.

Banks meeting any two of the following conditions are classified under Grade III: (i) CRAR of less than below 75 per cent of the minimum prescribed but 50 per cent or above the level required; (ii) net NPA of 10 per cent or more, but less than 15 per cent; (iii) incurred net losses for two years out of the last three years. Banks meeting the following conditions are classified under Grade IV: (i) CRAR of less than 50 per cent of the prescribed limit and (ii) net NPA at 15 per cent or more or incurred net losses for the last three consecutive years.

As at end-June 2004, the financial position of 732 UCBs were not considered satisfactory and were categorised under Grade III/IV (Table). While, 307 banks have been classified as Grade II (where slight deterioration in the financial condition is noticed), 529 banks are in Grade III (where the financial condition has deteriorated requiring supervisory action *viz*., ban on declaration of dividend, ban on opening of branches, *etc*.), and 203 banks in Grade IV (where the financial condition has worsened to such an extent requiring drastic supervisory action *viz*., imposition of directives, amalgamation, reconstruction, liquidation, *etc*.).

Table: Centre-wise Gradation of UCBs

Centres	Number of banks				Total
	Grade I	Grade II	Grade III	Grade IV	
1	2	3	4	5	**6**
Ahmedabad	132	53	93	50	**328**
Bangalore	105	58	115	20	**298**
Bhopal	24	18	25	15	**82**
Bhubaneswar	1	5	4	2	**12**
Chandigarh	11	0	2	4	**17**
Chennai	31	22	66	14	**133**
Guwahati	6	1	6	6	**19**
Hyderabad	44	21	56	13	**134**
Jaipur*	27	5	6	2	**40**
Jammu	2	2	0	0	**4**
Kolkata	30	9	6	6	**51**
Lucknow	57	3	12	8	**80**
Mumbai	303	61	68	31	**463**
Nagpur	75	41	38	22	**176**
New Delhi	12	0	3	1	**16**
Patna	5	0	0	0	**5**
Thiruvananthapuram	15	8	29	9	**61**
Total	**880**	**307**	**529**	**203**	**1,919**

* One UCB non-functional.
Note : Gradation in respect of 6 UCBs not determined.

advances against shares/debentures has been increased to 50 per cent with effect from January 5, 2004.

4.38 UCBs have been advised not to open Constituents' Subsidiary General Ledger (CSGL) Accounts of other UCBs, and to settle all their Government securities transactions compulsorily through Clearing Corporation of India Limited (CCIL). UCBs are advised to open demat account with a depository participant for holding public sector undertakings' (PSU) securities.

4.39 It has been the endeavour of the Reserve Bank to develop the urban co-operative banking sector on sound lines in order to provide security to depositors as well as bridge the financing gaps for SSIs, SMEs and small borrowers. Though the supervisory standards of these banks have been streamlined in recent years to bring them on par with the commercial banks, it is sometimes argued that these standards which are designed primarily for the commercial banks may not be suitable for the co-operative credit structure. International comparison of the existing regulatory framework for co-operative banking sector in a few major countries also indicates that in order to ensure overall smooth functioning of the financial system, it may be necessary to inculcate sound financial discipline in these institutions (Box IV.3).

Box IV.3: Regulation of Co-operative Banks: International Comparison

The origin of co-operative principles can be traced to 1800 - the early stage of Europe's industrial revolution. At first, the philosophy of equality, equity and self-help was confined mainly to the area of retail trade. The ideas of self-help, self-responsibility and self-administration deployed by a few men of vision like Raiffeisen and Schulze in Germany, spread very rapidly through Europe and rest of the world with the result that there are now more than 60,000 credit co-operatives operating in more than 100 countries.

At present, a majority of co-operative banks in Europe have acquired universal bank status, providing a full range of financial services to all types of customers (members and clients alike) as opposed to focusing on serving members with a specific product range. In some member states of the European Community, co-operative banks have been eminently successful *viz*., the Credit Agricole in France, Raiffeisen and People's Banks in Germany, Rabobank Nederland in the Netherlands and Austrian Raiffeisen banks. Co-operative banks with the universal bank status are subject to banking supervisory legislation in common with their commercial and savings bank competitors. The universal bank status accorded to co-operative banks entails that they are the only players in the banking market to have expanded their global market share in most European countries during the past two decades. The European Association of Co-operative Banks, created in 1970, functions as spokesperson for co-operative banks to the European Community (EC) authorities and comprises of member organisations from all the EC member states, Austria, the Czech Republic, Finland, Hungary, Sweden and Poland.

In the United States, co-operative banks, known as credit unions (CUs), with certain unique characteristics have evolved as increasingly competitive and customer-oriented providers of financial services to more than 68 million people. Like banking companies, CUs in the United Sates have a dual charter system - Federal or State. State-chartered credit unions are examined and supervised by state agencies, while federally chartered credit unions are examined and supervised by the National Credit Union Administration (NCUA), an agency of the federal government. The NCUA also examines state-chartered, federally insured institutions. In addition to chartering, supervising, examining, and insuring federal credit unions, the NCUA insures the accounts of state-chartered credit unions that voluntarily exercise the option to be federally insured, or are required by state law to be so. The credit union industry in the US has many tiers: credit unions, local chapters and State leagues of CUs, corporate credit unions, a national credit union 'bankers' bank', and national trade associations. Regulatory structures consist of a federal agency, a liquidity branch of that agency, and State regulators. A corporate credit union (CCU) is a credit union, providing investment, settlement, and liquidity services for its members. A CCU also serves as a bankers' bank for credit unions, accepting deposits and lending to them when loan demand is high. CCUs also provide their members with cheque clearing, automated clearing house processing, and other services, and function as a credit union clearing house. Charters generally establish rules for application requirements, purpose, membership, branching, and regulatory supervision. State-chartered CUs are examined and supervised by State agencies, while federally chartered CUs are examined and supervised by the NCUA. NCUA aids in CUs' insurance, liquidity and liquidation through its two operations National Credit Union Share Insurance Fund (NCUSIF) and the Central Liquidity Facility (CLF). The NCUA also examines State-chartered federally insured institutions.

The strength of the US credit union system, both State and Federal, depends on preserving the basic principle of dual chartering. Dual chartering system means that credits unions should have a meaningful choice between two strong and distinct charters: State or Federal. Credit union's ability to choose, to pass judgment on a charter by voting creates a healthy competition between charters creating an incentive for regulators (both State and Federal) to maximise efficiency in their examinations, reduce costs, and take innovative approaches to regulation while maintaining high standards for safety and soundness. These examination efficiencies and innovative approaches in turn, once proven successful, spread throughout the system. The concept of dual chartering also provides an invaluable safety valve for the credit union system.

Credit co-operatives of one form or another existed in some Australian states as far back as 1905. The first State Co-operative Act in Australia was passed in 1923 and was amended by a more flexible Small Loans Act in 1941. In 1946, the first of modern credit unions was registered in Sydney. During the formative period, most credit unions were parish or community oriented organisations. However, the co-operative concept of promoting thrift was quickly embraced by industry and employer groups, and the present movement is a mix of industry based credit unions, affinity based credit unions and community credit unions.

In Australia, it was decided to implement the recommendations of the Financial System Inquiry, 'The Wallis Report' which suggested a single prudential regulator for all deposit taking institutions including CUs, building societies and banks. The rationale was that all deposit taking institutions should provide the same level of safety to consumers. In July 1999, all Australian CUs moved from the State based Financial Institutions (FI) Scheme to the new national system of prudential and corporate regulation under the Australian Prudential Regulation Authority (APRA) and the Australian Securities and Investments Commission (ASIC). Consequently, CUs are supervised on the same basis as all other financial institutions, including banks. Under the new corporate regulatory system, credit unions became companies limited by shares under the corporation law. Every member of a credit union became a shareholder with one vote. Credit unions are thus similar to companies limited by shares and bound by the principles of mutuality, developed by the Credit Union Movement. Since July 1999 all CUs became public companies governed by the Corporations Act and regulated by the ASIC. The CUs operate within the regulatory framework and prudential supervision of the APRA. This structure provides high prudential standards for risk management, capital adequacy and disclosure.

References:

Ravoet, G. (1994), 'The Challenge Facing European Co-operative Banks', The World of Co-operative Enterprise, Plunkett Foundation.

Thomas, T. (1994), 'The Future Development of Co-operative Banks', The World of Co-operative Enterprise, Plunkett Foundation.

Official websites of National Credit Union Administration, USA, Australian Prudential Regulatory Authority, and Australian Institute of Credit Union Directors.

Resource Mobilisation and Deployment

4.40 The deposits and advances of the UCBs in 2003-04 increased by 8 per cent and 3 per cent, respectively, over 2002-03 and stood at Rs.1,10,256 crore and Rs.67,930 crore, respectively, as at end-March 2004. The paid up capital at Rs.3,267 crore as on March 31, 2004 showed an increase of 11 per cent over that in end-March 2003 (Chart IV.2).

