Task Force on Empowering RRB Boards for Operational Efficiency

31 January 2007

Reserve Bank of India
Mumbai

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The Task Force report is the product of many collaborative efforts. The Task Force met and discussed on various aspects of empowerment of Boards of RRBs for operational efficiency. The Task Force wishes to place on record, its gratitude to Dr. Y.V. Reddy, Governor, Reserve Bank of India for entrusting this task of national importance as also for providing necessary guidance. Smt. Usha Thorat, Deputy Governor, Reserve Bank of India had taken initiative to call a consultation meet of commercial banks and gave valuable inputs for the Task Force. We thank her as well as all the senior personnel of RPCD of Reserve Bank of India. The Task Force generated and considered a vast amount of materials in its deliberations and meeting with stakeholders and others. We would also like to mention the cooperation received from NABARD officials of Uttar Pradesh RO, Lucknow, Bihar RO, Patna and Assam RO, Guwahati, and the Chairman and staff of Baroda Eastern UP Gramin Bank, Assam Gramin Vikas Bank, and Uttar Bihar Kshetreya Gramin Bank, who not only coordinated the field visits at their end, but also provided significant inputs.

2. The Task Force Secretariat has played a crucial role in collecting information, analysing data and preparing background notes. The Task Force has a special word of commendation for the Secretariat set up for it by NABARD. The Task Force would like to mention Shri Lajja Ram, CGM, Shri P Satish, CGM, Shri B.B.Mohanty, CGM, Shri U.N. Srivastava, CGM, Shri D P Mishra, GM, Shri M.V. Ashok, GM, Shri K.S. Pillai, DGM, Shri N.C. Saha, DGM, Shri N.P. Mohapatra, AGM, Shri P.K.Kapoor, AGM, Shri S.J. Parkar, Manager and Shri Sunil Kumar, Asst.Gen.Manager, NABARD, Head Office, Mumbai who brought to bear on the logistical and operational aspects as also in collating and analyzing inputs received from various quarters. The contributions of Smt. Vandana Venugopalan, Smt. Bharti M. Jagasia, Smt. Geeta Yadav, and Shri V.P. Khapekar, for their secretarial assistance are acknowledged. We also acknowledge the contribution made by Monitoring Section of IDD comprising of Dr.U.S.Saha, DGM, Shri V.Mani, Manager and Shri A.K.Bohite . The Task Force would like to thank the Training Establishments of NABARD and particularly Sri G R Chintala, Faculty Member, BIRD, Lucknow for their valuable inputs. The Task Force also wishes to thank many learned experts from Govt. of India, Reserve Bank of India, NABARD, State Governments, Sponsor Banks, RRBs, RRB Staff / Officer Associations and others for their significant contributions.

3. I am grateful to all the members of the Task Force for their active participation in the deliberations in the meetings and their valuable contributions and suggestions. I thank Dr.R. Balakrishnan, ED, NABARD and Member-Secretary of the Task Force for his wholehearted involvement in finalising the report, within a short span of time.

(Dr. K.G. Karmakar)
Chairman

Place: Mumbai, 31 January 2007

INTRODUCTION

Unlike other commercial services, almost every individual needs financial services. One of the factors of the rural urban divide is the limited availability of financial services to the rural population. The introduction of the RRBs from the year 1975 was a bold attempt to ensure savings and credit opportunities to the rural population. The contribution of the RRBs to financial inclusion in rural areas has been significant. 196 RRBs, before the recent mergers, had a network of 14494 branches. They serviced 57952419 saving accounts and 12364391 loan accounts. They mobilised Rs.72510 crore as deposits and lent Rs.39764 crore as on 31 March 2006. Their role in micro finance coverage and the doubling of credit to agriculture has been noteworthy. It is also true that the banks are yet to attain their full potential in extending rural financial services. The reasons can be traced to issues of ownership, governance, human resources management, viability, etc. The need for a review of some of these complex issues has been felt.

2. The banking sector in India was highly regulated till the early nineties. The reforms of the banking sector since then, covered the introduction of prudential norms and deregulation of interest rates except for small loan accounts, etc. Even after deregulation, the banks continued to enjoy low cost funds from savings accounts. Recently, RRBs sponsored by the same commercial banks in a State have been merged and some more are in the process of merger. This has brought down the number of banks to 102 from 196.

3. In order to strengthen Regional Rural Banks (RRBs) and make them viable rural financial institutions, various measures have been taken from time to time. With a view to enhancing the operational efficiency of RRBs, Reserve Bank of India, vide its letter no. RPCD.CO.No.RRB. 2584 /03.05.33 (F)/2006-07 dated 11 September 2006, set up a Task Force to deliberate on areas where more autonomy could be given to the Boards of RRBs. The constitution of the "Task Force on Empowering RRB Boards for Operational Efficiency" is as under:

Chairman

Dr. K.G. Karmakar, Managing Director, NABARD

Members

1. Shri G.C. Chaturvedi, IAS, Joint Secretary, Ministry of Finance, Government of India
2. Shri A.K. Das, Special Secretary, Government of West Bengal
3. Dr.K.V. Rajan, Regional Director, Reserve Bank of India, Bhopal
4. Shri K. Bhattacharya, General Manager, Rural Planning & Credit Department, Reserve Bank of India, Mumbai.
5. Shri Anup Banerjee, Dy. Managing Director, State Bank of India, HO, Mumbai
6. Shri V.K. Nagar, General Manager, Punjab National Bank, HO, New Delhi
7. Shri T.V. Bhat, General Manager, Syndicate Bank, HO, Manipal
8. Shri N.S. Bose, Chairman South Malabar Gramin Bank, Malappuram, Kerala

Member Secretary

Dr. R. Balakrishnan, Executive Director, NABARD, Mumbai

4. The Terms of Reference of the Task Force are as under:

a) To review the present position, including policies and practices, in RRBs in the following areas:

Human resources management and development

Resource mobilisation and deployment of funds

Business environment and strategies

Legislative framework, including rules and regulations governing RRBs

b) To suggest measures for empowering the Boards of RRBs for operational efficiency, particularly in matters relating to

Evolving and implementing appropriate strategies/polices for assessment of manpower requirement as also recruitment, deployment, upgradation of skills and promotion of staff/officers, including schemes for performance oriented incentives/disincentives.

Exploring alternate investment avenues as also introduction of new products/ activities.

Evolving appropriate strategies for facing business challenges in rural areas, including developing a complete range of financial services for rural clientele.

Considering any consequential changes that may be required in legislation, rules and regulations governing RRBs.

c) To elucidate how autonomy of the Boards of RRBs can be ensured while safeguarding the oversight of the Empowered Committees for RRBs.

d) To consider any other issues relating to the above areas.

4.1. The Reserve Bank of India in their letter dated 11 September 2006 also indicated that the following points might be taken into consideration by the Task Force.

(i) Potential adverse impact of the withdrawal of interest on eligible CRR balance by RBI on the revenues of RRBs and their demand for restoration of interest on eligible CRR balances.

(ii) Review of the categorisation of branches, staffing norms and promotion policy in view of the general Increase in the business turnover of RRBs.

(iii) The need for lifting of embargo on recruitment to overcome the problem associated with the acute staff shortage and their adverse age profiles and the training requirements of existing staff.

(iv) Problems faced by the amalgamated RRBs due to lack of uniformity in IT packages inherited from the pre-amalgamated Banks and the need for standardisation of software packages.

It was further clarified that these four points are not advisory in nature but are suggestions for scrutiny by the Task Force.

5. Approach and Guiding Principles

(i) Views of the Directorates of Institutional Finance of some of the State Governments, GOI and RBI on the ToRs, sought.

(ii) Input from the sponsor banks of the RRBs on the ToR requested.

(iii) Opinions of the RRB Associations/Unions obtained.

(iv) Collection of field visit inputs by Task Force members by conducting quick studies.

(v) Study of existing literature and recommendations of the various Expert Committees on RRBs like those headed by Prof. Vyas, Shri K P Agrawal, Smt. Usha Thorat (North East Regional Financial Plan), Shri A.V. Sardesai (Internal Working Group by RBI), etc.

6. The Task Force held 04 meetings i.e. on 28 September 2006, 26 October 2006, 11 December 2006 and 28 December 2006 to firm up the recommendations. In the first meeting of the Task Force held on 28 September 2006, it was decided to:

(i) Analyse the statistical information, literature, inspection reports and other documents relevant to RRBs, available with NABARD.

(ii) Scan various reports on RRBs (Contents of the Reports summarised at Annexure – I.1)

(iii) Collect data through questionnaire from RRBs on investments, manpower planning and deployment.

(iv) Incorporate relevant views from various sources.

In the second meeting of the Task Force held on 26 October 2006, it was decided to conduct an impressionistic study to have a feel of the problems confronting some of the amalgamated RRBs. Three teams comprising of Task Force members visited three amalgamated banks having Head Quarters at Guwahati, Muzaffarpur and Rae Bareli. Besides, on 8 November 2006, Chairman of the Task Force had a meeting with a team of RBI officials led by Smt. Usha Thorat, DG, RBI and senior executives of SBI, BOB, CBI, UBI, etc. where discussions were held on some of the important issues relevant to the Task Force.

In the third meeting of the Task Force held on 11 December 2006, the draft report was placed before the members for discussion and it was clarified by the representatives of RBI that the legislative changes referred to the Terms of Reference needed to be examined in the context of bringing about operational efficiency and these do not cover the areas of ownership or shareholding pattern and as such the report may be amended accordingly.

The fourth and final meeting of the Task Force was held on 28 December 2006 and members endorsed the Final Report and Recommendations. Further editing was then done on the basis of discussions and the final report submitted to RBI on 31st January 2007.

As per the ToR, the report is structured as under:

Chapter 1 - Rural Credit and Regional Rural banks

(Performance overview, Rural financial scenario, RRBs and rural credit, RRBs and ongoing financial sector reforms, redefined role of RRBs in financial inclusion)

Chapter 2 - Stakeholders and empowering the Board of Directors

(Present role-play by Various Agencies, Amalgamation of RRBs, Current Status, Need for change after the amalgamation, Proposed change in view of the enlarged responsibility, Empowered Committee and RRBs.)

Chapter 3 - Financial Resources Management

(Financial Resources, Need for diversification, Responsibilities of the Board, External Support for Resource Management, Present Avenues of Resource Mobilisation, Possible sources of resources of RRBs and deployment thereof, New Avenues of Investment, Constraints and issues, How RRBs can manage investment on stand alone basis-support system, Enlarging the scope of the Board.)

Chapter 4 - Business Policy and Products

(Product and Services-Innovations, Experience of RRBs, Experience of Other Countries, RRBs to become One Stop Banking and financial service provider)

Chapter 5 - Organisational Structure & Human Resources Management

(Revised Structure of Amalgamated RRBs, Business Turnover and Categorisation of Branches, Three Tier system, Decentralisation and Delegation, Revisiting Agrawal Committee Recommendations, Man power Planning, Recruitment, Transfer and Placements, Promotion Opportunities, upgradation of skills, Incentive for Performance, Autonomy of the Board, Redeployment of Staff Members)

Chapter 6 - Internal Checks and Controls

(Revised Norms, Need for Board Supervision)

Chapter 7 - Modernisation of the Operating System

(Problems at operational level, Need to address through Standardization, Computerisation, IT platform)

Chapter 8 - Rural Banking in the North Eastern Region.
(Endorsement of Recommendation of the Committee on Financial Sector plan for North Eastern Region, empowerment of the Board of RRBs, Attention to educated unemployed, recruitment and training)

We record our sincere thanks to Govt. of India, Reserve Bank of India, RRBs across the country, various State Governments, RRB Associations and numerous individuals and organisations which participated in the consultation meetings and those who gave their views in written memoranda.

In conclusion, all members of the Task Force and the professional staff that helped us, are of the unanimous view that this has been one of the most satisfying assignments ever handled. This is so because the Task Force was assigned the task of unleashing the growth potential and energies of the RRBs, thereby enabling greater financial inclusion of the rural poor and have-nots.

Dr. K.G. Karmakar **Chairman**		
Shri G.C. Chaturvedi **Member**	**Shri A.K. Das** **Member**	**Dr.K.V. Rajan** **Member**
Shri K. Bhattacharya **Member**	**Shri Anup Banerjee** **Member**	**Shri V.K. Nagar** **Member**
Shri N.S. Bose Member	**Shri T.V. Bhat Member**	**Dr. R. Balakrishnan** **Member -Secretary**

Mumbai: 31 January 2007

CHAPTER 1

"The real source of market promise is not the wealthy few in the developing world, or even the emerging middle income consumers, it is the billions of aspiring poor who are joining the market economy for the first time" -C.K Prahalad

RURAL CREDIT AND REGIONAL RURAL BANKS

1.01 The performance of the Indian economy improved during 2005-06 with an estimated growth of 8.4 per cent as against 7.5 per cent (at 1999-2000 prices) in the previous year. Agriculture and allied activities is estimated to have registered a growth of 3.9 per cent, reviving from a low of 0.7 per cent in the previous year, thanks to the normal Southwest monsoon. The industry and services sectors showed marginal increase in growth from 8.6 and 9.9 per cent during 2004-05 to 8.7 and 10.0 per cent during 2005-06, respectively.

1.02 The share of agriculture and allied activities in total GDP (at 1999-2000 prices) declined from 24.4 (2001-02) to 19.9 per cent (2005-06) and the share of services sector increased from 50.3 to 54.0 per cent, while that of industry sector increased from 25.3 to 26.1 per cent during the same period. As a percentage to GDP at factor cost, the gross domestic savings improved from 26.5 during 2002-03 to 29.1 during 2004-05 and investments from 25.3 to 30.1 during the same period. Inflation, measured in terms of Wholesale Price Index, stood at 4.0 per cent as at end March 2006 as compared to 5.1 per cent as at end March 2005.

1.03 The gross capital formation (GCF) in agriculture fluctuated between Rs.38,176 crore and Rs.47,833 crore during the period 1999-2000 to 2004-05 while the ratio of GCF in agriculture to GDP from agriculture sector fluctuated between 8.4 and 10.2. It declined from 9.6 (1999-2000) to 8.7 (2004-05). Investments in agriculture to total GDP declined from 2.2% to 1.7% during the same period. This decline is attributed to stagnation or fall in public investment in irrigation since the mid-nineties. However, there is some indication of a reversal of this trend, as during 2003-04, public sector investment in agriculture reached its highest level at Rs.12,809 crore since the early nineties.

1.04 Agricultural exports grew at 27.4 per cent during 2005-06 as compared to 6.2 per cent during 2004-05. The share of agri-exports in total exports of the country deceased from 13.5 per cent during 2001-02, to 9.9 per cent during 2005-06. Agricultural imports grew at 2.8 per cent during 2004-05. During 2005-06, agricultural imports of food and related items rose to US $3,712 million. The share of vegetable oils in total agricultural imports declined from 63.4 during 2004-05 to 62.1 per cent during 2005-06, whereas the share of pulses increased from 10.1 to 16.8 per cent during the same period.

