CREDIT CONTROL AND OTHER MEASURES
SEPTEMBER 2003

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The Chief Executive Officers of
All Primary (Urban) Co-Operative Banks

Declaration of dividend by primary (urban) co-operative banks

As you are aware, urban co-operative banks (UCBs) are set up with the objective of promoting thrift among the members, provision of credit to members who are persons of limited means and extension of banking services to the customers, Several Expert Committees which have studied the working of UCBs have recognised the important role of UCBs in the country's banking system and the need to promote UCBs on sound and healthy lines.

2. The financial soundness and stability of the UCBs are crucial for protecting the interest of the depositors. Since the UCBs have limited sources for augmenting their capital funds, the boards of UCBs, should initiate steps to strengthen the financials of the UCBs through plough back of profits to general reserves. The State Co-operative Societies Acts contain provisions relating to transfer of **at least** one-fourth of the net profits each year to Reserve Fund so as to strengthen the capital funds, with a view to protecting the interests of the depositors. A tendency is, however, observed among the UCBs to distribute dividends at rates higher than what could be considered prudent in view of the financials of the bank. There have been instances of UCBs declaring higher dividends than the maximum prescribed under the Co-operative Societies Act. We have also been receiving requests from UCBs which are classified as Grade II, III or IV for permission to declare dividend on the ground that they have made adequate provisions for NPAs, or the requirements of CRAR have been complied with, *etc*. The distribution of dividend when the financial position of the bank is not sound, is imprudent and will be prejudicial to the interests of its depositors.

3. The matter has, therefore, been reviewed. It has been felt necessary to set out certain objective and transparent criteria for declaration of dividends by the UCBs. Accordingly, the following norms are set out for implementation by UCBs with immediate effect:

(a) Only banks which have not been classified by RBI as Grade II, III or IV may declare dividend, provided, however, that the dividend pay-out does not impair the bank's liquidity position.

(b) Banks classified as Grade II should obtain the prior permission from the concerned Regional Office of RBI to declare dividend. Their application will be considered if they comply with the following parameters:

(i) Compliance with the CRAR norms, as prescribed by the RBI.

(ii) Net NPAs of the bank are less than 10%, after making all the necessary provisions as per the assessment made by the RBI in its latest inspection report.

(iii) There is no default in CRR/SLR during the year for which dividend is proposed.

(iv) All the required provisions have been made for NPAs, investments and other assets as per the prudential norms prescribed by RBI. Where the bank has not been inspected recently by RBI and, therefore, NPAs, *etc*. have not been assessed by RBI, an Auditor's certificate to the effect that all necessary provisions have been made, should be submitted.

(v) Dividend is paid out of the net profit and after making all statutory provisions and adjustment for accumulated losses.

(c) Banks classified under Grade III and Grade IV should not declare any dividend until they are upgraded to Grade I or Grade II and subject to their satisfying the conditions at (b) above.

2. Please acknowledge receipt of this circular to our concerned Regional Office.