4.41 When the UCBs were brought under the purview of the Banking Regulation Act, 1949 (AACS) in 1966, there were 1,106 UCBs having own funds to the tune of Rs.58 crore, and their deposits and advances amounted to Rs.153 crore and Rs.167 crore, respectively. As on March 31, 2004, there were 1,924 banks whose own funds amounted to Rs.12,348 crore. Their deposits and advances registered a substantial rise and stood at Rs.1,10,256 crore and Rs.67,930 crore, respectively. The region-wise financial position of UCBs displayed wide regional diversity (Table IV.7).

Investments

4.42 The SLR investments of all the UCBs increased to Rs.45,299 crore from Rs.38,739 crore as at end-March 2004 registering an increase of 17 per cent over end-March 2003 partly due to a switch in deployment of funds from non-SLR investments. The non-SLR investments in bonds of public sector institutions/All India Financial Institutions (AIFIs), shares of AIFIs and units of UTI declined to Rs.2,921 crore as at end-March 2004 from Rs.3,349 crore as at end-March 2003.

Chart IV.2: Performance of Urban Co-operatives Banks

Table No. IV.7: Financial Indicators of Urban Co-operative Banks : Region-wise
(As at end-March 2004)

(Amount in Rs. crore)

Region	Share capital	Free Reserves	Deposits	Advances	Investments	CD Ratio
1	2	3	4	5	6	7
Ahmedabad	440	1,584	16,279	9,703	8,305	59.6
Bangalore	355	1,018	8,353	5,372	3,277	64.3
Bhopal	47	77	1,159	613	532	52.9
Bhubaneswar	22	38	606	345	313	56.8
Chandigarh	24	40	568	325	246	57.2
Chennai	146	162	3,132	2,121	1,342	67.7
Guwahati	8	8	276	135	121	48.8
Hyderabad	111	145	2,113	1,379	924	65.2
Jaipur	59	84	1,052	612	442	58.1
Jammu	4	4	184	112	52	60.5
Kolkata	96	107	1,750	929	969	53.1
Lucknow	138	262	2,310	1,442	781	62.4
Mumbai	1,468	4,957	60,725	37,424	25,842	61.6
Nagpur	239	399	8,628	5,628	3,615	65.2
New Delhi	36	83	850	308	415	36.3
Patna	3	7	30	17	15	56.4
Thiruvananthapuram	71	105	2,240	1,467	1,029	65.5
Total	**3,267**	**9,082**	**1,10,256**	**67,930**	**48,220**	**61.6**

Non-Performing Assets

4.43 The gross non-performing advances declined by 5 per cent to Rs.11,922 crore at end-March 2004 from Rs.12,509 crore as at end-March 2003. Net NPAs declined by 12 per cent to Rs.5,683 crore from Rs.6,428 crore during the same period (Table IV.8). In percentage terms, gross NPAs declined to 17.6 per cent from 19.0 per cent and net NPAs declined to 11.1 per cent from 13.0 per cent for the period under consideration. In absolute terms, however, the Gross and Net Non-Performing Investments have increased by 13 per cent and 14 per cent, respectively, *i.e.*, to Rs.365 crore from Rs.324 crore and to Rs.276 crore from Rs.242 crore, respectively, for the same period.

Table IV.8: Gross Non-Performing Assets of Urban Co-operative Banks

(Amount in Rs. crore)

Year (as at end-March)	No. of Reporting UCBs	Gross NPAs (Rs.crore)	Gross NPA as a percentage of total Advances
1	2	3	4
2000	1,748	4,535	12.2
2001	1,942	9,245	16.1
2002	1,937	13,706	21.9
2003	1,941	12,509	19.0
2004	1,926	11,922	17.6

Financial Performance of Scheduled UCBs

4.44 The size of scheduled UCBs declined during 2003-04 reflecting contraction of the UCB sector and a moderate decline in their numbers. The composition of liabilities remained broadly the same with modest decline in the share of deposits (Table IV.9). On the asset side, the share of investments increased while the share of loans and advances declined. This was in line with the trend witnessed in 2002-03 and in consonance with developments in the other segments of the financial sector.

4.45 The scheduled UCBs registered an increase in net profit due to a sharper decline in expenditure *vis-à-vis* income (Table IV.10). Interest income continued to decline as a proportion of total income. This was reflective of the changing asset composition and was in tune with the trends witnessed in the banking sector. The share of interest expenditure as well as operating expenditure increased while the provisions and contingencies nearly halved in absolute terms. Bank-wise details on the major indicators of financial performance of the scheduled UCBs are given in Appendix Table IV.4 and IV.5.

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

(As at end-March)

(Amount in Rs. crore)

Sr. No.	Item	2003	2004
1	2	3	4
1.	Capital	627 (1.2)	698 (1.2)
2.	Reserves	7,451 (14.3)	7,656 (13.6)
3.	Deposits	36,683 (70.2)	39,274 (69.8)
4.	Borrowings	571 (1.1)	642 (1.1)
5.	Other Liabilities	6,949 (13.3)	7,986 (14.2)
	Total Liabilities	**52,281 (100.0)**	**56,256 (100.0)**
1.	Cash	2,834 (5.4)	3,060 (5.4)
2.	Balances with Banks	2,186 (4.2)	2,207 (3.9)
3.	Money at call and short notice	306 (0.6)	424 (0.8)
4.	Investments	13,819 (26.4)	16,796 (29.9)
5.	Loans and Advances	23,854 (45.6)	24,044 (42.7)
6.	Other Assets	9,281 (17.8)	9,727 (17.3)
	Total Assets	**52,281 (100.0)**	**56,256 (100.0)**

* Data comprises of 50 audited and 5 unaudited banks for 2003-04 and 57 banks for 2002-03.

Notes : 1. Figures in brackets are percentages to total liabilities/assets

2. Components may not add-up to the aggregate figures due to rounding-off.

Source : Balance sheet of respective banks.

Table IV.10: Financial Performance of Scheduled Urban Co-operative Banks
(As at end-March)

(Amount in Rs. crore)

Item	2003	2004	Variation of (3) over (2)	
			Absolute	Percentage
1	2	3	4	5
A. Income (i+ii)	**5,291 (100.0)**	**4,995 (100.0)**	**-295**	**-5.6**
i) Interest Income	4,418 (83.5)	4,100 (82.1)	-318	-7.2
ii) Other Income	872 (16.5)	896 (17.9)	23	2.6
B. Expenditure (i+ii+iii)	**5,846 (100.0)**	**4,646 (100.0)**	**-1,200**	**-20.5**
i) Interest Expended	3,380 (57.8)	2,902 (62.6)	-474	-14.0
ii) Provisions and Contingencies	1,349 (23.1)	653 (14.1)	-695	-51.6
iii) Operating Expenses	1,118 (19.1)	1,086 (23.4)	-31	-2.8
of which : Wage Bill	563 (9.6)	594 (12.8)	29	5.2
C. Profit				
i) Operating Profit	**793**	**1,003**	**210**	**26.4**
ii) Net Profit	**-555**	**350**	**905**	**-163.0**
D. Total Assets	**52,281**	**56,256**	**3,976**	**7.6**

* Data comprises of 50 audited and 5 unaudited banks for 2003-04 and 57 banks for 2002-03.

Notes : 1. Figures in brackets are percentage shares in respective totals.
2. Components may not add-up to the aggregate figures due to rounding off.

Source : Balance sheet of respective banks.

3. Rural Co-operatives

4.46 The short-term rural co-operative credit system in India comprising State co-operative banks (StCBs) at the apex (State) level, central co-operative banks (CCBs) at the intermediate (district) level and primary agricultural co-operative Societies (PACS) at the grassroot (village) level, is designed essentially to provide for short-term credit needs for production purposes. StCBs and CCBs have over the years grown substantially in terms of coverage and outreach, and at end-March 2003, their number stood at 30 and 367, respectively. Most of the StCBs and CCBs were established prior to March 1, 1966, the date from which the Banking Regulation Act, 1949 was made applicable to the co-operative banks. Of these, only 13 StCBs and 73 CCBs have been granted licence by the Reserve Bank since 1966. The financial position of most of the StCBs and CCBs does not show any perceptible improvement. The accumulated losses of CCBs have increased to Rs.4,442 crore in 2002-03 from Rs.3,217 crore in 2000-01. The percentage of recovery to demand for StCBs and CCBs declined to 79 per cent and 61 per cent, respectively, in 2002-03 from 84 per cent and 67 per cent, respectively, in 2000-01. As on March 31, 2003, the gross NPAs to gross credit of StCBs and CCBs increased to 18 per cent and 22 per cent, respectively, from 12.7 per cent and 18.3 per cent, respectively, as at end-March 2001. Many of these short term rural co-operatives did not meet the minimum capital and reserve requirements stipulated under Section 11(1) of the Banking Regulation Act, 1949 (AACS).

4.47 State co-operative agriculture and rural development banks (SCARDBs) and primary co-operative agriculture and rural development banks (PCARDBs) which constitute the long-term rural co-operative credit structure, have negligible resource base of their own, and mostly raise resources through borrowings. Their poor recovery performance has affected their ability particularly at the primary level to cater to the credit needs of new and non-defaulting members. This has also resulted in low paid-up share capital, which constrains their borrowing capacity, and the consequent limited resources have inevitably led to low business levels.