1.05 The agricultural loans and advances disbursed by co-operative banks, commercial banks and RRBs increased by 44% and reached Rs.1,25,309 crore during 2004-05, with various initiatives taken by banks and monitored by NABARD in the implementation of the package for doubling of agricultural credit over a three year period (2004-07). The ground level credit flow to agriculture and allied activities reached Rs.1,57,480 crore during 2005-06, which is 26 per cent more than that of the previous year. Various measures have been announced in the Union Budget for 2006-07 to further enhance credit flow to the sector.

1.06 The credit portfolio of banks has changed markedly during the last 10 years. Personal loans grew faster than any other segment. It increased from 9.3% of the total bank credit in 1996 to 22.2% in 2005. This consists mainly of housing loans that increased from 2.8% of the bank credit to 11% over the period. Other personal loans comprising loans against fixed deposits, gold loans and unsecured personal loans also rose from 6.15 to 10.7 percent. In contrast, there has been a sharp decline in the share of lendings to industry. Credit to Industry as a whole fell from 48.8 percent to 38.5 percent and for small-scale industries, it fell from 10.1% in 1996 to 4.1% in 2005.

1.07 There has been a consistent improvement in asset quality over the past decade. According to CRISIL, India's banking sector displayed better asset quality than those of other Asian countries. A study has revealed that earlier the banks used the treasury gains to provide for the NPAs, whereas the current trend is on effective management of NPAs. The banks have been improving their capital adequacy, diversification of loans, credit profiling of borrowers and customer services.

1.08 The number of rural branches of commercial banks (including RRBs) came down from 32,981 in 1996 to 31,967 in 2005. Partly, this is attributed to upgradation of some rural branches as urban branches and relocation of unprofitable branches.

Rural Financial System

1.09 India is an agrarian country with 2/3rd of its population living in rural areas and most of them dependent on agriculture. In pre-independent India, cooperatives were among the major institutions providing finance to the rural population, as there were few rural branches of Commercial Banks. The All India Rural Credit Survey Committee in 1952 observed that a large share of the credit requirements of rural households particularly the poor, came from traditional sources such as relatives, traders, landlords and moneylenders.

1.10 Cooperative Banks started extending crop loans mostly with refinance support from RBI. There were limited arrangements for providing institutional credit for term loans under agriculture like minor irrigation, tractors, land development, etc. As per the recommendations of All India Rural Credit Survey Committee, the Agriculture Refinance Corporation was set up to provide refinance to the term lending cooperative institutions.

1.11 With the launching of Five Year Plan by the Government of India, with a thrust on rural infrastructure for agricultural development, the credit requirement for the sector increased manifold in the mid sixties. Realising the fact that cooperatives alone could not fulfil the huge demand for rural credit, commercial banks, which hitherto were almost outside the ambit of rural credit except for a peripheral role in the rural sector, were brought under social control of the Government followed by nationalisation of 14 major banks in 1969. These nationalised Commercial Banks, under aegis of the Lead Bank Scheme simultaneously, were called upon to extend agricultural credit on a priority basis and directed to expand their branches in the rural areas.

1.12 Although, the multi-agency approach was adopted for enhancing rural credit, the Banking Commission in the year 1972, observed that despite the massive expansion of branch network of commercial banks in the rural areas, a vast segment of the rural population comprising weaker sections and economically backward classes were deprived of banking facilities as their requirements were insignificant and financing them by commercial banks was perceived to be a non viable proposition. The Commission felt that an alternative credit delivery mechanism by way of setting up of specialised banks, particularly to cater to these segment of the population, could be explored by the Government. With the above objectives in view, Government of India constituted a Working Group on Rural Banks chaired by Shri M Narasimham, which came out with its recommendation on 31 July 1975 for setting up of state sponsored, region based, rural oriented commercial banks which would blend the rural touch, local feel and familiarity with rural problems with a low cost profile as possessed by cooperatives and professional discipline, ability to mobilise resources by way of deposits and access to money markets on the lines of commercial banks. The new institutions were visualised as a hybrid of commercial banks and cooperative banks to supplement the efforts of the existing RFIs. It was primarily aimed at financing small and marginal farmers, landless labourers, rural artisans, small traders and other weaker sections of rural society. Under a presidential ordinance followed by promalgamation of the Regional Rural Bank Act, 1976, RRBs came into being with the following mission:

"Developing the rural economy by providing, for the purpose of development of agriculture, trade, commerce, industry and other productive activities in the rural areas, credit and other facilities, particularly to the small and marginal farmers, agricultural labourers, artisans and small entrepreneurs and for matters connected therewith and incidental thereto."

Stages of Development

1.13 The performance of RRBs during the last 3 decades can be categorized into 3 phases as follows:

1975 - 1986	-	Expansion Phase
1986 - 1995	-	Declining Phase
1995 - 2006	-	Turn Around Phase

Based on the Narasimham Committee recommendations, the first five RRBs were established on 02 October 1975 under a presidential ordinance. By December 1979, 60 RRBs were established with to 2,420 branches having total deposits of Rs.123.22 crore and loan outstanding of Rs.161.41 crore. A Committee under the chairmanship of Prof. Dantwala examined the need for RRBs and their relevance in 1979, which endorsed the need for intensification of the process by covering more and more geographical areas under services of RRBs. Following the recommendations of the above Committee, the tempo in setting up of RRBs gained momentum and 85 RRBs were set up by the end of December 1980 with 3279 branches. By December 1987, 196 RRBs with 13353 branches came into being with deposits amounting to Rs.2305.82 crore in 224 lakh accounts and loans of Rs.2232.26 crore in 93 lakh accounts.

1.14 Although RRBs had a rapid expansion of branch network and increase in volume of business, these institutions went through a very difficult evolutionary process due to the following problems.

Very limited area of operations

High risk due to exposure only to the target group

Public perception that RRBs are poor man's banks

Mounting losses due to non-viable level of operations in branches located at resource-poor areas.

Switch over to narrow investment banking as a turn-over strategy

Heavy reliance on sponsor banks for investment avenues with low returns

Barring exceptions, step-motherly treatment from sponsor banks.

Chairman of RRBs under the direction of Regional Managers appointed as Board of Directors by sponsor banks

Burden of government subsidy schemes and inadequate knowledge of customers leading to low quality assets

Unionised staff with low commitment to profit orientation and functional efficiency.

Inadequate skills in treasury management for profit orientation

Inadequate exposure and skills to innovate products limiting the lending portfolios

Inadequate effort to achieve desired levels of excellence in staff competence for managing the affairs and business as an independent entity

Serious undermining of the Board by compulsions to look upto sponsor banks, GoI, NABARD and RBI for most decisions.

RRB hampered by an across the board ban on recruitment of staff.

All the above factors led to most of the RRBs eroding their capital and in many cases the depositors' funds as revealed from the following table:

Table 1.1

Performance of RRBs under Key Parameters

(Rs. crore)

Sr.No.	Key Indicators	31.03.1994	10	Profitability	31.03.1994
1	Owned Funds	222.83	a)	Number of RRBs in Profits	23
2	Deposits	8864.33	b)	Amount of Profits	21.91
3	Borrowings	1989.68	c)	Number of RRBs in Losses	173
4	Investments	4772.36	d)	Amount of Losses	388.86
5	Loans and Advances Outstanding	5253.02	e)	Number of RRBs having accumulated losses	176
6	Loans Issued	1439.99	f)	Total accumulated losses	1318.16
7	Profit/Losses	-366.95	g)	Number of RRBs sustainable viable	20
8	NPA %	43.07	h)	Number of RRBs current viable	13
9	Recovery %	46.23			

(source :compiled)

Turn Around Phase

1.15 The Government of India embarked upon banking sector reforms in 1991. As a part of the reform process, measures for strengthening various credit delivery systems were initiated. For RRBs, which were financially in very bad shape, various options like formation of National Rural Bank of India, merger of RRBs with their sponsor banks, etc. were examined. Considering the important role played by RRBs in dispensation of credit in rural areas, especially to the weaker sections of society, the continuance of the RRBs was found to be relevant. The Government of India, in consultation with RBI and NABARD decided to recapitalise the weak RRBs to improve their financial health. Following the above decision of GOI, Bhandari Committee and Basu Committee looked into the issues in depth and came out with rehabilitation packages consisting of both financial and non-financial components. Under the financial package, a sum of Rs.2188 crore was provided by the stakeholders of RRBs in the proportion of their equity holding during the period 1994-2000 for cleansing the balance sheet of 187 RRBs.

1.16 Under the non-financial package, the following steps were taken to make the RRBs financially viable on a sustainable basis:

RRBs, which hitherto were financing only target groups, were allowed to finance non-target groups.

RRBs were permitted to subscribe to the tier II bonds of sponsor banks or other institutions upto 10% of their owned funds.

RRBs were permitted to open / maintain non-resident rupee accounts.

RRBs were allowed to finance housing and education loan.

Introduction of DAP/ MOU and monitoring of implementation.

HR Development through massive training inputs by NABARD.

Conduct of ODI as a tool for corporate turn around.

Exposure visit to good institutions in the country and abroad.

Rationalization of Investment Pattern.

Innovative financing through SHGs – Acting as SHPIs.

RRBs shifted from narrow banking to credit disbursements.

Doubling of Agricultural Credit.

1.17. The revitalisation package worked very positively in turning around most of the RRBs as will be revealed from the comparative position of key statistics as on 31 March 1995 and 31March 2005. The position further improved during 2005-06 and about half the number of the RRBs as on 31 March 2006 attained sustainable viability while more than 1/3rd of the rest have attained current viability. RRBs, as a system have attained a landmark business level of Rs.112274 Crore and earned a net profit of Rs.709 crore. The gross loan was Rs.39764 crore. There has been spectacular achievement in loan recovery performance, NPA management, and branch and staff productivity.

Table 1.2

Comparative position of performance of RRBs

(Rs.in crore)

	Parameter	Value		
		1995	2005	2006
1	Number of RRBs	196	196	133
2	Number of Branches	14509	14484	14489
3	No. of Districts Covered	425	523	525
4	Staff (No.)	70848	68912	68629
5	Owned funds	268	6181	6647
6	Deposits	11141	62143	71327
7	Borrowings	2274	5524	7303
8	Investments	6128	36762	41182
9	Gross Loans and Advances	6291	32870	39713
10	CD Ratio	56%	53%	57%
11	Investment Deposit Ratio	55%	59%	56%
12	Per Branch Productivity	1.20	6.56	7.66
13	Per Staff Productivity	0.25	1.38	1.61
14	RRBs having accu. losses (No.)	175	83	58
15	RRBs in profit (No.)	32	166	111*
16	Current Profit	0.29	902	756*
17	RRBs in losses (No.)	164	30	22*
18	Current Losses (Rs.lakh)	423	154	191
19	Banks with sust. viability (No.)	12	111	75
20	Banks with current viability (No.)	32	56	36
21	Recovery (%)	51	78	80
22	Gross NPA (%)	43	8.53	7.28

* Position after amalgamation; hence number is not comparable with previous year.

(Source : Compiled)

Achieving the Mandate-Financial Inclusion

1.18 RRBs were set up with the intention of taking banking services to the villages to cover such categories of rural masses, which hitherto were considered unbankable by other RFIs specially the commercial banks. Annexure 1.2 depicts the performance of all RFIs in delivery of credit at the grass-roots level. It will be observed therefrom that although there has been substantial growth in lending of RRBs, their share is not commensurate with their vast network and manpower. RRBs have the potential to achieve a 25% share of the GLC as against less 10% as on 31 March 2005. In agricultural credit, the share of RRBs stand at 10% under crop loans while under medium/long term loans, the same is just 5%. However, there is a silver lining that the growth in lending in agriculture under the programme of doubling of credit, the average growth rate which was just 8% in 2000-01 increased substantially to 63.6% in 2004-05.

1.19 Annexure 1.3 contains the comparative position of number of Loan accounts and loans outstanding in respect of Public Sector Banks (PSBs) and RRBs for the period from March 2002 to March 2005. It is observed that the performance of RRBs has been highly satisfactory in so far as taking the banking services to the rural poor is concerned. RRBs have 121 lakh loan accounts out of about 1300 lakh rural households. The per account loan, as on 31 March 2005 was Rs. 21469 as against Rs. 97207 of the PSBs as on that date. This confirms that the RRBs, as mandated, have mostly covered the people of small means belonging to the target groups.

1.20 At present, RRBs cover 525 districts in the country. As per data available, 80 districts in the country are yet to be covered by RRBs. There is a need to ensure that all districts in every State/Union Territory are covered by RRBs. At present, there is no coverage of RRBs in districts such as Sikkim (4 districts), Goa (2 districts), Andaman and Nicobar islands (2 districts), Daman & Diu(2 districts), Lakshadeep, Delhi, and Chandigarh (1 each) as well as Pondicherry (4) . Similarly , 18 districts in Tamil Nadu , 10 districts in Arunachal Pradesh, 5 districts in Kerala 3 districts in Meghalaya, and 6 districts in Nagaland are yet to be covered by RRBs . The feasibility of covering the uncovered districts may be explored.

1.21 Recently, Reserve Bank of India has urged all banks to review their practices to promote financial inclusion. They have been advised to open no-frill accounts with minimum balances. New credit delivery models like business correspondents, business facilitators, postal services, etc as well as new technologies are being experimented with so as to reach the unreached customers. There is considerable imbalance in credit deployment by the banking system among many States of the country vis-à-vis the deposits generated therefrom. A comparison between deposits and credit of scheduled commercial banks with NSDP in different States is revealing :

Table 1.4

Banks Business and the Net State Domestic Product (NSDP)

State	Ratio of bank credit to NSDP	Ratio of Bank Deposits to NSDP
Himachal Pradesh	29.4	68.9
Punjab	40.4	88.2
Haryana	27.5	46.2
Rajasthan	26.4	42.1
Uttar Pradesh	23.9	63.1
Gujarat	32.5	59.3
Madhya Pradesh	24.7	49.4
Bihar	19.2	71.4
Jharkhand	18.2	68.2
West Bengal	29.8	55.3
Orissa	28.2	48.2
Maharastra	72.0	108.3
Andhra Pradesh	37.1	52.2
Karnataka	54.6	79.1
Kerala	40.0	85.0
Tamil Nadu	62.9	65.4
Sikkim	21.5	93.3
Arunachal Pradesh	13.6	54.2
Meghalaya	26.9	63.4
Manipur	6.7	21.2

Source; RBI-Basic Statistical Returns, (Financial Exclusion- Manas Chakravarthy)

The ratio of bank credit to NSDP among advanced States like Maharashtra, Karnataka, Tamilnadu, Kerala, Punjab, etc., was more favourable than that of States like Bihar, Madhya Pradesh, Uttar Pradesh, Jharkhand, NER States, etc. This indicates a sub-optimal deployment of credit in the backward States by the banking system. As far as RRBs are concerned, they need to shed their earlier image of 'narrow' banks and consider providing a range of products for all financial needs and focus on financial inclusion through progressive use of technologies and low cost alternative delivery channels like business correspondents and business facilitators.