4.48 Subsequent to the announcement made in the Union Budget 2004-05, Government of India has appointed a Task Force on Co-operatives under the Chairmanship of Prof. A. Vaidyanathan. The terms of reference include (i) to recommend an implementable action plan for reviving the Rural Co-operative Banking Institutions, taking into consideration, *inter alia*, the main recommendations made by various committees in this regard; (ii) to suggest an appropriate regulatory framework and the amendments, which may be necessary for the purpose, in the relevant laws; (iii) to make an assessment of the financial assistance that the Co-operative Banking Institutions will require for revival, the mode of such assistance, its sharing pattern and phasing; and (iv) to suggest any other measures required for improving the efficiency and viability of Rural

Co-operative Credit Institutions. The Task Force is expected to submit its report shortly.

Prudential Guidelines on Investment in Non-SLR Debt Securities

4.49 In order to streamline the investments made by StCBs and the CCBs, and to contain the risk arising out of their non-SLR investment portfolio, prudential guidelines on investment in non-SLR debt securities were issued in February 2004 on similar lines as those issued to scheduled commercial banks.

Inter-Branch Adjustment Accounts- Provisioning for Net Debit Balances

4.50 It was observed from the various financial indicators of the StCBs and CCBs that the number and amount of outstanding debit entries in the Inter-Branch Adjustment Accounts and the amount involved thereunder were increasing over the years. In order to put in place the best international accounting standards, it was decided to prescribe prudential provisioning norms for net debit balances outstanding in their Inter Branch Accounts in a phased manner. These instructions were issued in January 2004.

Licensing of State Co-operative Banks / Central Co-operative Banks

4.51 No StCB or CCB has been granted licence during 2003-04 under Section 22 of the Banking Regulation Act, 1949 (AACS) and the total number of licensed StCBs and CCBs stood at 13 and 73, respectively.

4.52 The licence applications of four CCBs, *viz*., Sibsagar DCCB Ltd. (Assam), Madhepura-Supaul DCCB Ltd., Darbhanga DCCB Ltd. (Bihar) and Raigad DCCB Ltd. (Chattisgarh) have been rejected during the year under review, taking the total number of such cases to seven.

State Co-operative Banks

Scheduling of StCBs

4.53 No StCB was included during 2003-04 in the Second Schedule under Section 42 of the Reserve Bank of India Act, 1934. The total number of scheduled StCBs remained unchanged at 16 as on March 31, 2004.

4.54 The composition of the liabilities of the StCBs in terms of major components (*viz*., capital, reserves, deposits, borrowings and other liabilities) remained broadly unaltered between end-March 2002 and end-March 2003 (Table IV.11). The recovery performance of StCBs as a proportion of demand at the all-India level declined to 79 per cent in 2002-03 from 82 per cent in 2001-02. Among the various States/Union Territories, the recovery performance in Rajasthan and Sikkim improved considerably, while it declined significantly in Andhra Pradesh and Arunachal Pradesh. The States where StCBs achieved more than 90 per cent recovery during 2002-03 include Gujarat, Haryana, Kerala, Madhya Pradesh, Punjab, Rajasthan and Tamil Nadu.

Table IV.11: Composition of Liabilities and Assets of State Co-operative Banks
(As at end-March)

(Amount in Rs. crore)

Sr. No.	Item	2002	2003
1	2	3	4
1	Capital	832 (1.5)	812 (1.4)
2	Reserves	5,880 (10.2)	6,348 (11.9
3	Deposits	36,191 (63.0)	36,658 (63.4)
4	Borrowings	11,673 (20.3)	11,365 (19.7)
5	Other Liabilities	2,902 (5.0)	2,579 (4.6)
	Total Liabilities	**57,478 (100.0)**	**57,762 (100.0)**
1	Cash and Bank Balance	3,576 (6.2)	3,693 (6.4)
2	Investments	16,825 (29.3)	17,210 (29.8)
3	Loans and Advances	32,678 (56.8)	32,798 (56.7)
4	Other Assets	4,399 (7.7)	4,061 (7.1)
	Total Assets	**57,478 (100.0)**	**57,762 (100.0)**

Notes : 1. Figures in brackets are percentages to total liabilities/assets.
2. 'Reserves' include credit balance in Profit and Loss Account shown separately by some of the banks.
3. Data for StCBs in the States of Rajasthan, Delhi, Jammu & Kashmir, Manipur, Bihar and Arunachal Pradesh not yet received.
4. Data for 2003 are provisional.

Source: NABARD.

Financial Performance of StCBs

4.55 There was a decline in overall income and expenditure of StCBs during 2002-03. However, the net profit increased mainly due to increase in miscellaneous income and reduction in wage bill (Table IV.12). Out of 24 reporting StCBs, 21 have earned profits aggregating to Rs.463 crore, while 3 made losses amounting to Rs.29 crore.

Central Co-operative Banks

4.56 The composition of the liabilities of Central co-operative banks (CCBs) remained broadly unaltered between end-March 2002 and end-March 2003 (Table IV.13). Deposits continued to account for nearly two-thirds of the total liabilities, while reserves recorded a growth of 19.7 per cent.

4.57 At the all-India level, recovery performance of CCBs declined to 61 per cent for the year 2002-03 from 66 per cent during 2001-02. A few States such as, Chattisgarh and Himachal Pradesh, registered improvement in recovery performance, while the recovery performance in Andhra Pradesh, Bihar, Jammu & Kashmir, Jharkhand, Karnataka, Orissa and Tamil Nadu declined considerably. Punjab and Uttaranchal achieved more than 80 per cent recovery during 2002-03 (Appendix Table IV.6).

Table IV.12: Financial Performance of State Co-operative Banks
(As at end-March)

(Amount in Rs. crore)

Item	2002	2003	Variation of (3) over (2) Absolute	Percentage
1	2	3	4	5
A. Income (i+ii)	**5,809 (100.0)**	**5,572 (100.0)**	**-237**	**-4.1**
i) Interest Income	5,508 (94.8)	5,229 (93.8)	-279	-5.1
ii) Other Income	301 (5.2)	343 (6.2)	42	14.0
B. Expenditure (i+ii+iii)	**5,632 (100.0)**	**5,137 (100.0)**	**-495**	**-8.8**
i) Interest Expended	4,192 (74.4)	3,978 (77.5)	-214	-5.1
ii) Provisions and Contingencies	1,024 (18.2)	700 (13.6)	-324	-31.6
iii) Operating Expenses	416 (7.4)	458 (8.9)	43	10.3
of which : Wage Bill	304 (5.4)	284 (5.5)	-20	-6.6
C. Profit				
i) Operating Profit	1,201	1,135	-66	-5.5
ii) Net Profit	177	435	258	145.8
D. Total Assets	**57,478**	**57,762**	**284**	**0.5**

Notes : 1. Figures in brackets are percentage to total liabilities/assets.
2. 'Reserves' include credit balance in Profit and Loss Account shown separately by some of the banks.
3. Data for StCBs in the States Rajasthan, Delhi, Jammu & Kashmir, Manipur, Bihar and Arunachal Pradesh not yet received.
4. Data for 2002-03 are provisional.

Source: NABARD.

Table IV.13: Composition of Liabilities and Assets of Central Co-operative Banks
(As at end-March)

(Amount in Rs. crore)

Sr. No.	Item	2002	2003
1	2	3	4
1	Capital	3,424 (3.2)	3,569 (3.1)
2	Reserves	10,717 (9.9)	12,829 (11.2)
3	Deposits	68,181 (63.3)	72,344 (63.0)
4	Borrowings	18,820 (17.5)	19,243 (16.7)
5	Other Liabilities	6,523 (6.1)	6,848 (6.0)
	Total Liabilities	**1,07,665 (100.0)**	**1,14,833 (100.0)**
1	Cash and Bank Balance	7,206 (6.7)	7,704 (6.7)
2	Investments	28,958 (26.9)	29,813 (26.0)
3	Loans and Advances	59,316 (55.1)	63,198 (55.0)
4	Other Assets	12,185 (11.3)	14,118 (12.3)
	Total Assets	**1,07,665 (100.0)**	**1,14,833 (100.0)**

Notes : 1. Figures in brackets are percentage shares to the respective total.
2. 'Reserves' include credit balance in Profit and Loss Account shown separately by some of the banks.
3. Data for CCBs in the States of Jammu & Kashmir, and Bihar not yet received.
4. Data for 2002-03 are provisional.

Source : NABARD.

Financial Performance of CCBs

4.58 CCBs as a whole continued to register losses during 2002-03 as well (Table IV.14 & IV.15). Interest income accounted for nearly 95 per cent of the total income, while interest expenditure accounted for nearly two-thirds of total expenditure. During 2002-03, out of 339 reporting CCBs, 234 made profits amounting to Rs.734 crore, while 105 CCBs made losses to the tune of Rs.859 crore. The deterioration in the overall profitability of CCBs could be attributed to higher expenses for provisions and contingencies.