1.22 The Credit Deposit ratio in different regions was as under:

Table 1.4

Region wise CD Ratio

Region	1996	2006
North	50.3	52.1
North-east	41.1	46.6
East	46.4	44.6
Central	42.0	44.5
West	71.4	49.5
South	74.8	93.7

The CD ratio has declined in the East but has increased in North East. Otherwise, the relative position among the different regions continued to remain almost the same over the last ten years. However, it is observed that the CD ratio was comparatively lower in North-East, East and Central Region States as compared to Southern and Western Region States; thereby indicating relatively low deployment of the resources generated by the banking system in the North-East, East and Central Region States. The RRBs in these areas have a role to promote financial inclusion in these regions.

1.23 The State-wise per capita credit flow data is also worthy of review. The position for 2004 - 2005, was as under:

Table 1.5

State wise Per Capita Credit Flow (Amt. In Rs.)

Chandigarh	133,762	Andhra Pradesh	10,809
Delhi	101,468	Himachal Pradesh	10,308
Maharashtra	29,984	Jammu & Kashmir	8,420
Goa	26,247	West Bengal	7,943
Tamil Nadu	18,598	Rajasthan	5,800
Karnataka	16,431	Orissa	5,417
Punjab	13,477	MP + Chhattisgarh	4,633
Kerala	12,473	UP + Uttaranchal	3,604
Gujarat	11,754	Assam	2,799
Haryana	11,018	Bihar + Jharkhand	1,937

(Source : Compiled)

It is observed that there is considerable scope for improving per capita credit flow by RRBs in States like Madhya Pradesh, Uttar Pradesh, Uttranchal, Bihar, Jharkhand, Rajasthan, Orissa and Assam.

CHAPTER 2

'When the rate of change inside an institution becomes slower than the rate of change outside, the end is in sight'-Jack Welch

STAKEHOLDERS AND EMPOWERING THE BOARD OF DIRECTORS

2.01 The real stakeholders of the rural banks are the rural population who use the services of the rural banks including those who can potentially avail of their financial services. The RRBs play a crucial role in financial inclusion. Rural banks are required to provide comprehensive financial services to the rural people. The financial services are not to be interpreted only as credit but include flexible savings products, safe remittance facilities within India and abroad, receipts from and payments to governments and utility service providers, insurance products, guarantees, debit/credit cards, investment channels and information on farm inputs, technology, markets, etc. These aspects are discussed in detail in Chapter 4 of the report. In the literal sense, the stakeholders are those who have subscribed to the share capital of the rural banks. This chapter takes a close look at the roles of the existing stakeholders. In terms of Section 6 of the RRB Act, 1976 the Central Government, the sponsor banks and the State Governments have subscribed to the share capital of the banks in the ratio of 50:35:15. The Act has spelt out the roles of the different owners.

2.02 Role of the Central Government

The powers of the Central Government as specified in the Act are listed in Annexure 2.1. It is seen that the Central Government has absolute powers, right from incorporation of an RRB, subscribing to its capital, appointing two directors on the board, notifying various rules and regulation for board meetings, appointments and promotions, staff regulation, determining remuneration and service conditions of the staff and officers, appointing auditors and fixation of their remuneration, giving direction to RRBs on policy matters involving public interest, amalgamation of RRBs and notification thereof and placing the working results / activities of the RRBs in both Houses of Parliament. In exercising such powers, the Central Government seeks the expertise and services of NABARD, which also maintains the database on RRBs.

Role of Reserve Bank of India

2.03 Reserve Bank of India is the Central Bank of the country. It performs a wide range of promotional functions to support national economic policy objectives. It is the Regulator and Supervisor of the financial system. It prescribes broad parameters for banking operations within which the country's banking and financial system functions, so as to ensure stability. As per the provisions of the RRB Act, 1976, RBI represents the GOI on the boards of RRBs. Recently RBI has constituted Empowered Committees for RRBs on a State-wise basis the role of which has been examined in detail separately in this chapter.

Role of Sponsor Bank

2.04 As per Section 2(g) of the RRB Act, 1976, the Sponsor Bank is identified as a bank. Sponsor Banks besides sponsoring the RRBs, also subscribe to 35% of the equity. As per Section 3(3) of the Act, the sponsor banks have to aid RRBs by providing management and financial assistance. Sponsor Banks also appoint Chairmen from among their own officers or otherwise, nominate two directors to the Board of the RRBs and depute such number of officers and employees as may be necessary for smooth functioning of RRBs. The Sponsor Banks provide refinance support to RRBs and help in maintaining liquidity. The various functions of the Sponsor Banks in relation to the RRBs are listed in Annexure 2.2.

Role of State Government

2.05 Though the State Governments have only a smaller holding of 15%, they have a greater stake in the banks as these banks play a significant role in implementing various credit-linked development schemes. The State Governments nominate two directors each to the Boards of RRBs functioning in the States. The State Government is expected to assist RRBs in their smooth functioning and facilitate the recovery of loans.

Role played by NABARD

2.06 Though not a shareholder, NABARD is also a stakeholder in these banks. NABARD assists the Central Government in relation to all its functions pertaining to RRBs. It provides policy inputs and has representation on the Board of Directors on behalf of GOI. NABARD provides concessional refinance support to augment the resource base of RRBs for lending to the desired sectors as also to enhance liquidity. NABARD has been playing a significant role in human resource development of the RRBs by imparting training to RRB officers, conducting organisation development initiatives (ODIs) and exposure visits within the country and abroad. NABARD extends help to the RRBs in all matters relating to its operational problems, business development, micro-finance, policy thrust, etc. NABARD has also been entrusted with the statutory supervision of the RRBs by way of conduct of offsite surveillance and onsite inspections. The role functions of NABARD are listed in Annexure 2.3

2.07 The Advisory Committee on Flow of Credit to Agriculture and related activities, 2004, under the chairmanship of Prof. V S Vyas, recommended the amalgamation of RRBs into State level institutions as it felt that the process of amalgamation would lead to significant reduction in cost of administration and economies of scale. With increasing competition in the rural financial markets, particularly from the private sector commercial banks and sponsor banks, the income of RRBs, which are essentially localised units, is likely to decline, threatening the sustainability of RRBs. By contrast, amalgamation would lead to enhanced coverage of geographical areas and the improved outreach of such amalgamated entities would enable them to ramp up growth by diversifying business portfolios. Amalgamation would further result in efficient and optimum utilisation of the financial and non-financial resources due to a combination of synergy and transaction costs sharing potentials. Amalgamation would lead to rationalisation of staff and their need based allocation and redeployment. Besides, the inter district transferability potential can improve the prevailing 'not so exemplary' work culture. Based on these recommendations, Govt. of India allowed RRBs sponsored by the same bank within the same State to be amalgamated in a phased exercise. So far 137 of the 196 RRBs sponsored by different banks have been amalgamated into 43 new entities (a few more proposals are under consideration). Together with 59 standalone / unamalgamated banks, the total number of RRBs now stand at 102. By the time the State-wise sponsor bank-wise consolidation of RRBs is complete, the number of RRBs could reduce to 96.

Further, State-wise consolidation of banks has the potential to unleash considerable synergies in terms of manpower redeployment and fund resources maneuverability, initiation to new product launches, especially those driven by technologies like internet banking, remittance transaction, debit/credit cards and anywhere banking services, transaction cost savings, etc. in the long term. The larger area of operations consequential to consolidation also provides considerable leverage in profit and viability prospects of RRBs due to their ability for cross-transfer of business risks across different regions of operational areas and sectors. The branch-wise distribution of banks at the present level of consolidation (i.e. 102 RRBs), after the completion of the on-going State-wise/sponsor bank-wise consolidation is given in Table below:

Table 2.1

Potential impact of consolidation in the Branch network of banks

Sr. No.	No. of branches of RRBs (Range)	Pre-amalgamation stage	No. of banks in the Range	
			Present stage of consolidation	On completion of State-wise, sponsor bank-wise consolidation
1	> 1000			
2	< 1000 but > 700			2
3	< 700 but > 500		2	2
4	< 500 but > 300		9	10
5	< 300 but > 100	41	42	36
6	Less than 100	155	49	27
	Total	**196**	**102**	**77**

(Source : Compiled)

The table shows that consolidation can lead to creation of a number of modest and medium sized banks, which will no longer remain tiny banks with little means. Similarly, a simple realignment of financial performance data for of the year 2005-06 in tune with post-consolidation scenario as visualised above reveals a considerably improved viability status for the consolidated RRBs.

Table 2.2

Viability status of RRBs in different scenarios of consolidation
(based on 2005-06 balance sheet figures)

(Rs. crore)

Sr. No.	Particulars	No. of banks in the category		
		Pre-amalgamation	At present stage of amalgamation	On completion of State-wise, sponsor bank-wise amalgamation
(1)	(2)	(3)	(4)	(5)
1	Total No. of RRBs	196	102	77
2	No. of RRBs in profits	163	83	64
	(% of total)	83%	81%	83%
3	No. of RRBs in losses	33	19	13
	(% of total)	17%	19%	17%
4	No. of RRBs with accumulated losses	89	51	42
5	Amount of accumulated losses	2725	2674	2619

(* figures provisional) (Source : Compiled)

The analysis establishes considerable merit in the proposal for further consolidation of banks as recommended by various Expert Committees that previously studied the subject of viable RRB operation and supported by an overwhelming majority of other important stakeholders like senior functionaries of banks, employees and their unions, etc., with whom the Task Force had occasion to interface. The RBI's recent policy prescription for the financial sector reforms also laid considerable emphasis on banking consolidation and self-reliance. The Internal Working Group of RBI on RRBs under the chairmanship of Shri A.V. Sardesai also recommended State-wise consolidation of RRBs. While supporting such State level consolidation process, the Task Force considers that pushing the consolidation agenda beyond State levels may not be worth pursuing as the same could compromise the regional characteristics that are fundamental to RRBs and may lead to creation of banking structures parallel to Commercial Banks, which may not address the banking needs of the rural people.

2.09 Changes in Role of Sponsor Banks.

The sponsor banks which hold 35% of the equity including Rs.766 crore as part of the recapitalisation package, controls the management role fully including deputing the Chairmen, General Managers and other senior officers. This was the need of the hour in 1976 when RRBs had no staff and no management experience. This system needs a relook at this juncture. The Boards of the RRBs will have to take upon themselves much of the responsibilities, which are hitherto with the sponsor banks.

In the above context the Task Force has examined an important issue as regards changes in the role the of sponsor banks. The need for sponsor bank was essential at the time of setting up of RRBs and also to run the same till such time, the RRBs themselves were in a position to operate on stand-alone basis without operational support. Besides, RRBs being very small units, with limited area of operations, manpower, business levels as compared to commercial banks for conduct of business / undertaking any development, there was little economy of scale, necessitating the need for support / hand holding from sponsor banks.

In the changed scenario after amalgamation, there is a need to review the relationship of sponsor bank vis-à-vis RRB. Sponsor banks are sometimes perceived as competing in the same business and product market space with RRBs. The relationship between sponsor banks and RRBs needs to be changed into a synergistic one, beneficial to both banks. As already announced by Finance Minister, Sponsor Banks are squarely responsible for the performance of the RRBs sponsored by them. Therefore, the Task Force recommends that an MoU be executed between the sponsor bank and the Govt of India as regards the performance of RRBs under various key parameters such as incremental growth in business, outreach, profitability, improvement in CD ratio, reduction in NPAs, etc. In turn, sponsor banks may, as usual, sign MoUs with their sponsored RRBs.

<u>Need for All-India perspective for RRBs</u>

2.10 As the number of RRBs would be quite substantial, there is likelihood that these banks being State specific may develop extremely disparate cultures in the long run. This may not be in keeping with the all India perspective expected of RRBs. Further, the RRB system needs a common vision and strategy to be able to make an impact on the lives of the rural population it seeks to serve. Synergy among all the RRBs will enhance their value to rural customers.

As stated earlier, the real stakeholders of these banks are the present and future clientele. Credit planning should give way to credit marketing and relationship banking. Any banking relationship is based on trust and faith between customers and the bank. The client should be confident of availing financial services particularly credit as per need and repayment capacity. The RRBs should monitor and ensure that the client would use credit in a productive way and honour the terms of the loan contract. As averred, there is indeed a fortune at the bottom of the pyramid and rural poverty could be eradicated with the help of rural banks. The RRBs have to appreciate the fact that poor people are also productive and consumption credit for them is not a misuse of resources, but necessary for survival, at times. The RRBs have to rededicate themselves to these real stakeholders.

Governance and autonomy issues

2.11 The Task Force undertook a detailed examination of the distribution pattern of Board agenda items across the States and found that nearly 45-50% of agenda items relate to administration and other issues and hardly 12-15% items in a year related to policy issues, as may be seen from the Table below.

Table 2.3
RRB Board Agenda Items in terms of percentage (State-wise average)

Sr. No.	State	Policy Issues	Business Plan/ Loans	Review of Performance	Admn. & Operational	Others
1.	T.N.	12	26	19	34	9
2.	A.P.	13	25	26	30	6
3.	Assam	23	16	17	30	14
4.	Rajasthan	10	19	17	46	8
5.	Orissa	16	12	28	33	11
6.	Jharkhand	7	6	9	58	20
7.	Arunachal P	10	30	40	10	10
8.	W.V.	12	17	42	26	12
9.	Karnataka	10	18	29	29	14
10.	H.P.	22	11	19	41	7
11.	Uttranchal	11	35	17	26	11
12.	Chhattisgarh	11	18	40	26	5
13.	Gujarat	16	20	28	26	10
14.	Manipur	40	20	40	-	-
15.	Agartala	11	7	37	29	16
16.	U.P.	5	29	30	11	15
17.	Maharashtra	7	22	22	46	3
18.	Kerala	12	25	25	24	13

(Source : Compiled)

The Board of Directors of RRBs rarely discuss policy issues as these are supposed to be done by RBI/GoI/NABARD. The Board of Directors of RRBs, need to concentrate on business development and policies relevant for the RRBs.

Board of Directors

2.12 In terms of Section 8 of the RRB Act 1976, "the general superintendence, direction and management of the affairs and business of RRBs vests in a Board of Directors who may exercise all the powers and discharge all the functions which may be exercised or discharged by the RRBs". In exercising these functions, the Board shall act on business principles and shall have due regard to public interest.

2.13 The above provision in the Act has empowered the Board and given full rights and responsibilities in all matters relating to RRBs. After analysing the decisions taken in Board meetings of RRBs for 2005-06, the Task Force has observed that inspite of the powers conferred on the Board, the decisions are not finalised at that level. The Board often prefers to refer issues to the sponsor bank or NABARD, as the case may be, or defers the issues for the future. Such a practice has evolved in spite of the fact that five professional bankers represent the Board of RRB and adequate power is vested in the Board to take appropriate decisions. The resultant effect of such indecisiveness inevitably delays the decision making process, thereby causing inefficiency, disputes, HR problems, etc., which in turn affect the growth and progress of the RRBs.

2.14 The top policy making body of any progressive institution should reflect a fair cross section of the public interest and that of other important stakeholders whose well being is closely linked with the fortunes of that institution. The flavour of times and dictates of public policy demand representation to women in top policy making bodies. A non-institutional minority shareholder or a long-term depositor of a bank is another important stakeholder interested in the fair performance of that bank. Similarly, human resources in organisations are no more to be considered liabilities and many organisations with a modern outlook have started accounting them as assets in the annual financial statements. While considering the struggling past of RRBs, notwithstanding the hiccups of occasional agitations and legal battles with Banks' management, sometimes, even on trivial issues, the Task Force cannot but acknowledge the contributions made by the field personnel in ramping up business volumes. The employees of RRBs are important stakeholders who could hugely influence the fortunes of the institutions.

Size and Composition of the Boards

2.15 Section 9(1) of the RRBs Act, 1976 provides that the Board of Directors of the RRB shall consist of the Chairman and 8 other directors to be nominated as follows:

(a) Two directors, who are not officers of the Central Government, State Government, Reserve Bank, National Bank, Sponsor Bank or any other bank, to be nominated by the Central Government;

(b) One director, who is an officer of the Reserve Bank, to be nominated by that Bank;

(c) One director, who is an officer of the National Bank, to be nominated by that Bank; two directors, who are officers of the Sponsor Bank, to be nominated by that Bank; and

(d) Two directors, who are officers of the concerned State Government, to be nominated by that Government.

2.16 It is also provided in Section 9 (2) that the Central Government may increase the number of members of the Board; so however, that the number of directors does not exceed fifteen in the aggregate and also prescribes the manner in which the additional number may be filled up. At present, the size of the Board of Directors of RRBs is uniform at 9 members for all RRBs without reference to the size and area of operations of the banks.

2.17 The composition of the Board should however reflect the shareholders in the new set up and the need for specialisation. The following minimum composition of the Board is suggested:

(i) One official each from RBI, NABARD and the State Govt. and two from the sponsor bank

(ii) Three directors from amongst expert in rural economics, rural development, information technology, chartered accountancy, cottage and village industries, small and micro enterprises, or persons having experience in the working of Cooperative Banks, regional rural banks or commercial banks or any other matter the special knowledge or professional experience which is considered by the GoI, in consultation with RBI / NB as useful to the RRB, to be nominated by that Authority (GoI), with the proviso that at least one of such experts will be a woman .

(iii) The existing RRB Act provides for making need based increase in the number of Directors of Board upto 15. The Task Force recognises that such contingencies could arise in exceptional situations for individual RRBs and therefore favours the retention of that clause in the RRB Act, unaltered. However, this provision may now be invoked, keeping in view the amalgamation/merger of RRBs. There are now RRBs with 8 branches (Nagaland RRB) rising upto 680 branches (Uttar Bihar KGB, Muzaffarpur, Bihar).

The nominees should be of sufficient seniority and experience. NABARD, in consultation with GOI, may fill the remaining vacancies with experts in banking, micro finance, agriculture, small industries, and accountancy, InfoTech, etc.

The Chairman

2.19 Section 11 of the RRB Act 1976 provides for the sponsor bank to appoint Chairmen of RRBs from among its officers who possess the fit and proper criteria prescribed thereof in consultation with NABARD other than in exceptional situations that warrant adherence to other prescriptions laid down by the Act. However, the emerging environment and circumstances of RRBs are not what it used to be in the past and calls for an image change as entities independent of the sponsor banks. The Committee on Financial Sector Plan for North Eastern Region under Mrs. Usha Thorat, Deputy Governor, RBI which examined the issue of positioning of Chairman in RRBs observed that the problem faced by RRBs include lack of dynamism/ motivation of CEO, staff constraints in some RRBs, inadequate interest taken by Sponsor Banks, etc. and suggested that wherever required, RRBs may be allowed to recruit CEOs from market on contract basis with remuneration linked to achievement of specified targets in terms of financial inclusion and business levels. A Parliament Committee recommended that NABARD be entrusted with the responsibility for selection and appointment of Chairman of all RRBs by preparing an All India Panel. The Task Force recommends that the Chairman of all RRBs be selected on merit and on competitive basis and appointed by the sponsor bank from amongst a panel of qualifying officers of, based on criteria to be prescribed for the purpose, from time to time. The CEO's panel needs to be prepared by the sponsor bank in consultation with NABARD, based on the fit and proper criteria generally prescribed by RBI for commercial banks. To encourage the deputation of talented officers as Chairmen of RRBs, the Task Force feels that the RRB Chairman be given due weightage by the parent institution for promotion of the officer to the next higher grade as and when he is eligible for promotion. The pay/allowances and incentives should be attractive so as to encourage performance. Further, though the RRBs Act, 1976 does not prescribe any minimum period for appointment of a Chairman on the Board of RRB (though maximum period is stipulated), the Task Force recommends that sponsor bank/NABARD may take care that the minimum period for which a Chairman should hold office is not less than 2 years and upto a maximum period of 5 years.

Term of Directors

2.20 As of now, the term of nominee directors is two years and a nominee director continues to be in position till his successor is nominated. It is recommended that the term of nominee directors may be as long as prescribed by the institutions nominating them but in any case not exceeding two terms of two years at a point of time and no director may be nominated for more than two terms of two years each. The term of nominee directors may also be for a minimum period of two years though they may be eligible for re-nomination for another term of two years.

Committees

2.21 Delegation of power and monitoring their end-use are key factors in corporate governance. As the Board of Directors cannot meet frequently, there is a need for institutional arrangements to deal with various issues. There is also a need for expert opinion on relevant fields. Section 15 of RRBs Act, 1976 provides for constitution of Committees as needed by the RRB. Such Committees may consist wholly of Directors or partly of Directors and partly of other persons as the Board may think fit. It is, therefore, suggested that the Board of Directors of RRB may constitute such Committees as may be required by them for efficient operations of the respective Banks but they must necessarily have the following Committees:

Risk Management Committee to take care of Asset-Liability Management, credit risks, decisions on interest risks and review of interest structure, as also for effective recovery policies including compromise and settlement procedures. The Risk Management Committee may not wholly consist of Directors. The Committee may be constituted with the Chairman, one of the Board members having knowledge on the subject and 2/3 senior officials of the Bank.

Management Committee: The Management Committee will comprise of the Chairman and 3-4 senior executives of the RRBs and shall deal with loan sanctions, innovative banking products, operational instructions, general administration, computerisation, career progression, etc. and related issues.

Investment, HR and IT Committee: This Committee is not envisaged as a Committee of the Board but shall comprise of senior personnel of the RRB. They could co-opt external experts in HR, IT and Investments, for specific issues, as and when required for efficient operations.

Audit Committee of the Board for supervising the internal supervision systems, audit of policies framed by the Board and its implementation, ensuring integrity of statutory information supplied to regulator institutions, decisions relating to framing of annual balance sheets and profit and loss accounts as also accounting policies related thereto, audit of annual accounts and its compliance as also compliance of various inspections undertaken by supervising authorities. The Audit Committee may co-opt a practising Chartered Accountant as member.

Functions of the Board

2.22 The Board of Directors are required to concentrate essentially on corporate and business policy functions viz., framing strategic objectives, setting corporate values, guiding the formulation of corporate strategy, business planning, annual budgeting and setting performance objectives at different levels; policy formulation with reference to general functioning of the bank as also specific policies with reference to business development, business risks, investment and human resource management, etc; lay down lines of responsibility, accountability and delegation of powers at different levels and introduce reporting and monitoring systems therefor; monitoring the effectiveness of the general governance practices at different levels; monitoring corporate performance and the financial health of the bank as also overseeing major items of capital expenditure; monitoring and managing potential conflicts of interest of management, Board members and stakeholders; guiding the human resource development policies in the bank as also selection, career progression and development of staff towards the key objectives. This may be done within the prescribed ceiling based on earlier experience as also efficiency and business requirements ensuring the integrity of the accounting and financial reporting system, causing audit of the accounts on annual basis and its communication to all concerned and overseeing the process of disclosures and the communication of information/ data to various authorities. However, an area of concern is that the Board functions are not being organized in a professional and business like manner. Most RRBs have not followed an annual schedule of agenda for the meetings. Policy issues, business growth, new products and services, challenges before the RRBs specially competition from other agencies, ALM, frauds, internal checks and control, etc. are either sidelined or seldom discussed. A disproportionate amount of the time and discussions are devoted to administrative issues. What is of paramount importance is that the Boards of RRB should delegate powers at various levels and the Board then acts as a watchdog through reviews, to monitor whether delegations put in place have been exercised properly on the principle of operational freedom with accountability.

2.23 With a view to empower the Boards of RRBs, it is essential that the Board is informed on a periodical basis on various pre-selected parameters to enable it to discharge the responsibility of overseeing the performance of the bank as a whole and that the RRBs function in accordance with the guidelines issued by RBI/NABARD/ GOI/State Governments. Keeping this in view the Task Force feels that broad guidelines can be laid down to ensure that the agenda in respect of reviews placed before the Board follow a set pattern annually which would indicate a calendar for items of agenda to be put up to the Board. A model calendar has been drawn up for the RRBs as indicated in Annexure 2.4.

2.24 The priorities of the Board would comprise the following aspects:

Establishing corporate goals and objectives
Creating an environment of shared objectives and priorities across the bank
Business planning and Implementation
Annual budgeting and setting performance standards
Marketing and customer relationships
Resource mobilization and management
Loan policy
Product innovation for total financial services
Credit plus services: training and extension-technical and commercial
Micro-finance innovations (self help groups, JLGs, farmer clubs and micro enterprises)
Investment policy and options
Financial inclusion
Credit, operational and market risk management
Liquidity and asset liability management
Human Resource Management: recruitment, training and placement
Industrial relations and motivation
Delegation of powers and monitoring
Accounts, audit and internal controls
MIS and monitoring systems
Review of interest margins and profitability
Technology applications
Investor relationships

Over the year the Board agenda should cover the above aspects of RRB operations with suitable periodicity. While some of the concerns are dealt with in other sections of the report, some elaboration on the Board functions and responsibilities would be in order.

2.25 Various policy and operational circulars are issued by higher agencies like RBI, NABARD & Sponsor Banks to RRBs uniformly on an all India basis. As such the Board of RRBs are not in a position to function independently in the interests of the RRB or in the interest of the Public in the area of operations of the RRBs. The Task Force is of the view that having regard to the independence of the Board of the RRB and to ensure that Board attains autonomy in discharge of its duties, such higher institutions need not issue routine directions to the Management of the RRBs on operational matters. Broad policy should be advised, based on which RRB Boards decide the operationalisation parameters, keeping in view the interests of RRBs and interests of Public in the area of operations. The Boards of RRBs are to be made more independent by providing them with a broader policy framework within which the RRBs should be enabled to develop their viable operational plans and policies. Most of the Directors on the Boards of RRBs should be free from any business or other relationship with the RRB that could interfere with their independent judgment. On the other hand, the functioning of the Board should be subjected to strict scrutiny by the Regulatory/Supervisory Authorities to ensure a healthy system of checks and balances at the corporate level.

2.26 The mission of the RRB system is well articulated in the preamble to the RRB Act, 1976. RRBs may provide for the purpose of development of agriculture, trade, commerce, industry and other productive activities in the rural areas, credit and other facilities particularly to the small farmers, agricultural labourers, artisans and small entrepreneurs etc. The Board has to translate this broad mission into specific goals, objectives and activities keeping in view the requirements and the potential of the area of its operations. Potential is not measured in material terms, but in the minds of the people. The Board should have a feel of the bank’s client base and tune the organisation to meet client/stakeholder aspirations keeping in view the RRB's interests.

2.27 It is not enough if the Board sets appropriate goals and objectives. They have to be widely shared and made part of the culture and activities of the organisation.

Motivation through example and two-way communication becomes very important. Informal communication is as important as the formal one. The top management should not only be in constant touch with the intermediate and cutting edge levels at branches but also with the clients. The Board should review the efficacy of this approach. The client should feel comfortable approaching the RRBs. The bank's products and relationships should reflect this concern. The generic products should be presented in a way that appeal to the rural customers. For instance the erstwhile Siwan RRB in Bihar made a success of its loan product for foreign education. The poor people had no hesitation to approach Prathama Bank in Moradabad of UP. The members of SHGs and farmer clubs felt that they were part of the bank itself. The Board should ensure that the objectives get translated as products and practices that encourage the rural population to deal with the bank.

2.28 The Board has to set quantitative indicators in the form of an annual business plan subdivided into quarters. The indicators could cover all aspects of the development action plan. The reviews should focus on the reasons that contributed to the achievement or non-achievement and the remedial action. The Board will monitor the attainment of quarterly targets.

2.29 The average credit deposit ratio of the RRBs is 55.68% as of 31 March 2006. This points to the fact that the funds are not the constraint for credit expansion. The investment portfolio is in excess of SLR requirements. Effectively, the rural savings are transferred to the urban areas. The need of the hour is not credit planning but credit marketing in rural areas by RRBs. Marketing starts with building durable relationships. Financial inclusion is an essential part of the strategy. Subsidy schemes of the Government should become entry points for new relationships rather than one off transactions. The performance of the RRBs in credit, NPA management and profitability crucially depends on this approach.

2.30 By its very composition, the Board is dominated by the sponsor bank nominees. It is true that once the Chairman takes up position in the RRB, he identifies himself with the bank. However, often his seniors from the sponsor bank are nominated on the Board, which effectively takes away his freedom to decide on important issues. While It has been widely acknowledged that the representatives of other stakeholders played a constructive role in business expansion, the role of the State Government nominees was limited by absence or narrow concern about the participation of the bank in various subsidy schemes. Similarly, the non-official directors had a negligible role to play in the governance of RRBs in many cases.

Orientation and Training

2.31 It is observed that sporadic efforts are being made for training of officials and non-official directors of RRBs. However, there is a general impression that the majority of the Directors on the Boards of RRBs need to be adequately oriented towards the functions of RRBs and their own responsibilities as nominee directors.

Repositioning the Role of the Sponsor Banks

2.32 The Task Force suggests that the role of sponsor bank should be supportive and be broadly confined to the following :

(i) Extending management support as required by RRBs.
(ii)Nominating its share of members in the Board of Directors to provide expert and unbiased advice to RRBs.
(iii) Providing funds for which the RRBs may also have the freedom to choose from any bank/financial institutions.
(iv) Providing expert guidance/ help in investment related issues for which RRBs may also have the freedom to choose from alternatives, if available from other banks/primary dealers.
(v) Conducting management audit till alternative arrangements are made by the RRBs, themselves.