Table IV.14: Financial Performance of Central Co-operative Banks

(As at end-March)

(Amount in Rs. crore)

Item	2002	2003	Variation of (3) over (2)	
			Absolute	Percentage
1	2	3	4	5
A. Income (i+ii)	**11,546 (100.0)**	**11,808 (100.0)**	**262**	**2.3**
i) Interest Income	10,911 (94.5)	11,188 (94.8)	277	2.5
ii) Other Income	635 (5.5)	620 (5.2)	-15	-2.4
B. Expenditure (i+ii+iii)	**11,579 (100.0)**	**11,933 (100.0)**	**354**	**3.1**
i) Interest Expended	7,693 (66.5)	7,711 (64.6)	18	0.2
ii) Provisions and Contingencies	2,065 (17.8)	2,286 (19.2)	221	10.7
iii) Operating Expenses	1,821 (15.7)	1,936 (16.2)	115	6.3
of which : Wage Bill	1,402 (12.1)	1,441 (12.1)	39	2.8
C. Profit				
i) Operating Profit	**2,031**	**2,162**	**131**	**6.5**
ii) Net Loss	**-34**	**-125**	**–**	**–**
D. Total Assets	**1,07,665**	**1,14,833**	**7,168**	**6.7**

Notes : 1. Figures in brackets are percentage shares to the respective totals.
2. 'Reserves' include credit balance in Profit and Loss Account shown separately by some of the banks
3. Data for CCBs in the States of Jammu & Kashmir and Bihar not yet received.
4. 2002-03 data provisional

Source : NABARD.

Primary Agricultural Credit Societies

4.59 PACS as the grassroot level arm of short-term co-operative credit, mediate directly with individual borrowers, grant short-term to medium-term loans and also undertake distribution and marketing functions. There were 1,12,309 PACS as on March 31, 2003 with about 120 million 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, in particular, has been extending funds to develop the infrastructure of PACS.

NPA Position

4.60 The NPAs assets of rural co-operative banks remained high. The asset quality of the higher tier, *i.e.*, StCBs was, however, relatively better than that of the lower tier, *i.e.*, CCBs (Table IV.16).

Table IV.15: Select Financial Ratios of Co-operative Banks

(As at end-March)

(Per cent)

Item	Scheduled UCBs		StCBs		CCBs	
	2003	2004	2002	2003	2002	2003
1	2	3	4	5	6	7
Operating Profit	1.5	1.8	2.1	2.0	1.9	1.9
Net Profit	-1.1	0.6	0.3	0.9	–	-0.1
Income	10.1	8.9	10.1	9.7	10.7	10.3
Interest Income	8.5	7.3	9.6	9.1	10.1	9.8
Other Income	1.7	1.6	0.5	0.6	0.6	0.6
Expenditure	11.2	8.6	9.8	8.9	10.8	10.4
Interest Expended	6.5	8.3	7.3	6.9	7.2	6.7
Operating Expenses	6.5	5.2	0.7	0.8	1.7	1.7
Wage Bill	1.1	1.1	0.5	0.5	1.3	1.3
Provisions and Contingencies	2.6	1.2	1.8	1.2	1.9	2.0
Spread (Net Interest Income)	2.0	2.1	2.3	2.2	3.0	3.0

Note : Figures are percentage to Total Assets of concerned group.

Table IV.16: Composition of Gross NPAs
(As on March 31, 2003)

(Amount in Rs. crore)

Asset Quality	StCBs	CCBs
1	2	3
Substandard Assets	3,535	7,603
Doubtful Assets	2,443	5,060
Loss Assets	306	1,199
Total NPAs	6,284	13,862
Percentage of NPAs to loans outstanding	18.0	22.0

4.61 Poor recovery performance continues to be a growing area of concern in the case of co-operative credit structure. During 2002-03 both the short-term and long-term credit have witnessed a fall in the rate of recovery.

4.62 In order to address the problem of large NPAs being faced by the rural credit co-operatives, NABARD has issued guidelines to co-operative banks on One-Time Settlement (OTS) scheme for NPAs on the lines of Reserve Bank's guidelines to commercial banks. The guidelines provide for a simplified non-discretionary and non-discriminatory mechanism for compromise settlement of NPAs of Rs.10 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 remained operative initially till September 30, 2003 but was further extended up to July 31, 2004 for acceptance of cases for OTS for NPAs under all loans and up to October 31, 2004 for completion of process of settlement. Finally, co-operative banks were given discretion to formulate OTS scheme for amounts of NPAs beyond the above cut-off level and date with the approval of Board of Directors and the Registrar of Co-operative Societies.

Long-Term Rural Co-operatives

4.63 The long-term co-operative credit structure consists of State Co-operative Agriculture and Rural Development Banks (SCARDBs) and Primary Co-operative Agriculture and Rural Development Banks (PCARDBs). Total number of SCARDBs is placed at 20, while that of PCARDBs is placed at 768.

Performance

4.64 Important performance parameters of SCARDBs and PCARDBs as on March 31, 2002 and March 31, 2003 are given in Table IV.17.

4.65 The share capital of SCARDBs increased at a higher rate of 8 per cent compared with the growth of 4 per cent for PCARDBs. The deposits of both the term-lending rural co-operatives declined during 2002-03 – the decline in deposits of PCARDBs (13.3 per cent) being steeper than that for SCARDBs (4.4 per

Table IV.17: Performance of Long-term Co-operative Credit Structure

(Amount in Rs. crore)

Item	SCARDBs		PCARDBs	
	2002	2003	2002	2003
1	2	3	4	5
Number	20	20	768	768
Share Capital	676	732	856	891
Of which: from State Government	89	90	122	128
Reserves	1,808	2,159	1,637	1,839
Deposits	571	546	256	222
Borrowings	14,845	15,910	10,334	11,217
Loans and advances (issued)	2,746	2,964	2,045	2,151
Loans and Advances (outstanding)	14,147	15,385	9,982	10,775

Notes: 1. Data for 2003 are provisional.
2. The assets and liabilities of Maharashtra SCARDB have been bifurcated between the Apex Bank and DCARMDBs in Maharashtra as on October 1, 2001, with the shift to the federal structure.

Table IV.18: Working Results - SCARDBs and PCARDBs

Agency/year	Total Number	Profit-making		Loss-making	
		Number	Amount (Rs. crore)	Number	Amount (Rs. crore)
1	2	3	4	5	6
SCARDBs					
2000-01	19	10	90	9	129
2001-02	20	9	86	11	180
2002-03	20	8	61	12	163
PCARDBs					
2000-01	732	273	49	459	165
2001-02	768	191	47	577	294
2002-03	768	226	54	542	330

Note : Data are provisional.

cent). On the other hand, loans and advances issued by SCARDBs and PCARDBs increased by 7.9 per cent and 5.8 per cent, respectively. The loans and advances outstanding of SCARDBs increased to Rs.15,385 crore (March 31, 2003) from Rs.14,147 crore (March 31, 2002), showing a growth rate of 8.8 per cent. Similarly, the outstanding loans and advances of PCARDBs increased by 7.9 per cent to Rs.10,775 crore (March 31, 2003) from Rs.9,982 crore (March 31, 2002).

Working Results

4.66 A comparative position of working results of SCARDBs and PCARDBs for three years *viz.*, 2000-01 to 2002-03 reveals that while the total number of SCARDBs has remained more or less static, those of PCARDBs have increased by 36 in 2001-02 (Table IV.18).

4.67 The performance of most of the profit earning SCARDBs showed further improvement, while that of most of the loss making SCARDBs deteriorated further. The performance of the co-operative banks during 2002-03 varied widely across the States. While profit making PCARDBs improved their performance during 2002-03, losses declined in case of many States. The net margin earned by the SCARDBs and PCARDBs continued to be negative at 1.5 per cent and 1.8 per cent, respectively. Ten of the 20 SCARDBs had positive net margins and the remaining ten registered negative net margins. PCARDBs in three States recorded positive net margins, while these in nine States registered negative net margins.

4.68 The profitability of SCARDBs during 2002-03 showed a downward trend as compared with 2001-02, while accumulated losses of both SCARDBs and PCARDBs were on the increase (Table IV.19).

Non-Performing Assets

4.69 The prudential norms of income recognition, asset classification, provisioning were made applicable to SCARDBs/PCARDBs from 1997-98. The NPAs were estimated at Rs.3,134 crore for SCARDBs and Rs.3,569 crore for PCARDBs forming 21.1 per cent and 33.1 per cent of total loans outstanding, respectively, as on March 31, 2003. The NPAs to loans ratio of SCARDBs increased during 2002-03 after showing a decline in 2001-02, while that of PCARDBs continued to rise over the level in 2001-02 (Table IV.20).

Table IV.19: Accumulated losses of SCARDBs and PCARDBs

(Rs. crore)

Year	SCARDBs	PCARDBs
1	2	3
2000-01	907	1,157
2001-02	492*	1,944
2002-03	654	2,325

* Accumulated Losses of 29 DCARMDBs in Maharashtra, which were branches of Maharashtra SCARDB under the unitary structure in 2000-01, now included under PCARDBs in 2001-02 on conversion to federal structure as on October 1, 2001.

Table IV.20: Non-performing Assets of SCARDBs and PCARDBs
(as percentage to loans outstanding)

Agency	2001	2002	2003
1	2	3	4
SCARDBs	20.5	18.5	21.1
PCARDBs	24.3	30.3	33.1

Note: Data in respect of DCARMDBs in Maharashtra not available.

Recovery performance

4.70 Recovery performance of SCARDBs and PCARDBs deteriorated during 2002-03. At the state level, the recovery performance of SCARDBs showed improvements in the states of Jammu & Kashmir and Pondicherry, while for PCARDBs recovery improved only in case of Orissa. The SCARDBs of Haryana, Kerala, Punjab, Pondicherry, Rajasthan, Uttar Pradesh and West Bengal States registered a recovery of above 60 per cent. The average recovery of 201 out of 768 PCARDBs was more than 60 per cent of total demand. However, the average recovery for the entire sector declined to 44 per cent at the end of June 2003 as compared with 48 per cent in end June 2002 (Table IV.21).

Management of Co-operatives

4.71 The phenomenon of supersession of elected Boards of Management continued in many SCARDBs and PCARDBs during the year (Table IV.22).

Co-operative Development Fund

4.72 Co-operative Development Fund (CDF) was constituted by NABARD in the year 1992-93 under the provision of Section 45 of NABARD Act 1981 for strengthening the co-operative credit institutions with emphasis on infrastructure development at primary level, human resource development, improved MIS, *etc*.

Table IV.21: Percentage of Recovery to Demand
(As at end-June)

Agency	2001	2002	2003
1	2	3	4
SCARDBs	58	55	49
PCARDBs	53	48	44

Table IV.22: Elected Boards under Supersession
(As at end-March)

Particulars	SCARDBs	PCARDBs
1	2	3
a. Total number of Institutions	20	768
b. No. of Institutions where Boards are under supersession	8	378
c. Percentage of Boards under supersession	40	49

4.73 During the year 2003-04, a sum of Rs.4.86 crore have been sanctioned and Rs.4.38 crore disbursed to co-operative credit institutions for purposes such as infrastructure development of PACS, computerisation of MIS, purchase of motorcycles for field staff, reimbursement of training expenditure to Agricultural Co-operative Staff Training Institute (ACSTI) / Junior Level Training Centre (JLTC) and as prize money to best performing co-operative credit institutions. Of this, an amount of Rs.75 lakh was sanctioned to 25 StCBs, 15 SCARDBs, National Federation of State Co-operative Banks Ltd. (NAFSCOB), National Co-operative Agriculture and Rural Development Banks' Federation (NCARDBF) and National Centre for Management Development in Agriculture and Rural Development Banking (NCMDARDB) for computerising their MIS against which Rs.56 lakh was disbursed.

Development Action Plan / Memorandum of Understanding

4.74 The mechanism of preparation of institution specific Development Action Plans (DAPs) by co-operative banks introduced in 1994-95 as a measure for institutional strengthening was continued during 2003-04. Memoranda of Understanding (MoU) were executed between the NABARD, State Governments and banks for obtaining proper commitments for taking necessary action to achieve the business targets in DAPs. At the apex level, all 21 StCBs and 10 SCARDBs executed annual MoU for 2003-04. The implementation of DAPs and compliance to MoUs covenants were monitored by the NABARD along with the representatives from State Governments and the Reserve Bank through Monitoring and Review Committees set up at State and district level. The process of Organisation Development Intervention also continued during the year, and in the initial phase, 134 co-operative banks have been covered. This has been instrumental in bringing about perceptible paradigm shift and change in the mindset and attitude of the staff as well as management.

4.75 An impact evaluation study was conducted by the NABARD Regional Offices, and the findings of the study reveal that DAP/MoU exercise had brought about awareness in banks at senior management level of the need to conduct the business of banks in a more professional manner. Banks have also become cost conscious and cost of management as a percentage to working capital had declined in most of the banks. The DAP/MoU process helped banks in diversification of loan business particularly in financing for non-farm sector (NFS), rural housing, SHGs *etc.*, and mobilisation of low cost deposits. Further, the process also contributed to the increase of per employee productivity. Achievement of targets under DAP was found to be in the range of 85 per cent to 100 per cent in owned funds, deposits, loans issued, loans outstanding and working funds.

4. NABARD and the Co-operative Sector

4.76 National Bank for Agriculture and Rural Development (NABARD) is the apex institution entrusted with a pivotal role in 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 investment credit, the Government of India and the Reserve Bank contributed a cumulative amount of Rs.550 crore and Rs.1,450 crore, respectively. With these contributions, the effective capital base of NABARD amounted to Rs.2,000 crore at end-March 2004. NABARD has also been permitted to issue capital gains tax exemption bonds since 2000-01.

4.77 More than 50 per cent of the rural credit is disbursed by the co-operative banks and Regional Rural Banks (RRBs). NABARD is responsible for regulating and supervising the functions of co-operative banks and RRBs. In this direction NABARD has been taking various initiatives in association with Government of India and the Reserve Bank to improve the health of co-operative banks and Regional Rural Banks.

Policy Initiatives by NABARD

4.78 The Board of Supervision (BoS) for StCBs, CCBs and RRBs constituted by NABARD in 1999 to provide guidance and direction to the Bank on matters relating to supervision, met six times during 2003-04. The issues deliberated by the Board of Supervision included *inter alia* review of insolvent StCBs and CCBs, prescription of 'trigger points' for taking supervisory/regulatory action against certain StCBs and CCBs, sponsor bank-wise review of RRBs' performance, review of follow-up action taken in respect of banks recommended for regulatory action. The BoS recommended the introduction of a Common Accounting System for StCBs and CCBs in order to bring about symmetry in their financial statements and transparency through additional disclosures. The recommendations are being examined.

General Line of Credit to NABARD

4.79 The Reserve Bank has been providing General Lines of Credit (GLC) to NABARD under Section 17(4E) of the Reserve Bank of India Act 1934, to enable the latter to meet the short-term credit requirements of scheduled commercial banks, StCBs and RRBs. For the year 2003-04 (July-June), the Reserve Bank sanctioned an aggregate credit limit of Rs.6,500 crore comprising Rs.5,650 crore under GLC-I and Rs.850 crore under GLC-II at rates of interest of 6 per cent and 6.25 per cent, respectively. The GLC limit was renewed at Rs.5,200 crore for the year 2004-05, with GLC-I at Rs.5,000 crore and GLC-II at Rs.200 crore at rates of interest of 6 per cent and 6.25 per cent, respectively.

Amendment of the NABARD Act, 1981

4.80 The NABARD Act, 1981 was amended in September 2003 enabling it to refinance CCBs directly. The Scheme is proposed to be implemented selectively in respect of CCBs complying with Section 11(1) of the Banking Regulation Act, 1949 (AACS) and certain other conditions.

Resources of NABARD

4.81 The net accretion to the (outstanding) resources of NABARD including RIDF deposits at Rs.5,818 crore during 2003-04 showed a quantum jump of over 11.6 per cent over 2002-03 (Table IV.23). The net accretion to reserves and

Table IV.23: Net Accretion in the Resources of NABARD
(As at end-March)

(Amount in Rs. crore)

Type of Resource	2003	2004
1	2	3
Capital	–	–
Reserves and Surplus	693	972
NRC (LTO) Fund	222	125
NRC (Stabilisation) Fund	222	26
Deposits	-20	-28
Bonds and Debentures	2,624	3,181
Borrowings from Central Government	-243	-26
Borrowings from RBI	-708	-1,598
Foreign Currency Loans	52	-5
Corporate Borrowings	0	2,500
RIDF Deposits	2,434	-70
Other Liabilities	-370	673
Other Funds	67	68
Total	**4,973**	**5,818**

Source: NABARD.

surplus amounted to Rs.972 crore in 2003-04, compared with Rs.693 crore in 2002-03. However, deposits with NABARD (including the RIDF deposits raised from banks) witnessed a decline in 2003-04 as compared with 2002-03. As a result, reliance on market borrowings through the issuance of bonds and debentures increased substantially in 2003-04, while borrowings from the Central Government declined. Other borrowings from commercial banks also increased.

Rural Infrastructure Development Fund

4.82 RIDF was set up with NABARD under the initiative of the Central Government in 1995-96[3] to provide loans to State Government for financing rural infrastructure projects. Since then, nine tranches of allocations have been made towards the Fund. The commercial banks make contributions towards the Fund in accordance with the shortfall in their priority/ agriculture sector lending. Since 1999-2000 (RIDF-V), the scope has been widened to enable utilisation of loan by Panchayati Raj Institutions (PRIs), Self-Help Groups (SHGs), Non-Government Organisations (NGOs), *etc.*

4.83 During 2003-04, deposits received under RIDF was Rs.2,159 crore from commercial banks. At end-March 2004, the cumulative deposits stood at Rs.18,305 crore (Table IV.24). Deposits amounting to Rs.2,229 crore were redeemed during the year.