Arrangements for Recruitment of staff at various levels.

2.33 The functioning of many RRBs is hampered by insufficiency of staff due to prescribed ban on staff recruitment. The age profiles of RRBs employees reveal that there would be mass retirements over the next six years. Staff augmentation remains an issue to be urgently addressed. However, the previously available instrument of Banking Services Recruitment Boards (BSRB), which the RRB Rules specifically provide for relating to recruitments, is no more functional. The Task Force recommends that GoI may urgently accredit and notify suitable access to All-India / State Level Staff Selection Institutions of repute (like IBPS, Mumbai, etc) which could conduct selection tests (written/oral) for recruitment of clerical/officer level staff for RRBs, on a State-wise basis.

Implementation of SARFAESI Act:

2.34 Under the Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act 2002, which has come into force w.e.f. 21st June 2002, commercial banks are empowered to deal with defaulter borrowers outside courts on their own. Under the provisions of this Act, authorised officers of commercial banks can issue a notice in writing to defaulter borrowers including guarantors to discharge in full his liabilities within 60 days from the date of notice, failing which the bank shall be entitled to take possession, manage or dispose of the asset in the manner prescribed in this Act without intervention of any court or tribunal.

Under these provisions of the SARFAESI Act, 2002 Commercial Banks have been able to recover substantial amount of dues from defaulters thereby reducing their NPAs. However, the RRBs have been kept out of the purview of this Act. RRBs are expected to depend on the recovery process through courts and Govt. machinery, which takes much time to effect recovery. RRBs also do not have the staff/legal expertise as available with commercial banks, for constituting a recovery cell or enforcing legal claims. To enable better recovery from defaulters, the Securitisation Act, 2002 should also be extended to RRBs. The Securitisation Act, if extended to RRBs, can enhance their recovery process and the Debt Recovery Tribunals (DRT) will have to be suitably notified.

Applicability of Section 80(P) of Income Tax Act

2.35 As per Finance Bill, 2006 the provisions for exemption granted under section 80(P) of the Income Tax Act available to RRBs (treating them as deemed cooperative society) have been withdrawn. The RRBs are now required by law, to pay income tax on all earnings. The Task Force is of the opinion that in view of the developmental role played by the RRBs for development of the rural masses and considering their high cost of operations in rural areas with significant business and default risks, low profit margins, need to finance at lower rates of interest to financially weaker rural sections of societies and that the RRBs as a separate rural credit system are yet to consolidate and are poised at a critical stage of take off, post-amalgamation the provisions under section 80(P) of Income Tax Act may be continued for a further period of 5 years or till the restructuring process is completed, whichever is earlier.

Empowered Committees for RRBs

2.36 One of the Terms of Reference is to elucidate how autonomy of the Board of RRB can be ensured while safeguarding the over sight of the Empowered Committees for RRBs. The Union Finance Minister in his Budget Speech for the year 2004-05 had stated that Government had entrusted the implementation of policy to enhance agricultural credit to all the banks. He had also indicated that RRBs should adopt a new governance standard and abide by the prudential regulations so that they will qualify for receiving funds from Government for their restructuring. In order to achieve the above objective, Reserve Bank of India by its notification No.RPCD.CO.RRB.175/ 03.05.33(F)/2004-05 dated 02 September 2004 had constituted a Committee which is known as the Empowered Committee (EC) for RRBs. The broad functions of the EC are as under-

(i) Monitor the flow of agricultural advances and advances granted by RRBs.

(ii) Work out institutional arrangements for monthly feedback on achievement of targets for advances, particularly to agriculture.

(iii) Remove impediments and procedural problems faced by RRBs in extending finance as well as formulate innovative products for stepping up credit in rural areas.

(iv) Provide guidance to the RRBs on operational issues/problems, implementation of Lead Bank Scheme and Service Area Approach, investment of non-SLR surplus funds, performance under Annual Action Plan and priority sector, credit under various

Government sponsored programmes, prudential norms, branch expansion/rationalization programme, etc.

(v) Periodically review of financial performance of RRBs.

(vi) Examine the initiatives taken by RRBs for financing of contract farming, financing of input suppliers and output purchasers in case of agricultural lending, etc.

The meetings are conducted on a monthly basis. The Committee has the Regional Director, local office of RBI as Chairman and CGM, NABARD, GM In-charge of RRB Division of Sponsor Banks, senior functionaries SLBC and the State Governments as members. However, the Chairmen of RRBs are not made members of EC. The forum of EC is also being utilised to discuss and monitor the proposals for amalgamation of RRBs. With a view to ensuring smooth transition of the business/undertakings of the erstwhile RRBs to the new RRB from the effective date of amalgamation, the operational issues relating to maintenance of CRR, SLR, etc., by the erstwhile RRBs and subsequently by the new RRB/s, are also envisaged to be sorted out at the level of the Empowered Committee. Applications received from RRBs for opening of currency chests would be examined and recommended by EC based on the prescribed norms to Reserve Bank for consideration. On the issue of branch licensing of RRBs (which has been delegated to Regional Offices of RBI since June 13, 2006), the role of ECs is to examine and make recommendations on applications of RRBs for opening of new branches, merger of branches, etc. Similarly, requests from RRBs for conduct of forex business as limited authorised dealers (Category-II), opening/maintaining of NRE/NRO Rupee Accounts, etc. would also be examined by ECs. With a view to enlarging the scope of financial inclusion, ECs have been advised to identify the uncovered district/s, if any, which could be covered by the existing RRB/s so as to persuade the concerned sponsor bank to approach the Government of India (Ministry of Finance) for extension of the area of operation of RRB/s sponsored by it. ECs have been requested to discuss and ascertain as to which RRBs are desirous of handling pension / other government business of the State Government. Regional Directors would act as a facilitator for the RRBs to undertake the aforesaid business and request the State Government to do the needful. Considering the comprehensiveness and multiplicity of important issues being transacted by the EC, the Task Force feels that Chairmen of RRBs could also be appointed as Members of the Committee. The present periodicity for conduct of meetings on a monthly basis is too short a period for data collection, analysis and initiating follow up action. Therefore, the Task Force recommends that the meetings be held on a quarterly basis, for greater effectiveness. Besides, the

Empowered Committee may ensure that no RRB is constrained in its business decisions by the sponsor bank and that requisite financial and managerial support is ensured.

CHAPTER 3

"Gaon ka pani gaon mein, gaon ka paisa gaon mein"

FINANCIAL RESOURCES MANAGEMENT

3.01 The fountain of resources for RRBs is the savings of the rural population. The Indian rural population, despite low incomes, has a strong tendency to save for tomorrow by postponing today's meager consumption. This is true of even backward States and regions. The financial resources of RRBs are the share capital including share capital deposits, public deposits and refinance.

Owned Funds

3.02 The owned funds of RRBs comprising share capital, share capital deposits (received as recapitalisation support) and reserves of profit making RRBs stood at Rs.6762 crore as on 31 March 2006 as against Rs.6181 crore as on 31 March 2005. The core capital and share capital deposits amounted to Rs.2180 crore while the balance amount represents reserves. Of the core capital Rs.98 crore by way of initial equity and Rs.1094 crore by way of share capital deposits was contributed by GOI and the balance being the share of the Sponsor Banks and the State Governments. Various Expert Groups that examined the viability issues of RRBs opined that because of poor initial share capital base (at Rs. 25 lakh) the RRBs were congenitally unviable. The authorised and paid up share capital have since been enhanced to Rs.5 crore and Rs.1 crore respectively. As per the balance sheet data as on 31 March 2006 the system had an accumulated losses of Rs.2674 crore. The loss position would make a significant dip if the ongoing phase of consolidation is allowed to complete its full run.

Capital Adequacy

3.03 RRBs operate in the same business environment as that of other banking business entities and more or less have the same products and markets. RRBs are therefore prone to similar business risks and shocks. Post amalgamations, many

RRBs have acquired sizes and business volumes comparable with that of mid-size commercial banks. The Task Force, therefore, recommends that the RRBs be subjected to the same level of safeguards and regulatory norms regarding capital sufficiency measured in terms of capital funds to risk weighted assets. On the lines of the recommendations of the Task Force on Revival of Cooperatives (which have since been accepted by GOI), the RRBs, may strive to comply with a Capital to Risk weighted Asset Ratio (CRAR) requirement of 7%. The share holders of RRBs may review the position after 3 years and consider recapitalisation wherever necessary so as to enable the banks to attain 7% CRAR . Further, funds requirements to elevate the CRAR to 9% in stages may be met through internal accretions of business surpluses by the RRBs.

Deposits

3.04 Presently RRBs are mobilising deposits from their operational area and they offer a variety of deposit products that are generally available in commercial banks. The gross deposits of the RRBs as of 31 March 2006 were Rs.72, 510 crore, an increase of Rs.10, 367 crore (16.7%) over the previous year which is higher than the national average and the highest in the last four years. Five of the RRBs had deposits of more than Rs.2000 crore each. The growth in deposits in RRBs has been impressive. There is a larger share of terms deposits in the banks compared to that in commercial banks. These banks face competition from commercial banks in semi urban and urban centers.

3.05 RRBs are in the forefront of implementing subsidy schemes of the government for the farmers and the poor. However, when it comes to deposits of government agencies, commercial banks are preferred. This continues to be a genuine complaint from RRBs. It is recommended that the Reserve Bank and GoI clarify the status of the RRBs to the State Governments so that they get their patronage by way of deposits of developmental agencies. Further, at present the “capital gains account” is permitted to be opened only in SBI and Nationalised Banks. The tax authorities need not discriminate against RRBs and permit deposits of sale proceeds of assets in RRBs for being recognised as eligible for capital gains tax relief.

Refinance

3.06 In the early years, the RRBs needed refinance from sponsor banks and NABARD to a significant extent to meet the credit demand. Over time the deposits of these banks overtook the lending and the benefits of the relatively cheap resources went to sponsor banks. Now the RRBs avail refinance from NABARD only where it is concessional like advances for seasonal agricultural operations and self help groups. During 2005-06, NABARD sanctioned short-term credit limits of Rs.2256.90 crore to 119 banks and disbursed investment refinance of Rs.1132.40 crore.

3.07 The deployment of resources of RRBs is broadly in the credit and investment portfolios. RRBs provide finance to the rural population to meet their production and investment credit requirements in agriculture and credit requirements for small businesses, self-employment, professional services, rural industries and tiny sectors. RRBs have also adapted to the financing of emerging retail, housing and SME sectors. Normally, 50-60% of the funds are being deployed by the RRBs in the farm sector of rural India.

3.08 As on 31 March 2006, the loans and advances of the RRB system aggregated Rs.39, 764 crore, an increase of Rs.6894 crore (21%) over the previous year. The growth was high due to the emphasis on doubling of credit to agriculture. An analysis revealed that 73 RRBs had a growth rate above the national average while 15 RRBs had a growth rate of below 10%. 31 RRBs recorded a growth rate of more than 30%.

3.09 The RRBs are permitted to invest in the Government Securities. Each RRB has an investment policy framed in consultation with the Funds and Investment Department of the Sponsor Bank. The Sponsor Bank helps the RRBs in the sale and purchase of Govt. securities. The RRBs also have short-term surplus funds, which are placed with Public Sector Banks. As on 31 March 2006, the investment portfolio of the RRBs was of the order of Rs.38, 442 crore, an increase of Rs.1680 crore (4.57%) over the previous year. It is significant that the non-SLR investments most of which should have been earmarked for rural lending aggregated to Rs.17, 638 crore.

Cash Management

3.10 Funds Management envisages the deployment of funds so as to maximise returns. Cash Management is an integral part of funds management as cash is the most liquid form of funds available to the banker. Idle cash on hand does not yield any income but at the same time, the banker has to keep certain amount of cash with him for the day-to-day requirements. Ideal cash management aims at keeping such cash balances to an optimum level with a view to ensuring safety, liquidity and profitability.

3.11 The main problem in the cash management of banks is the accumulation of cash with them. This is attributed to the following aspects:

Most of the transactions in the rural economy take place in terms of cash and there is continuous increase in currency with public, which ultimately finds its way to the banks.

Location of Rural and Semi-urban branches/remote areas without adequate infrastructural facilities for frequent remittance of cash.

Over enthusiasm on the part of banks in accepting deposits often resulting in accumulation of small denomination notes and soiled notes.

Acceptance of cash only on limited days or denominations at currency chests.

Ineffective utilisation of cash by banks, which lead to non-sorting of, notes which in turn results in non-acceptance by currency chests.

Seasonality in the rural activities requiring high liquidity.

Lesser usage of other forms of money in rural areas.

The process of cash management has to start from planning for cash requirements. This has to take into account the environmental factors, locational advantages/disadvantages, seasonality and the heavy payment/receipt days of the week.

3.12 The next stage is the fixation of cash retention limits and periodical monitoring/ review thereof. The cash retention limit of branches has been fixed by many of the banks by linking the cash requirements to the total quantum of deposits/demand and time liabilities. However, this method is not very scientific. A more reasonable method would be to fix a maximum and a minimum limit for the cash holdings depending on the daily cash transactions i.e. average receipts and average payments. Other relevant factors that are to be taken into account are the availability of currency chests/cash pooling centers, T.T. discounting facilities, etc.

The monitoring systems need to look beyond complying with the CRR requirements to checking the idle funds. Similarly, the cash levels need to be monitored in absolute terms rather than as percentage to deposits on the basis of a close analysis of trends on different occasions.

3.13 The commercial banks enjoy interest free float funds from remittances, handling of foreign exchange, insurance claims, subsidy funds, tax receipts, pension and other government payments, etc. However, similar opportunities are almost non-existent for RRBs. These banks need arrangements to issue drafts and other speedier remittance facilities through inter bank networking or through arrangements with a large bank. They should also have opportunities in participating in government receipts and payments.

3.14 RRBs, being scheduled banks, are treated at par with commercial banks for maintenance of CRR and SLR. RRBs are required to maintain 5.5% of demand and time liabilities as balances in CRR. Presently these banks also have to maintain 5.5 % of NDTL as average CRR on daily basis. The net liabilities to banking system with a maturity of 15 days and upto one year are completely exempted.

RBI had paid interest at savings bank rate of 3.5% on 2% of CRR balance i.e. difference between the present CRR and statutory CRR (5% -3% = 2%). This, however, has been discontinued with effect from 24 June 2006. While Public Sector/ Private Sector Banks have certain compensating factors (such as float funds, large number of high value zero interest current accounts, diverse avenues of remunerative business), such advantages are not available to RRBs. The financial resources of RRBs are scarce and relatively costlier. The financial margin available to them is also very thin and the risk costs are higher. There is a uniform view that under the circumstances, there is no justification for pre-empting 5.5% of the deposits of RRBs at no return to the banks. Therefore, the Task Force is of the view that the Reserve Bank may consider the request of RRBs for reduction of CRR to 3% as they serve the poorer and neglected sectors of society and also consider restoration of payment of interest on balance maintained as CRR.