4.84 As at end-March 2004, the total corpus of the fund under the tranches I to X of the RIDF aggregated to Rs.42,000 crore. The cumulative amounts sanctioned and disbursed under the different tranches till end-March 2004 stood at Rs.34,678 crore and Rs.21,067 crore respectively (Table IV.25). The amount of loans sanctioned and funds disbursed under different tranches of RIDF as on July 16, 2004 aggregated Rs.35,174 crores and Rs.21.742 crore, respectively.

4.85 Out of the total sanction of Rs.34,678 crore, States in the southern region availed of

Table IV.24: Deposits Mobilised under Rural Infrastructure Development Fund

(Amount in Rs. crore)

Year	RIDF I	RIDF II	RIDF III	RIDF IV	RIDF V	RIDF VI	RIDF VII	RIDF VIII	RIDF IX	Total
1	2	3	4	5	6	7	8	9	10	11
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
1999-00	67	539	796	605	300	–	–	–	–	2,307
2000-01	–	161	413	440	850	790	–	–	–	2,654
2001-02	–	155	264	–	689	988	1,495	–	–	3,591
2002-03	–	–	188	168	541	816	731	1,413	–	3,857
2003-04	–	–	–	–	261	503	257	681	457	2,159
Total	**1,587**	**2,225**	**2,308**	**1,413**	**2,641**	**3,097**	**2,483**	**2,094**	**457**	**18,305**

Source: NABARD.

[3] Also see Box II.5 of the Report.

Table IV.25: Loans Sanctioned and Disbursed under RIDF
(As on March 31, 2004)

(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	1,911	1,761	92.2
II	1996	2,500	2,659	2,398	90.2
III	1997	2,500	2,718	2,444	89.9
IV	1998	3,000	2,913	2,266	77.8
V	1999	3,500	3,514	2,712	77.2
VI	2000	4,500	4,550	3,274	72.0
VII	2001	5,000	4,893	2,769	56.6
VIII	2002	5,500	6,083	2,450	40.3
IX	2003	5,500	5,438	994	18.3
X	2004	8,000	–	–	–
Total		**42,000**	**34,678**	**21,067**	**60.8**

Source: NABARD.

sanctions totalling Rs.9,939 crore and among the States in the zone Andhra Pradesh had availed the highest amount of Rs.4,480 crore. The States in the central zone have availed sanctions totalling Rs.7,127 crore. Within this zone, Uttar Pradesh had availed the highest amount of Rs.3,136 crore. The five States of the northern zone had availed Rs.6,138 crore and Rajasthan stood first in the zone by availing Rs.1,807 crore. States in the western zone had availed Rs.5,450 crore. Maharashtra had availed the highest amount of Rs.2,804 crore within the zone. States in the eastern zone had availed an amount of Rs.4,643 crore, with West Bengal availing the maximum sanction of Rs.2,487 crore. Total sanctions to the north eastern region was Rs.1,381 crore and Assam had availed the highest amount of Rs.645 crore (Appendix Table IV.7).

4.86 With the disbursement of Rs.3,922 crore during the year (2003-04), the cumulative disbursements under RIDF as on March 31, 2004 amounted Rs.21,067 crore. Andhra Pradesh had availed the highest amount of loan of Rs.2,817 crore. States in the north-eastern region had availed Rs.733 crore. Within north eastern region, Assam had availed the highest amount of Rs.295 crore.

4.87 The interest rate on RIDF loans has been reduced from 13 per cent under RIDF I to 6.5 per cent per annum under RIDF IX. The scope of the projects eligible for RIDF loans has been enlarged by including innovative projects such as information technology enabled services and new activities such as system improvement and mini-hydel under power sector, construction of primary/secondary school building and primary health centre, rain water harvesting structures, *etc.*

4.88 Rural roads and bridges continued to account for 46.8 per cent of RIDF loans sanctioned under various tranches followed by irrigation sector 35.4 per cent. Projects covered during 2003-04 included soil conservation, watershed development, drainage improvement, flood protection, forest management, rural drinking water supply, system improvement in power sector, buildings for primary health centers and primary/secondary schools, Anganwadis, Shishu Siksha Kendra, rural libraries, riverine fisheries, *etc.*

4.89 During 2003-04, 20,178 projects involving a loan amount of Rs.5,438 crore were sanctioned under RIDF-IX. Rural roads and bridges accounted for 13.1 per cent of the number of projects and 30.3 per cent of the loan amount sanctioned during 2003-04. Irrigation projects accounted for 62.1 per cent of the number of projects and 42.6 per cent of the loan amount sanctioned.

Credit from NABARD

4.90 NABARD provides short-term credit facilities to StCBs for financing seasonal agricultural operations (SAO), marketing of crops, fisheries activities, production/procurement and marketing activities of co-operative weavers societies, financing of rural artisans through PACS and purchase and distribution of fertilizers, *etc.* During the year 2003-04, a new line of credit for

Table IV.26: NABARD's Credit to StCBs, State Government and RRBs

(Amount in Rs. crore)

Category	2003 (July-June)				2004 (July-June)			
	Limits	Drawals	Repayments	Outstanding	Limits	Drawals	Repayments	Outstanding
1	2	3	4	5	6	7	8	9
1. State Co-operative Banks								
a. Short-term	7,430	7,910	8,238	5,185	8,524	8,719	8,918	4,985
b. Medium-term	880	18	130	356	288	576	302	630
Total (a+b)	**8,310**	**7,928**	**8,368**	**5,540**	**8,812**	**9,294**	**9,220**	**5,615**
2. State Governments Long-term	61	28	74	441	40	85	67	460
3. Regional Rural Banks								
a. Short-term	1,406	1,097	1,487	869	1,433	989	1,245	613
b. Medium-term	3	0	12	24	0	0	15	8
Total (a+b)	**1,409**	**1,097**	**1,499**	**892**	**1,433**	**989**	**1,260**	**621**
Grand Total (1+2+3)	**9,779**	**9,053**	**9,940**	**6,874**	**10,284**	**10,369**	**10,547**	**6,696**

Source: NABARD.

financing of agricultural, allied and marketing activities was introduced. Besides medium-term loans are also provided to StCBs and RRBs and for converting short-term to medium-term loans and for other approved agricultural purposes. NABARD also provides long-term loans to State Governments for contributing to the share capital of co-operative credit institutions.

4.91 During 2003-04, NABARD sanctioned total credit aggregating to about Rs.8,812 crore to State co-operative banks, which was higher by about 6 per cent over the sanctioned amount in 2002-03. The outstanding credit extended by NABARD to StCBs and State Governments at around Rs.6,075 crore was also higher than that in 2002-03 (Table IV.26). A major part of the outstanding refinance was for short-term purposes (Rs.4,819 crore or 82 per cent). Seasonal agricultural operations (SAO) amounted for bulk (94 per cent) of outstanding refinance to StCBs.

4.92 During 2003-04, NABARD sanctioned around Rs.288 crore for conversion of short-term loans to medium-term loans due to crop failure on account of drought, which was however, lower than that of Rs.880 crore sanctioned in 2002-03. NABARD also sanctioned long-term loans to nine State Governments amounting to around Rs.39 crore as contributions to the share capital of co-operative credit institutions.

4.93 Considering the declining trend of interest rates in the economy, the co-operative banks were given the option of repayment of entire refinance outstanding above seven per cent without any prepayment charges to NABARD. Weak StCBs were given the option of resetting interest rate on the high cost of outstanding refinance at an uniform rate of eight per cent, provided that they enter into a MoU with NABARD for implementation of DAPs. NABARD's interest rate structure for term loans effective from February 13, 2004, is presented in Table IV.27.

Table IV.27: NABARD's Structure of Interest Rates for Term Loans

Size of limit	Rate of interest to ultimate beneficiaries	Rate of Interest on Refinance	
		Commercial banks SCARDBs	RRBs/ StCBs/
1	2	3	4
Upto Rs.50,000	Rate of interest to the beneficiaries is to be determined by the Banks subject to guidelines laid down by the Reserve Bank of India.	5.75	5.75
Above Rs.50,000 and Upto Rs.2 lakh		6.50	6.50
Above Rs.2 lakh*		6.50	6.50

* 6.75 per cent for NFS, 7.00 per cent for all purpose other than Minor Irrigation, Dryland Farming, Land & Wasteland Development, SGSY, SHGs, SC/ST Action Plan, Organic farming, Contract Farming under AEZ, Aromatic & Medicinal Plants, Rural Housing; 5.75 per cent for all categories of loans disbursed in North-Eastern regions; and 7.5 per cent on Interim finance to SCARDBs.

4.94 Two major innovations in the field of rural credit delivery in the nineties are the Kisan Credit Card (KCC) Scheme and the Self-Help Group (SHG)-bank linkage programme. As a pioneering credit delivery innovation, Kisan Credit Card Scheme aims at provision of adequate and timely support from the banking system to the farmers for their cultivation needs including purchase of inputs in a flexible and cost effective manner (Box IV.4).

Box IV.4: Kisan Credit Card

In the Union Budget for 1998-99, an announcement was made for formulation of a model Scheme by NABARD for issue of Kisan Credit Cards (KCC) to farmers. The details of the model Scheme were circulated by the Reserve Bank to commercial banks and by NABARD to co-operative banks and RRBs in August 1998, with instructions to introduce the same in their respective area of operation. The KCC Scheme has since been stabilised as a major source of crop loans, but the investment credit requirement of the farmers *viz*., allied and non-farm activities, remained outside the ambit of the scheme entailing additional cost and time, and procedural inconvenience. Keeping this in view, NABARD revised the KCC Scheme as the 'Scheme to cover term loans for agriculture and allied activities under Kisan Credit Card Scheme' on October 4, 2004.

Beneficiaries covered under the Scheme are issued with a credit card and a pass book or a credit card cum pass book incorporating the name, address, particulars of land holding, borrowing limit, validity period, a passport size photograph of holder, *etc*., which may serve both as an identity card and facilitate recording of transactions on an ongoing basis. The borrower is required to produce the card cum pass book whenever he/she operates the account. Term credit as well as short term/working capital credit facilities are provided through the KCC, and three separate records are maintained in the passbook for (i) short term credit/crop loans, (ii) working capital credit for allied activities, and (iii) term credit. Short term credit/crop loan is in the form of a revolving cash credit facility involving any number of drawals and repayments within the limit fixed on the basis of operational land holding, cropping pattern and scale of finance. The entire production credit needs for full year plus ancillary activities related to crop production are considered while fixing limits. Sub-limits may be fixed at the discretion of banks. The quantum of limits for term and working capital credit is based on unit cost of asset proposed to be acquired by the farmers, the allied activities already being undertaken on the farm, and the bank's judgement of farmer's repayment capacity. The validity of the KCC has been extended from three years to five years. While short term as well as working capital credit is repayable in 12 months, the terms loan is be repaid within a maximum period of five years, depending on the type of activity/investment as per the existing guidelines. Conversion/reschedulement of loans is also permissible in case of damage to crops due to natural calamities. Security, margin, rate of interest and prudential norms are applicable as per RBI/NABARD stipulations.

Major benefits of KCC are minimum paper work and simplification of documentation for drawal of funds from the bank leading to reduction in work load for branch staff. Besides these, other benefits are improvement in recycling of funds and better recovery of loans, reduction in transaction cost to the banks and better Banker-Client relationships.

GIC has agreed that the crop loans disbursed for eligible crops under the Crop Insurance Scheme will be covered under the CCIS, now under Rashtriya Krishi Bima Yojana (RKBY). However, the banks are expected to maintain all back up records relating to compliance with 'RKBY' and its seasonality discipline, cut-off date for submitting declarations and end use, *etc*. as in the case of normal crop loans.

The KCC Scheme is being implemented in all the States and Union Territories by all commercial banks, RRBs, state co-operative banks / central co-operative banks/PACS and scheduled primary co-operative banks. Up to March 31, 2004, these agencies had together issued 414 lakh cards indicating a wider acceptability of the KCC. A summary position of the progress made by various agencies is given in Table.

Table: Agency-wise, Year-wise Number of Kisan Cards (up to March 31, 2004)

(cards in lakh)

Year	Co-operative Banks	RRBs	Commercial Banks	Total
1998-99	1.56	0.06	6.22	7.84
1999-2000	35.95	1.73	13.66	51.34
2000-01	58.14	6.48	23.90	86.52
2001-02	54.36	8.34	30.71	93.41
2002-03	45.79	9.64	27.00	82.43
2003-04	48.78	12.74	30.94	92.25
Total	**242.68**	**38.99**	**132.43**	**414.00**
Share in Total (per cent)	59.0	9.0	32.0	100.0

The National Council of Applied Economic Research (NCAER) conducted a national impact assessment survey of KCC scheme. The study has brought out several advantages of the KCC scheme which include *inter alia*, an increase in the flow of credit to the agriculture sector, a substantial reduction in the exclusive borrowing from the informal sector for short-term credit needs, a significant saving in time spent on availment of short-term agricultural loans and an overall reduction in cost of credit delivery. The survey indicates that the KCC scheme has had a positive impact on the cost of borrowings with a reduction in interest cost in both the formal and informal sector. The survey identified areas where further fine-tuning is needed, *viz*., restrictions imposed on the issuance of KCCs by security conscious banks; restrictions of the use of KCCs only at card issuing branches; non-availability of incentives/rewards to borrowers for timely repayments; low credit limits to meet the farmers' requirements and low awareness level regarding the provision of the personal accident insurance scheme. With a view to further improving the flow of credit to agricultural sector under the scheme, IBA has been advised to look into these suggestions and take remedial action.

4.95 Going by the remarkable progress achieved since inception of the Scheme and the fact that the co-operative banks and RRBs in most of the States have achieved/overachieved the targets, it can be assumed that most of the 'eligible farmers' have now been brought under the KCC fold. Banks have been advised to bring new farmers, including defaulters under KCC Scheme.

5. Issues in Micro Credit

4.96 The Reserve Bank had issued guidelines to banks in February 2000 for mainstreaming micro credit and enhancing the outreach of micro credit providers. These guidelines *inter alia* stipulated that micro credit extended by banks to individual borrowers directly or through an intermediary would be reckoned as part of their priority sector lending. In order to give banks freedom for lending under micro finance, specific models for micro-finance were not stipulated. However, the Reserve Bank has been supporting the SHG-bank linkage programme of NABARD initiated in 1991-92.

4.97 The SHG-bank linkage programme has now emerged as the major micro-finance programme in the country and is being implemented by commercial banks, Regional Rural Banks and co-operative banks. While 563 districts in all the States/UTs have been covered under this programme, 560 banks including 48 commercial banks, 196 RRBs and 316 co-operative banks along with 3,024 NGOs are now associated with the SHG-bank linkage programme. The number of SHGs linked to banks aggregated to 1,079,091 as on March 31, 2004. This translates into an estimated 16.7 million poor families being brought within the fold of formal banking services as on March 31, 2004. Ninety per cent of the groups linked with banks are exclusively women groups. Cumulative disbursement of bank loans to these SHGs stood at Rs.3,904 crore as on March 31, 2004 with an average loan of Rs.36,179 per SHG and Rs.2,412 per family.

4.98 The Reserve Bank had set up four groups in October 2002 to look into issues relating to structure and sustainability, funding, regulations and capacity building of Micro-Finance Institutions (MFIs). Pursuant to the Groups' recommendations, the mid-term Review of monetary and credit policy for 2003-04 announced that (i) banks should provide adequate incentives to their branches for financing the SHGs making the procedures absolutely simple and easy, (ii) the group dynamics of working of the SHGs be left to themselves and need neither be regulated nor formal structures be imposed or insisted upon and (iii) the approach to micro-financing of SHGs should be totally hassle-free and that it may include consumption expenditures.

4.99 Based on the recommendations of the Advisory Committee on Flow of Credit to Agriculture and Related Activities from the Banking System (Chairman: Shri V.S. Vyas), it has been announced in the annual policy Statement for 2004-05 that in order to protect the interests of depositors, MFIs would not be permitted to accept public deposits unless they comply with the extant regulatory framework of the Reserve Bank.

4.100 Having gone through the phases of (i) pilot testing during 1992 to 1995, (ii) mainstreaming during 1996 to 1998 and (iii) expansion from 1998 onwards, the SHG-bank linkage programme assumed the shape of a micro finance movement in many parts of the country during the year 2003-04 and made inroads into the other areas. Considering the overwhelming sucess of the programme, NABARD set a target of covering one third of the rural poor through linkage of 10 lakh SHGs under the SHG-bank linkage programme by year 2008. A sustained campaign of creating awareness and intensive efforts at building capacity of NGOs, Government agencies and banks in dealing with the SHGs followed. The target was realised by end of March 31, 2004, much ahead of the schedule, reflecting the acceptance of the approach by all stakeholders including the rural poor.

4.101 A massive expansion of the programme was witnessed during 2003-04 with credit linkage of 3.62 lakh new SHGs by the banking system. The growth rate was 41 per cent over 2002-03, increasing the cumulative number of such SHGs to 10.8 lakh. The banks extended loans of Rs.1,856 crore during 2003-04, registering a growth of 81 per cent over 2002-03, cumulatively aggregating to Rs.3,904 crore. In addition, it is estimated that presently SHGs manage their owned funds of the order of Rs.650 crore. The average size of the SHG loans increased to Rs.36,179 from an average of Rs.28,560 showing a deepening of the credit access among the SHGs. The programme continued to enlist massive mobilisation of the rural poor women (90 per cent) into the self-managed, doorstep based micro finance

Table IV.28: Model-wise Linkage Position
(As on March 31, 2004)

(Amount in Rs. crore)

Model	Type	Number of SHGs	Bank loan
1	2	3	4
I	SHGs formed and financed by banks	2,17,624 (20)	549.87 (14)
II	SHGs formed by NGOs / Government agencies, *etc.* and financed by banks	7,77,326 (72)	3,164.72 (81)
III	SHGs financed by banks using NGOs' formal agencies as financial intermediaries	84,141 (8)	189.62 (5)
	Grand Total	**10,79,091**	**3,904.21**

Note: Figures in bracket are percentages to the total.

movement. The number of poor families benefiting through SHGs increased to over 167 lakh as on March 31, 2004 from 116 lakh as on March 31, 2003 registering a growth of 44 per cent.