3.16 The cash management strategies are as under:

Creation of awareness regarding the magnitude of the problem and its implications amongst the staff.

Performance in cash management to be incorporated as an integral part in the appraisal of the performance of the branch/staff concerned.

Opening of more currency chests.

Streamlining the process for sorting of notes, remittance of notes, etc.

Developing infrastructure for communication, faster reporting system and monitoring techniques.

Utilisation of common cash van/armed guards for prompt remittance of cash.

The linkage system now popularised by RBI wherein clusters of branches are linked to a currency chest for local cash management.

Implementation of the recommendations of the Nayak Committee such as coinisation of Rs.1, 2 and 5 the most commonly used denominations establishing currency transit centers to streamline the system of remittance of soiled notes, etc.

Just like cash holdings, balances in current account with banks are idle funds and these are required to keep at a lowest possible level. The balances in these accounts are maintained mainly to meet clearing requirements and remittances. When the clearing is 'against' the same will have to be squared immediately by providing funds and for this sufficient balances are to be maintained. However, the idle balances can be brought down to a considerable level by utilising T.T. discounting facilities. The branch managers should be trained for judicious use of T.T. discounting facilities on a few days in a month rather than maintaining huge balances in current account throughout the month.

<u>Asset-Liability Management</u>

3.17 RRBs are exposed to risk relating to credit, market, operational, reputation, etc. With liberalisation in the Indian financial markets over the last few years and growing integration of domestic markets with external markets, the risks associated with banks' operations have become complex and large, requiring strategic management. As the 'RRBs' are an integral part of the financial system and most of these banks are undertaking business as varied as in the case of commercial banks, there is an imperative need for RRBs in general, to put in place appropriate internal control and risk management systems. The recent events like, amalgamation of banks, etc., in the RRB sector, reinforces the immediate need for introduction/adoption of sound risk management policies, practices and procedures.

3.18 The Task Force recommends that the RRBs adopt the Asset Liability Management system as a tool for risk management in future. NABARD may take steps to operationalise the instructions for ALM in RRBs. The model guidelines are given in Annexure 3.1 The Boards of RRBs may adopt the guidelines with modifications to suit their specific requirements.

Investment Management

3.19 The term banking is defined as accepting deposits for the purpose of lending. As banks are to carry out business as per stipulations of various Acts, each bank is subjected to a certain regulatory framework. The scheduled banks, of which RRBs are also a part, are required to part with a portion of their Deposits as CRR with RBI under Section 42 of RBI Act, 1934 and also require investing in specified instruments to meet the Statutory Liquid Ratio under Section 24 of the Banking Regulation Act, 1949. The present stipulation for CRR and SLR are at 5.5% and 25% of DTL respectively. Each bank after complying with these stipulations is to lend the remaining deposits. The borrowing supplements such lendable resources in case of higher demand. However, in case of low demand for credit, available funds need to be invested prudently in a systematic manner so that such investments called non-SLR investments generate revenues to the bank and provide liquidity as warranted.

3.20 Looking back, it may be observed that till the early Nineties, the average CD Ratio of all the RRBs was very high. But with application of prudential norms, the scenario changed completely. RRBs, to be in a safer zone, gradually turned to conduct narrow banking by investing a major part of resources in investments. As the return on such investments was very high compared to cost of deposits, RRBs gained substantially in such narrow banking operations. Term Deposits with Sponsor Bank had a major share of this portfolio. The RRBs had the lion share of income from investment than credit, as will be revealed from the table no. 3.1.

Table 3.1

Income from Investment vis-à-vis Credit

YEAR	INVEST MENT	INCOME OUT OF ADVANCES	INCOME OUT OF INVESTM ENTS	OTHER INCOME	TOTAL INCOME	% SHARE OF INCOME ON ADVANC S TO TOTAL INCOME	% SHARE OF INCOME ON INVESTMENT TO TOTAL INCOME
1996-97	11503.00	743.83	1303.86	108.41	2156.10	34.50	60.47
1997-98	14904.00	961.76	1651.06	147.60	2760.43	34.84	59.81
1998-99	18944.00	1136.88	2149.35	156.69	3442.92	33.02	62.42
1999-00	22945.00	1383.81	2561.67	212.71	4158.19	33.28	61.60
2000-01	27636.00	1684.95	2940.99	233.88	4859.82	34.67	60.51
2001-02	30532.00	1985.92	3197.45	367.24	5550.61	35.77	57.60
2002-03	33063.00	2263.57	3192.25	429.20	5885.01	38.46	54.24
2003-04	36135.00	2555.80	2981.93	706.26	6243.99	40.93	47.75
2004-05	36762.00	3045.69	2629.27	460.19	6135.15	49.64	42.85

(Source : Compiled)

3.21 With a southward movement of interest rates, and gradual growth of credit demand, investment became less attractive RRBs had to follow other banks to dispense more credit. Such a situation led to gradual increase in CD Ratio and a fall in ID Ratio as will be revealed from Table 3.2. As on 31 March 2006, the ID Ratio was 53.02% compared to CD Ratio of 59 %. Investment portfolio is sizeable in many RRBs with good returns augmenting profitability.

3.22 The entire money market is subject to complex operations and the complexity is growing over the period. Another reality is that most of the RRBs lack expertise in investment operations and had been fully dependent on Sponsor Banks. Besides, like other banks, RRBs are also subjected to various regulatory prescriptions in investments particularly in Non-SLR Investments. With the development of money market, besides banks, many other non-banking companies have also started operations. Banks/ Fis are not just holding the securities till maturity but have also started trading of securities for better profitability. In the process, income out of investment/trading forms a major portion of their income. Most of the RRBs hitherto have kept away from these activities due to inherent weaknesses such as locational disadvantages, not having exposure to money market and dependence on sponsor banks. RRBs need to change their approach and involve actively in the investment operations by judicious deployment of surplus resources to enhance their profitability.

In the above context, the Task Force has examined the following:

Status of investment portfolios of RRBs

Return on SLR and Non-SLR investments vis-à-vis cost of funds (Average yield and how the same is beneficial based on cost of funds)

Regulatory prescriptions in investment

Prevailing arrangement of investments

Recommendations for changed arrangements for such investments

Need for skill upgradation of RRBs in the field of investments

Need for putting up proper decision making with accountability

Introduction of Asset Liability Management system.

Need for modification in some existing stipulations.

3.24 The Task Force, in order to firm up its recommendations, had sought suggestions from Sponsor Banks, RRBs and others, and also called for relevant data from amalgamated RRBs so that the recommendations are based on ground situations and are realistic and implementable. The comparative position of CD Ratio and Investment Deposit Ratio of RRBs for a period from 1995 to 2006 is furnished in table 3.2 :

Table 3.2

Credit & Investment to Deposit Ratios

Year	**ID Ratio**	**CD Ratio**	**Year**	**ID Ratio**	**CD Ratio**
1995	55	56	2001	72	41
1996	56	55	2002	69	42
1997	53	59	2003	66	44
1998	48	64	2004	64	46
1999	70	42	2005	59	53
2000	71	41	2006	56	57

(Source : Compiled)

It will be observed from the above table that as against a statutory requirement of just 25% investment in the form of SLR, the RRBs had IDR as high as 72 percent in 2001. It will further be observed that over the last 4–5 years, the IDR has come down with the corresponding increase in CDR. As on 31 March 2006, the IDR and CDR have become almost equal but IDR continues at a very high level compared to the requirement. A further analysis revealed that only 11 RRBs had less than 30% IDR which is considered to be ideal while 22 RRBs had IDR more than 70% as on that date. The share of SLR and Non-SLR investments as on 31 March 2006 was

54% and 46% respectively. It further reveals that SLR investment was about 29% of deposits and is marginally higher than the requirement of 25 %. Entire Non-SLR investment is excess investment.

3.25 It is further observed that as per RBI stipulation, most of the RRBs have placed the entire SLR investments in G-Sec, while a small amount remains in deposits with Sponsor Banks as part of SLR investment in some RRBs. In most banks, a major part of Non-SLR investment is in the form of short-term deposits with banks, mostly with Sponsor Banks yielding low returns.

Returns on Investments

3.26 Data collected from the amalgamated RRBs for last 3 years ending 31 March 2006 (both pre and post amalgamation) shows that while the return on SLR and Non-SLR are declining, return on G-Sec., which was ranging between around 6% and 10.5% in 2004 has come down to around 2% in 2006.In NSLR Investment, while there is about 1% fall in the yield in bonds, there is substantial decrease in the yield on deposits. In many RRBs, the yield on such deposits were lesser than the cost of funds resulting in. negative returns.

3.27 With the application of Income Tax to RRBs from the current financial year, RRBs will have to pay income tax on such interest earnings, resulting in further reduction in returns on investment. At present, while making investment in the under noted avenues except in FDRs, RRBs seek advice from the concerned Department of the Sponsor Bank as under :

Investing in Tier II bonds of Sponsor Bank and other Banks.

Investing in High Yielding bonds of public sector financial institutions.

Investing in Mutual Funds.

Investing in Shares and Debentures.

Investing in Bank FDRs.

3.28 The RRB Boards are expected to ensure the following:

A well-defined investment policy is in place.

Put in place a proper risk management system capturing and analyzing risk in NSLR

Investments are made in accordance with systems, procedures and prudential regulatory prescriptions.

Prescribe limit on certain investments as per regulatory norms

Review investments periodically twice in a year

Total investments and disinvestments
Compliance with prescribed prudential limits
Rating migration of issues / issues held
Periodic valuation / amortisation
Accounting for profit / losses
Creation of Investment Fluctuation Reserves

In spite of such wide expected functions of the Board, due to complexities of money market, locational disadvantages and non-availability of proper skills and exposure, most of the RRBs have entrusted the entire operations of Treasury Management to the sponsor banks, while others act only on advice of sponsor banks. In such a situation, although RRBs could avoid accountability, they were deprived from gaining experience/ exposure in a very important area of their operations.

3.29 Having regard to the above situation and also due to certain scams in the co-operative banks, RBI also preferred to restrict the RRB investments only through sponsor banks. Such a situation has its own advantages and disadvantages, viz.

RRBs felt safe and free from any accountability
Delayed decisions resulted in missing many good investment opportunities
Due to lack of timely advice, RRBs failed to comply with amortization provision, valuation and accounting procedures
Adopt safer avenue to park in sponsor bank deposits irrespective of yield
Parking large amount in current account for liquidity purposes, which did not even fetch cost of funds as return

<u>Regulatory Prescriptions</u>

3.30 Although investments in various instruments including deposits with sponsor banks were eligible for SLR earlier, RRBs were brought on par with commercial banks. All RRBs have been advised to invest SLR in G-Sec only. In case of holding FDR with sponsor bank, RRBs were advised to invest such amount in G-Sec only on maturity of FDs. As regards NSLR investments, RRBs are allowed to invest in many instruments, viz., FDs, tier II capital of sponsor banks and other banks, high yielding bonds of public sector institutions, Mutual Funds, Shares and debentures, etc. As per regulatory prescriptions, certain prudential limits / norms have been fixed for investment in NSLR

RRBs should not invest in non-SLR debt securities of original maturity of less than one year other than commercial paper and certificate of deposits

RBI regulations preclude banks extending credit facilities for certain purposes. RRBs should ensure that such activities are not financed by way of funds raised through the NSLR securities.

RRBs must not invest in unrated debt securities, unlisted securities and unlisted shares of all India financial institutions.

Investments in bonds of all India financial institutions, unsecured redeemable bonds floated by nationalized banks, infrastructure bonds of All India Financial Institutions, units of UTI subject to application of Exposure norms at 15% of owned fund.

Since NSLR securities are mostly in the form of credit substitutes, RRBs are to treat such investment proposal as high volume credit proposal and subject the same for credit appraisal.

Restriction of not exceeding 5% of the incremental deposits of preceding financial year to be invested in units of UTI

RRB Board should lay down a policy and prudential limits on investments in bonds and debentures including sub-limits for PSU, corporate and guaranteed bonds.

Board is also to stipulate entry level minimum ratings and industry-wise maturity-wise issue-wise limits

As regards investments in shares, convertible debenture of corporate and units of equity oriented mutual funds; the following norms are to be followed:

Guidelines to limit investments to unlisted securities (or where listing will be done in 3 months) and issuers with a current rating

Guarantee not to be the only factor for credit decision. Any proposal for funding government budgets should be avoided

Follow the norms laid down for NPIs

Bank investment in unlisted Non-SLR should not exceed 10% of its total investment in non-SLR securities as on March 31st of the previous year

The investment in unlisted Non-SLR may exceed limit of 10% by additional 10% if the investment is in securitisation papers for infrastructure projects, and bonds / debentures issued by Securitisation Companies and Reconstruction Companies

Alternative Investments

3.31 With the amalgamation of RRBs and likely formation of State level banks, the situation is going to change completely due to following reasons:

RRBs will have locational advantage of Head Office, having proximity to money market

Increased business volume lead to recognize RRB an important players in the money market

Availability of advisors from PDs and MFs in proximity as an important client

Capacity to set up investment office and engage / recruit professionals

In the above changed scenario, investment process improvement could be attempted by the RRBs in the following manner:

RRBs may need to be given autonomy in investment management and flexibility to take external advise and proper capacity building of its own staff

The Chairman of RRB may be empowered to make investment decisions independently upto certain limit.

RRBs may be allowed to participate in the Call Money Market. This will augment the profitability of the bank as the surplus funds can be invested on daily basis and earn interest at an average rate of 6%. To participate in Call Money Market, RRBs may need some initial guidance from sponsor banks.

RRBs may need to open a Back Office at the State Capital. Having a Back Office at state capital will help them to participate in the Money Market briskly and also help in getting the instruments drawn and collected easily, operate the RBI account for necessary investments on time. Investments in Commercial Papers and Call Deposits can also be made when the rate of return is more than the rate of return on short term FDRs of Banks, through the Back Office to generate income.

Constitution of a investment committee or investment committee of Board consisting experts in the field as member having adequate delegation to take investment decisions.

A panel of advisors could be identified from PDs / MFs / other agencies related to investment activities to extend guidance and also assistance in investments. A list of PDs and Mutual Funds for consultation by RRBs is placed in Annexure 3.2.

3.32 On the basis of suggestions/advice received from various quarters, the Task Force recommends the following:

(i) RRBs need to undertake investments by themselves and may be enabled to have access to investment avenues/channels of investment other than the sponsor bank so as to secure better returns without sacrificing safety concerns. However, the purchase and sale of government securities for SLR and other investments may be done with the support of sponsor bank.

(ii) RRBs may have to set up separate investment cells to be manned by trained officers having exposure to treasury operations and risk management.