Model-wise Trends

4.102 Three models have emerged under the SHG-bank linkage programme over the years, which are detailed in Table IV.28. Bulk of the finance extended by the banks is under Model II where the bank-branch finances SHGs promoted by a facilitating agency such as NGOs, Government agencies, farmers' clubs, *etc*. The share of the three models in total linkage did not undergo substantial change over 2002-03. However, the trends clearly indicate that Model II seems to be most acceptable format in the SHG-bank linkage programme.

Agency-wise Trends

4.103 In terms of participation of different banking agencies under the programme, during 2003-04, the co-operative banks increased their share of SHGs financed to 13 per cent as on March 31, 2004 from 11 per cent as on March 31, 2003. The total number of SHGs financed by co-operatives rose from 78,959 by the end of March 2003 to 1,34,671 as at end-March 2004, reflecting the significant interest being evinced by co-operative sector (Table IV.29).

Progress over the Years

4.104 The SHG-bank linkage programme has been positioned in the banking system as a commercial proposition, with advantages of lower transaction costs, near zero NPAs and generation of goodwill among the rural clientele for the bank branches leading to other quantifiable benefits in business expansion. All the 48 commercial banks and 196 RRBs now participate in the programme in addition to 316 out of total 368 CCBs. A summary of progress under SHG bank linkage programme made from 1992-93 to 2003-04 is presented in Table IV.30.

Table IV.29: Agency-wise Linkage Position
(As at end-March)

(Amount in Rs. crore)

Agency	Number of SHGs		Bank loan	
Cumulative position	2003	2004	2003	2004
1	2	3	4	5
Commercial Banks	3,61,061 (50)	5,38,422 (49)	1,150 (56)	2,255 (58)
Regional Rural Banks	2,77,340 (39)	4,05,998 (38)	727 (36)	1,278 (33)
Credit Co-operative Banks	78,959 (11)	1,34,671 (13)	172 (8)	371 (9)
Total	**7,17,360**	**1,079,091**	**2,049**	**3,904**

Note: Figures in bracket are percentages to the total.

Table IV.30: SHG-Bank Linkage Programme
(As on March 31, 2004)

Year	Total SHGs financed by banks			Bank Loan			Refinance		
	During the Year		Cumulative	During the year		Cumulative	During the year		Cumulative
	Number	Growth (per cent)	Number	Amount (Rs. crore)	Growth (per cent)	Amount (Rs. crore)	Amount (Rs. crore)	Growth (per cent)	Amount (Rs. crore
1	2	3	4	5	6	7	8	9	10
1998-99	32,995	–	32,995	57	–	57	52	–	52
1999-00	81,780	148	1,14,775	136	138	193	98	88	150
2000-01	1,49,050	82	2,63,825	288	112	481	251	156	401
2001-02	1,97,653	33	4,61,478	545	89	1,026	396	58	796
2002-03	2,55,882	29	7,17,360	1,022	87	2,049	622	57	1,419
2003-04	3,61,731	41	10,79,091	1,856	81	3,904	705	13	2,124

4.105 With increasing number of NGOs and Government development agencies realising the benefits of delivering various social sector services through the SHG mechanism, the task of promotion of a large number of quality SHGs has been made easy. The total number of the SHG Promoting Agencies (NGOs and Government agencies) associated in the programme rose to 3,024 as on March 31, 2004 from 2,800 as on March 31, 2003. Besides, other informal arrangements such as Farmers' Clubs promoted by banks, rural volunteers, *etc*. were also operationalised for promotion of quality SHGs to ensure rapid expansion of the programme in backward regions.

4.106 On account of the head start made by the programme in the southern States and also some major initiatives by the State Governments, the programme has gained the shape of a movement. However, during 2003-04, the programme expanded rapidly in the non-southern States with credit linkage of over 1.51 lakh SHGs as compared with 1.09 lakh SHGs linked in 2002-03. The expansion of the programme was significant in States, which were identified by NABARD for intensive interventions such as Assam (195 per cent), Uttaranchal (100 per cent), Bihar (92 per cent), Orissa (63 per cent), Madhya Pradesh (62 per cent), and Jharkhand (37 per cent).

4.107 As a part of the strategy to widen partner institutions, NABARD stepped up its capacity building support to partner institutions by way of financial assistance for promotion of quality SHGs to NGOs, RRBs, CCBs, Farmers' Clubs and Rural Volunteers working as Self Help Promoting Institutions (SHPIs), initiating district level dialogues, enlisting partner support, besides investing significantly in training and awareness building among the stakeholders, dissemination of best practices, *etc*. The amount of cumulative grant support sanctioned aggregated Rs.15 crore covering 785 NGOs for promotion of 1,15,279 SHGs as on March 31, 2004 as against the cumulative grant of Rs.10 crore sanctioned to 564 NGOs for 78,011 SHGs as on March 31, 2003. Realising the need for providing need based training to different segments of the stakeholders, NABARD conducted/supported various training/sensitisation and exposure programmes covering more than 1.59 lakh members of SHGs, over 26,000 bank officials, about 7,300 NGO staff, about 5,900 officials of Government agencies, and about 300 trainers during 2003-04.

Other Initiatives

4.108 New initiatives taken include *inter alia*:

- A pilot project aimed at building synergy between the Gramin Bank approach with the SHG Bank Linkage Programme in tribal area of Orissa State, in association of an NGO and Kalahandi Gramin Bank.
- A Pilot Project for expanding the outreach and quality of services of the rural banks using IT enabled services has been initiated with Sri Vishakha Gramin Bank in Andhra Pradesh.
- A Pilot Project on 'Computer Munshi' to be implemented through an NGO for piloting a self-sustaining mechanism to prepare

SHG accounts and ensure better tracking of the SHGs.

- A Pilot Project for financing mid-segment clients comprising small/tenant farmers/ oral lessees (traders) through Joint Liability Groups (Box IV.5).

- Building collaboration with the Post Office network in Tamil Nadu for financing 200 SHGs. These initiatives are expected to set to direction for further expansion of access to banking services for identified client groups.

Box IV.5: Smoothening Credit Flow to Small Borrowers through Joint Liability Group Approach

The micro-finance approaches have succeeded in reaching out to a large number of rural poor. However, there is need to address the issues of sustainable access to credit for the mid-segment of the rural society. This segment primarily comprises of small and marginal farmers and artisans, whose credit needs, are often larger in size and longer in duration than the micro-credit being purveyed through the SHG-bank linkage programme. This segment of borrowers also represent bulk of the loan accounts at the branch level and contribute to larger share of transaction cost in view of small average loans outstanding. In addition, there are large number of tenant farmers/oral lessees, who cannot offer tangible collaterals and thus do not fit into the traditional financing approaches of the banking system. With an increasing number of such prospective borrowers, it was considered urgent to address the entire range of issues concerning extension of credit to them. After a consultative process during 2003-04, a Pilot Project was initiated by NABARD to explore the potential of replication of Joint Liability Group (JLG) approach successfully adopted by Bank for Agriculture and Agricultural Co-operatives of Thailand, with suitable indigenisation of the methodology to meet the local requirements.

Objectives of the pilot project of NABARD

The Pilot Project on financing JLGs aims to evolve supplementary credit technologies to facilitate smoother flow of quality credit to mid segment credit takers by assisting establishment and financing of JLGs. Apart from this, the aim is also to build mutual trust and confidence between bankers and small clients using different models of JLGs as collateral enhancers and collateral substitutes and make a comparative assessment of its usefulness in the context of Indian banking.

General Features of JLG

A Joint Liability Group to be established under the pilot project is an assembly of 5-10 member clients (new or existing) for a bank, informally recognised by the bank as a group. The JLG members offer an undertaking to the bank that enables them to jointly receive such amounts as deemed eligible by the bank for pursuing individual or joint activities- as found suitable by the group. The main purpose of JLG is to facilitate mutual loan guaranteeing and execution of joint liability agreement making them severally and jointly liable for payment of interest and repayment of loans obtained from the bank. The management of the JLG will be kept simple with little or no financial administration within the group. The members of JLG normally live in the same neighbourhood or in the same village and are from the same socio- economic background and environment. They may be mostly engaged in the same production activities and are expected to know and trust each other well.

The Project has been launched in the later half of the year 2003-04 in eight RRBs and one SCARDB. The initial results have been quite encouraging as could be seen from the experience of the Pandyan Grama Bank in Tamil Nadu which extended credit in the form of small loans to over 500 clients for fisheries, agriculture, petty trade, *etc.*, by financing 105 JLGs with loans of over Rs.1 crore. The initial assessment suggests the possibility of scaling up credit flow to the agriculture sector to quality clients in JLGs. It could also serve as a credit tool for reaching segments of the agrarian population who do not have ownership rights or till leased lands. The flexibility of the system, simplicity of documentation and cheaper credit seems to entice the potential borrower to this approach. However, the borrower selection for JLGs, needs to be made with caution and the process of education of clients needs to be given due attention, for the scheme to be effective.