(iii) RRBs may have to recruit treasury / finance manager from the open market for investment purposes, with adequate computer knowledge.

(iv) Each RRB may constitute an Investment Committee with knowledgeable officers as members.

(v) Such Committees may be delegated full powers to take investment decisions.

(vi) Chairmen of the RRB may also be delegated powers for funds investment at enhanced level, depending upon business levels, by the Board of Directors.

(vii) Till such time RRBs are able to nurture adequate levels of expertise within the institution, RRBs could take the help of sponsor banks, primary dealers and mutual funds.

(viii) RRBs be given freedom to place their money in term deposits with any bank (including private sector / foreign banks) / financial institution on offered rates of interest and subject to other stipulations. Investments in STDRs and Inter Bank – Inter RRB deposits / Inter Bank Participatory Certificates, may be permitted.

(ix) In the context of RBI package announced in December 2005 wherein RRBs have been given freedom to resort to lending / borrowing to other RRBs irrespective of sponsor banks, a proper system with safeguard needs to be evolved for operationalisation.

(x) Scope of investment under SLR could be considered for extension to GOI bond, SG bond, Treasury bill, Central/State Govt. Guaranteed bonds and other approved securities.

(xi) Ceiling on investment on shares and debentures of corporates and units of mutual fund including subscription to the tier-II capital of banks / FIs may suitably be revised upwards.

(xii) Level playing field with commercial banks in case of NRE / FC / NRB / FCRA, certificates of deposits may be extended to RRBs in coordination with sponsor banks.

(xiii) Specialised training in treasury operations for the RRB officials with right aptitude, qualification and expertise may be provided by BTC, Mumbai, NIBM, Pune or BIRD, Lucknow. Exposure to treasury and money market operations for RRB officials in sponsor banks could also be considered.

(xiv) RRBs may be enabled to place their short-term surpluses through any commercial bank, for investments in CBLO, in coordination with sponsor banks.

(xv) There are requests from RRBs for review of the ceiling of investment in Mutual Funds. Keeping in view the policy prevailing in other banks, RBI may consider the desirability of reviewing the same.

(xvi) The RRBs may open a Demat Account for investment operations if not already done.

(xvii) The Board of RRBs may review the Investment Policy at least once a year and all investment operations, once in three months.

CHAPTER 4

'Small opportunities are often the beginning of great enterprises' - Demosthenes

BUSINESS POLICY AND PRODUCTS

Financial Inclusion

4.01 It is worth recalling that the RRBs were established to provide credit and related services for developing the rural economy that includes agriculture, trade, commerce, industry and other productive activities in rural areas. The focus is on small and marginal farmers, agricultural labourers, artisans and small entrepreneurs. Unlike other commercial services every individual or every family needs financial services. Therefore, the objective of financial inclusion in rural areas is very relevant. Financial inclusion is not just opening a savings account, though it is the crucial first step. It would mean providing total financial services at par with what is available to the urbanites, though there could be some variations.

4.02 The rural banks have to equip themselves to become one stop banking and financial services provider. They can forge links with agencies involved in rural development. While the services are available in urban areas in close vicinity, it is not the case for most villages and habitats. People have to sacrifice considerable time and incur costs to reach the bank. There is a special responsibility cast on these banks to reach out to those villages and habitats not served by any banking outlet. It is no longer possible to attend to walk in service only. The banks have to switch to a marketing approach as against mere planning and house keeping. Offices and personnel do not have to be located in remote areas to be buried in paper work. Their chief purpose is to build enduring business relationships. It is necessary to decentralize actual service with centralised accounting and data processing systems. Automation is not a luxury, but a necessity more so, for rural banks.

The real stakeholders

4.03 The Task Force strongly endorses the view that the principal stakeholders are the rural population in the service areas of the rural banks and not the employees or owners. The latter two sections have to contribute to the service of the real stakeholders and not profit at their cost. There cannot be any compromise on this basic principle. In fact, the Task Force feels that the staff of the rural banks appreciate the idea that the rewards they can get is closely linked to the financial health of the RRBs which depend on the prosperity of their rural clientele. The most tangible security to bank loans is the prosperity and not collateral. The fact that about 51% of the rural families are not reached by the formal financial system is a real opportunity for the RRBs. The Board and the Chairman of the RRB require operational freedom coupled with accountability to meet the above objectives.

Banking a relationship

4.04 The bank's policies and products have to be tuned to meet the aspirations and expectations of the clientele more than half way. Development banking is about taking risks and managing them and not avoiding risk. High risks, high cost of services and misuse of credit are terms used to deny credit to the rural families. Each of these issues can be addressed innovatively.

4.05 The high-risk perception is not validated by facts. It is not a secret that the default rates in the organized sector are in fact more than that in the rural sector. High risk arises out of the flaw in the relationship between the bank and the customer. The rural poor are treated as a one-time nuisance when they approach the bank for credit under one of the Government subsidy schemes. Often the approach is not direct, but through middlemen. There is a difference between a middleman and a facilitator. The relationship between the banker and the customer is one of faith and endurance. The bank should have faith in the customer to use the credit in an appropriate manner and to honour the terms of the credit. The customer should have faith that the bank will meet all the productive needs of the family subject to its capacity to earn and repay. At the poverty levels obtaining in rural areas, survival itself is most important and the product for small loans should be composite taking into account the minimum needs. The project approach is not suitable for micro finance. Recognition of this principle has made possible the grand success of the self help group linkage project what it is today.

4.06 When available bank credit meets only a segment of the needs of the poor man, he is forced to approach the moneylender or trader to meet his credit needs. The moneylender gets an opportunity to exploit this at the cost of the banking relationship. Once in the debt trap of the moneylender, the poor man loses the capacity to meet the bank's obligations and loses his credibility. He becomes a defaulter and is shunned by the formal banking system. The moneylender cannot be, indeed need not be, eliminated. What is needed is that the banks offer an aggressive competition to him. The rural banks can and should adopt this strategy.

4.07 The banks should reach out to every rural household not receiving comprehensive financial services. The cost becomes affordable with volumes. Full coverage of villages can help the bank to practice doorstep banking and reduce service costs. A corollary is to create a subtle competition among households and even villages in building better relationships through rewards in terms of cost of credit and volume of credit. Farmer clubs and self-help groups advocated by NABARD could act as business facilitators.

4.08 One of the reasons for the relatively high defaults and consequent risk costs, is the lack of transparency in the bank's dealings with the poor. The rural banks also disburse subsidies along with credit. Leaving alone the media exposures, the members of the Task Force are aware of the leakages in subsidies and the rent cost for sanction of loans. A new culture of zero tolerance for corruption should become the policy of the RRBs. Normally corruption in RRBs is never mentioned. This Task Force would like to address this question head on. Three are a few concrete steps that could be taken.

4.09 Subsidies should not be treated as patronage but as entitlement for the target group. There are two phases of administering subsidies. First is to identify the eligible person, purpose and the amount of entitlement. The second is the fund flow. The Government of Gujarat has identified different categories of BPL people on a village-wise basis with the help of the gram panchayat in a transparent manner as per Ministry of Rural Development norms and has made the list accessible through the web. This should be made a mandatory practice. A prerequisite for proper flow of funds is to identify the receiver by name, branch code where he has an account and the account number. The subsidy entitlement should go directly to the credit of the account through ECS where possible. This system will facilitate easy monitoring of the entitlement reaching the right person in time, without leakages.

4.10 Delay by itself can well be a corrupt practice. All standard processes of the bank should be time bound with norms for each process. The bank's outlets should display customer related information for ready reference. Electronic kiosks may provide such information. The village could have "friends of bank clubs" or farmers' clubs who help in building up the proper banking relationship, through peer rapport, peer monitoring and help in recoveries. They can also act as watchdogs against undesirable practices. Such informal bodies can be considered as bank facilitators, as envisaged by the Reserve Bank.

4.11 Lastly the concept of misuse of credit. Money is fungible. As explained earlier, for micro credit the purposive credit has no significance. As such the concept of micro credit is not compatible with misuse. It should be a composite limit taking into account the economic and consumption needs of the household based on repayment capacity. The borrower should be able to operate single savings cum credit account on which interest is charged on debits and interest is paid on credits. The traditional accounting system should be changed to make it flexible. The Kisan Credit Cards, Swarojgar Credit Cards and Grameen Credit Cards by whatever name called, can be made smart cards enabling drawal of money from designated offsite ATMs. Project concept will be applicable for credit requirements over say a lakh of rupees at current prices.

Product Range

4.12 The basic banking services are savings and deposit accounts. The next in order are micro credit and project finance. Housing, education, personal loans are also the needs of the clientele and have to be a part of the credit portfolio. Bank guarantee is a normal banking service not available from the rural banks. The rural people need efficient remittance services not only within the district or state but also across the country and in some cases to foreign countries. The children of rural parents study or work abroad and they are not comfortable with a bank, which has no foreign exchange arrangement. From the point of the RRBs such services provide cost free float funds and non-fund based incomes. Life and non-life insurance including crop/animal/bird insurance are felt needs of the people and the banks should offer reliable agency services in this regard. It is not only the RRBs that need investment opportunities, but its rural customers too. The customers need avenues to invest in small savings, government securities, mutual funds and equities. It is also a legitimate expectation that the banks provide investment and demat services. A RRB's financial products should be designed from the customer's point of view to promote its business, in coordination with sponsor banks.

4.13 The restrictions for financing only certain class of borrowers for agricultural and non-agricultural purposes under Section 18 of the Act have to be removed. While 60% of the advances may be earmarked for the priority sector with a sub-limit of 40% for agriculture and agro processing, the banks may lend 40% for other commercial purposes. Individual education loans, loans for educational and health institutions deserve priority. With the help of NABARD/Sponsor Bank refinance, the RRBs can increase the CD ratio to 80% in two years. The loan diversification could help in the cross subsidisation of loans to the weaker sections, to some extent.

4.14 The non-fund business of the RRBs is valuable to the banks and its customers. Though the RRBs are allowed to participate in insurance agency business and referral on no-risk basis, the pre-requisites for participation in such activities may be liberalised further so as to facilitate entry of a larger number of banks into these areas. Collection of taxes and other government business such as payment of teachers' salaries and pension payments will make up for gaps in services.

4.15 An efficient banking service will have to take care of what is known as supply chain credit. It is not enough if the agricultural, allied or non-farm production is financed. The bank can play a credit-led leadership role by providing credit across the chain including storage, processing, transportation, marketing and retailing. The leadership role for RRBs is in creating a non-exploitative network resulting in overall advantage for all participants. An important advantage of the approach is that credit disbursed to one segment will help in recovery of loans from another link in the chain.

Exposure Limits

4.16 There will be occasions when the RRBs would meet opportunities to finance that exceeds the exposure limits under regulatory norms or are self imposed. In such a case, RRBs may join in consortium financing arrangements on pari pasu basis with Public Sector Banks/ DFIs.

Credit Plus

4.17 Credit becomes an effective instrument of development when it is coupled with relevant knowledge inputs. Farmers need both technological and commercial information. The former will include soil and water management, agronomical practices, inputs management, organic farming, precision approach, etc. The latter is about demand and supply projection, price discovery, crop diversification, contract farming, organizing producer groups/companies, etc. The bank may arrange both technical and commercial extension services with the help of concerned agencies and technology platforms.

Product Development

4.18 The bank should develop savings, credit and other product lines keeping in view the existing and potential requirements of the clientele. This is the marketing approach. The bank should be one step ahead in meeting the rural clientele needs in a way that is acceptable. All processes relating to banking should be user friendly at minimum cost and inconvenience to the customer and the bank itself. This is a cultural question rather than directions from above.

4.19 The credit products should address the needs of all those who want to help themselves through new ventures and improving and expanding existing enterprises in all the three sectors which appreciate the needs of the customer in a flexible way. The principle of credit is that there is a liquidity shortage in the initial stages of any venture. The bank has to look at the total needs of the venture and not confine itself to certain components. Depending upon the assets and income level of the entrepreneur, the involvement of the borrower could be fixed. There is also the risk perception. Developing a continuing relationship banking is a collateral substitute. Blind application of unit costs is not good banking. Finally, banking skills is about recognising what is acceptable risk.

4.20 In the changing scenario, the RRBs have to explore new products and innovations and should develop a complete range of financial services for the rural clientele. A write up on the suggested Financial Services for rural clientele is given in Annexure 4.1.

CHAPTER 5

"It is not the strongest of the species that survive, nor the most intelligent, but the one most responsive to change." – Charles Darwin

ORGANISATIONAL STRUCTURE AND HUMAN RESOURCES MANAGEMENT

5.01 The organisational structure of RRBs is to be reviewed in the context of the amalgamation of the banks underway. Operational efficiency is enhanced with decentralised decision making and centralised monitoring. Modern technology permits centralised accounting and monitoring, freeing the staff at the cutting edge level to interact with the clients, both existing and potential. It is not just the organisational chart, but the systems and procedures established by the management that make a better organisation.

5.02 At present there are a total of 102 RRBs, consisting of 43 amalgamated RRBs (137 constituent RRBs) and 59 stand-alone RRBs with 14495 branches. The picture would change when some of the stand-alone banks are also taken up for merger. The amalgamation will bring about economies of scale and better risk management capability. After the merger/amalgamation process, the Head Offices of the erstwhile RRBs generally operate as controlling offices. It is recommended that they be designated as Regional Offices.

5.03 The organisational structure that existed prior to amalgamation of RRBs is set out below. The Head Office of an RRB normally had three to seven departments depending upon the branch network and volume of business.

Table 5.1

Staffing Pattern of HO as per existing Manpower Norms

Designation	**Size of branch network**			
	Upto 50	**51 to 100**	**101 to 150**	**More than 150**
Chairman	1	1	1	1
General Manager	1	1	2	2
Officer in Scale III	3	4	6	7
Officer in Scale II	2	3	5	6
Officer in Scale I	3	4-6	7-10	11-15
Assistants (Multi-purpose)	3	4-5	6-7	8-9
	13	17-20	27-31	35-40

(Source : Compiled)

5.04 RRBs with less than 50 branches did not have an area office, as per the norms. Once the branch network reaches the level of 50, the RRBs can have one area office with an Area Manager and thereafter for branch network exceeding 75 - one-area office for every 25 branches is permitted. The area office is normally attached to a larger branch in the command area. The Area Managers are delegated powers for sanctioning of loans, approval of administrative expenses, etc. and they are generally officers in Scale III.

At present, branches having business level up to Rupees Two crore, measured by the average aggregate deposits and advances during the last two years, are categorised as small branches or Grade A branches and headed by Scale I Officers. Branches with average aggregate deposits and advances above Rupees Two crore and upto Rs.12.50 crore are identified as medium branches or Grade B branches. The RRB branches whose average aggregate deposits and advances are more than Rs.12.50 crore are categorised as large branches or Grade C branches and headed by a Scale III Officer.

5.06 Consequent upon amalgamation, the size of the banks has increased considerably, in terms of volume of business, new business areas, area of operation and branch network and staff. NABARD consulted the sponsor banks on the issue on 13 July 2005. Based on consensus arrived at, the norms for Grades of officers to be posted as Chairman and the organisational structure, were decided. On approval of Government of India, the guidelines were issued by NABARD.

5.07 The amalgamated banks have a three-tier structure viz. head office, controlling offices and branches. The Chairman will decide the exact number of Departments in Head Office and the requirements of staff. The controlling offices may have 3-4 Departments / divisions with adequate delegation of powers and manpower so that not many cases get referred to Head Office.

The Task Force has revisited the categorisation of branches and manpower as stipulated in the Agrawal Committee Report. In the above connection, exhaustive data as regards number of branches based on business volume, category-wise, manpower actually deployed in such branches, the requirements of controlling offices and manpower deployment therein and requirements of Head Office with manpower deployed, is required to be collected and analysed. The Task Force recommends that matters relating to categorisation of branches, staffing norms, promotions, policies and other HR matters may be studied in depth by a Committee/Task Force set up specifically for the purpose by GOI.

5.09 The organisational structure was standardised in consultation with 12 major Sponsor banks and approved by GOI. However, the structure was not given effect to by many of the RRBs. Some of the banks have continued with the organisational structure of the former banks. Some have converted the erstwhile Head Offices of constituent banks as controlling offices without a reference to the number of branches. The re-deployment of staff has not been effected from the erstwhile Head Offices. Some of the banks adopted a four-tier model by continuing the Area Office concept with an additional tier of Controlling Office also. The total staff strength of the Head Offices ranged between 26 and 103 with no correlation to the volume of business. The staff strength of the Controlling Office also varied widely from 7 to 45.

5.10 Keeping in view the spread of the banks, the volume of business and the need for economy, the Task Force recommends only a three-tier structure for the banks. The normal tendency is to increase the staff in the Controlling Offices and the Head Offices and starve the branches of the needed staff. The recommendation, therefore, is that the staff in the Head Offices and the Controlling Offices be kept down to the minimum level and the surplus staff re-deployed in the branches. It is recommended that the allocation of work and the staffing should be decided by the management of each bank. The delegation of powers should be such that 75% of the loan sanctions are made at the branch level and 95% at the controlling office level.

5.11 Major recruitment for various positions in RRBs was carried out only during the first 15 years and thereafter the RRBs have generally not recruited staff. The staff with considerable experience in rural banking is a valuable asset of the system. The limited career progression and banking exposure has affected the morale of the staff. The absence of fresh recruitment for several years has denied the banks of energetic youngsters. The induction of sponsor bank staff at senior positions has also been a bottleneck for higher responsibilities and experience as far as RRB officials are concerned. Despite the parity with the sponsor banks in compensation, there have been grievances over certain other benefits.

5.12 The Agarwal Committee report of May 2000 had suggested comprehensive manpower assessment norms, which were adopted by the RRBs. The Committee recommended 4.20 persons per unit with relaxations for the North East, hilly and desert areas. Additional manpower could be considered where the banks achieved a CD ratio greater than 60% and an NPA less than 5%. In other words, the manpower was linked to better business performance. The Committee favoured internal promotions upto the level of General Manager. The clerical staff was to become multi purpose workers. The norms suggested by the Committee appear to be valid even after the mergers. However, sufficient emphasis on the need for infusion of new recruits and their capacity building on a continuing basis, does not seem have been emphasized. The officers of the banks can get promotional opportunities consequent on the mergers and the external withdrawal of officers on deputation from the sponsor banks at higher levels. The resulting vacancies in the junior positions should be filled with new recruits with diverse qualifications and the right aptitude/attitude for rural service. Officers should invariably start their career in a branch and not in the Controlling office or Head Office.

5.13 Lack of promotion opportunities has been one of the issues repeatedly referred to by the Associations. While promotions up to Officers in Scale III have been effected by most banks, there have been no promotions beyond Scale III in any of the RRBs. There is one RRB where no promotions have been carried out beyond Scale I. Currently the approved policy for promotions is based on seniority-cum-merit in all cadres. It is essential that the management of the RRBs make a comprehensive study of the manpower requirements in each operational unit of the bank as per the suggested pattern and accordingly decide on the vacancies that would consequently arise. The Board may decide on the number of vacancies that need to be filled up either immediately or within a fixed time frame depending on the urgency of the need without referring the matter to the sponsor bank or NABARD. The promotion policy may be modified to ensure that 50% of the vacancies are filled up on the basis of seniority-cum-merit and 50% by merit in all cadres upto Scale III so as to reward a better performance and specialized qualifications. The career path should be such that opportunities are available to each employee/officer to have at least 3 promotions during their entire career. While at present the branch categorization norms take care of promotions from Scale I to Scale II and from II to III., there are no clear cut branch categorization norms to facilitate promotions from clerical cadre to officer scale I cadre as well as from Messenger cadre to clerical cadre.

5.14 All promotions in RRBs are guided by the RRB Promotion Rules, 1998 as notified by the Govt. of India vide their notification No.SO642 (E) dated 29 July 1998. However, in the above Rules, it had been indicated that the written examinations would be conducted by the Banking Service Recruitment Board (BSRB), which has since been abolished. In the recent past, in the absence of BSRB, all banks including commercial banks and even NABARD has been taking recourse to the services of the Institute for Banking Personnel Selection (IBPS) or some such organisation for undertaking the written examinations. At the instance of Govt. of India, the promotions in RRB Rules, 1998 was suitably modified to introduce the involvement of the IBPS, Mumbai or some such similar organisation instead of the BSRB and had forwarded the same to Govt. of India for approval and due notification. The Task Force recommends that NABARD be authorised to take a decision in such matters.

Transfers

5.15 Transfer of staff in RRB was not a big issue until now as most banks had an area of operations not exceeding 2 to 3 districts and most of the staff when transferred from one branch to another, did not involve much relocation of family, etc., and could commute from the same place. However, in the amalgamated era of the RRBs, where several banks of the same sponsor bank within a State have been amalgamated, the area of operations extends upto 10 to 12 districts and the distance from one end of the operational area to the other could exceed 600-700 kilometers. In this scenario, the Task Force felt that staff transfer is an issue, which has to be handled very carefully, and it may not be desirable to introduce large-scale ad-hoc transfers. Generally, transfers may coincide with promotions and may be need based.

5.16 Most RRBs do not have a transfer policy as approved by the Board and in the present scenario to ensure the support of the staff; it would be desirable to have a transparent transfer policy duly approved by the Board. The Task Force felt that the RRBs may consider framing suitable transfer policies for their staff wherein incentives are considered for good performance in terms of increase in business, recovery of loans through personal efforts not only in respect of existing accounts but also with due weightage for written off accounts. Besides, weightage may be given for efforts taken for customer satisfaction, specialised activities like formation of Self-Help Groups, Farmers Clubs, Joint Liability Groups, Village Surveys, organization of village camps with positive results, etc.

5.17 Recruitment of Staff

Recruitment of staff in RRBs has been very nominal during the last 10 to 15 years. It is only during the first decade of their existence that the RRBs saw a huge recruitment process for staff in all cadres beginning with sub-staff, clerks and officers. However, since the growth in business was not commensurate with the need for a large-scale recruitment, the RRBs also went slow in the process of recruitment of staff. This has resulted in the large scale ageing of staff in the RRBs and currently the average age of the RRB staff is between 45-50. However, it is essential to look to the future requirements of the banks when retirements, resignations, etc. take place. Further, the RRBs have came into a new era of existence in the amalgamated form where these banks are expected to compete on equal footing with the other commercial banks both public sector as well as private sector. The RRBs also are now being exposed to a variety of business opportunities, technological advancements in banking automation besides newer approaches to customer service. Keeping all this in view, the Task Force considers it imperative that the RRBs consider meeting immediate vacancies after a comprehensive manpower assessment is undertaken as well as future requirements, taking into consideration the retirements, etc. Even where staff is surplus ,as per revised manpower norms, recruitment may be made to fill in 50% vacancies on account of retirement since April 2000 and also additionally to the specialized cadres of Agriculture Extension Officers, Officers for Information Technology work, Law officers, Chartered Accountants, Management Graduates, etc. on need basis.

5.18 Recruitment in RRBs were governed by the RRB Promotions and Recruitment Rules, 1998 as notified by the Govt. of India vide their notification No.SO642 (E) dated 29 July 1998. The Rules were very comprehensive and had detailed guidelines for recruitment of each cadre. It was also envisaged therein that the written examinations would be conducted by the BSRB, which has since been abolished. At the instance of the Govt. of India, these rules were suggested for modification to introduce the involvement of IBPS or some such similar organisation instead of BSRB and were forwarded the same to Govt. of India for approval and due notification. The notifications are yet to be issued and the Task Force felt that the

Govt. of India would have to speed up the process of issuing the notification. In connection with the written examinations after the abolition of BSRB, some of the RRBs have been getting the examinations conducted by outside agencies like National Institute of Personnel Management (NIPM), Mumbai, etc. to introduce professionalism in the recruitment process. The Board may initiate the process of manpower assessment for various levels of staff and undertake the process of recruitment on the basis of status of vacancies keeping in view the sustainability of business.

5.19 The Task Force is of the view that the banks should also make assessment for recruiting specialised officers in Law, Investment Management, Information Technology, Chartered Accountants, Agriculture Graduates, Management Graduates, etc. to the existing cadres. Care may have to be taken to ensure that internal candidates who have the necessary qualifications and competence should be kept in mind before recruiting from outside. As regards competence in Information Technology is concerned, the Task Force feels that for all fresh recruitments in clerical as well as Officer cadre, ability to operate standard office software packages should be a prerequisite.

Performance related incentives for Staff

5.20 Monetary and non-monetary incentives are one of the most established performance motivators in any Institution. As monetary incentives are not easy for implementation in public sector institutions like banks including some RRBs, the Task Force feels that based on some of the non-monetary incentives which have been implemented successfully in many banks which includes some of the RRBs, the following types of non-monetary incentives may be considered for the RRBs:

i) Deputing Officers who have performed well for training programmes/exposure visits to some Asian countries would be a very useful incentive;

ii) Performance awards for the best three branches and their branch managers who were associated with the performance for a minimum of one year should be considered with incentives. There may be various innovations like having lunch with the Chairman/General Manager etc. or visit to a nearby resort , etc

iii) Merit certificates can be issued for good performance under special programmes like SHGs, VVV, 100 percent inclusion, improvement in recovery, etc.

iv) While transfer is generally used as a disincentive or punishment, the fact is that it can be effectively used as a non-monetary incentive to reward good performance for transfer to a place of choice.

Capacity Building

5.21 Capacity building in terms of imparting skill, knowledge and attitudinal changes has been one of the major areas of neglect in RRBs. Several reasons can be attributed to the problem like lack of own training establishments, lack of concern by the sponsor banks, lack of a specilised training system in the RRBs, etc. Currently training for staff of RRBs are provided either by Training Establishments of the Sponsor banks, dedicated Training Establishments of NABARD like the Bankers' Institute for Rural Development (BIRD), Lucknow, and the Regional Training Colleges of NABARD at Bolpur (West Bengal) and Mangalore (Karnataka) . Besides the College of Agriculture Banking, RBI at Pune also organises a few programmes. Most of the training programmes organised by these institutions have been largely covering only the officers and the training to clerks, if any, are organised only at the Training Establishments of the sponsor banks. Training for sub-staff is practically non-existent.

5.22 RRBs in general do not have a formalised Training Department or a Training system to follow up periodical training of their staff. In the absence of the required staff-wise database, the RRBs would not be able to formulate a proper training plan for them. To enable the RRBs to put in place such a system, it would be in the interests of the RRBs to have a small Training Cell within the Human Resources Management Department and introduce a system of maintaining staff-wise Training cards for all the staff from Chairman to the sub-staff. The RRBs may conduct Training Needs Identification (TNI) with the help of either the Sponsor bank or professionally qualified organisations like BIRD, NIBM, etc or seek the assistance of NABARD in this regard. Based on the results of the TNI, the staff of the bank needs to be deputed for training to various training institutes or seek the assistance of such institutes for organising on location programmes exclusively for the bank.

5.23 Training Infrastructure.

RRBs do not have exclusive training establishments of their own and their training requirements are met by the Training establishments of either the Sponsor banks or the NABARD through the Regional Training Colleges at Mangalore and Bolpur as well as BIRD at Lucknow. The capacity of these Institutions is nowhere near the requirements. The Task Force felt that as many sponsor banks have elaborate training infrastructure, if one Training establishment is identified in each State owned by any bank, for organising required training programmes for the staff of the RRBs within the State on a cost sharing basis between the RRB concerned and the concerned Sponsor banks, it would go a long way to benefit the training- starved RRBs to a great extent and training establishments would also be able to recover a part of their investment out of the training fees. NABARD may undertake a study in this regard and operationalise a workable training system for RRB staff.

5.24 With the amalgamation of RRBs into new entities, the area of operation is enlarged and has altered the operational management process in these banks. In tune with the changing client needs, the training needs of these organisations have also changed, based on the studies conducted by BIRD during the past one year. The Institute has identified some of the major training needs for the officers in the amalgamated RRBs as indicated below:

i) <u>Branch banking - Upscaling of business operations and opportunities</u>

At the field level, it is observed that the average branch of RRB achieves lower productivity than the branch of a commercial bank operating in the same rural area. In comparison, more often than not, the business level of a RRB branch is found to be around 20% of the business level of a branch of the sponsor bank operating in the neighbourhood. Our earlier efforts to impress the RRB staff in this regard did not bear requisite fruits on account of the mind set that their bank was a local bank catering to a limited operational area. With amalgamation, the area of operations and size of the amalgamated RRBs have almost equalled a big region or a Zone of commercial bank. Hence, there is a need to ramp up business growth. This 4-5 day programme would provide both attitudinal and skill inputs for improving business viability and branch productivity of the branch managers and officers of RRBs working in rural and semi-urban branches.

ii) <u>Credit appraisal and monitoring - farm sector and non-farm sector (2 modules)</u>

Field studies have revealed that scientific appraisal and monitoring of credit proposals is one of the most critical requirements of RRB officers. This was on account of their limited skill, mind set and earlier business parameters on account of the area limitations, single party exposure norms or credit squeeze in loss making banks. These inputs would be provided in two modules of 5 days each focusing on credit appraisal and monitoring techniques required by officers for financing a) farm sector activities starting from crop loan and b) non-farm sector activities starting from composite loans for meeting the working capital requirements of small business and rural artisans.

iii) Credit diversification and emerging opportunities

Field studies have further revealed that the RRB managers need appraisal and monitoring skills in emerging areas of rural credit like appraisal of hi-tech and export oriented projects in rural areas; rural godowns and market yards; medicinal and aromatic plants; agro processing activities in rural areas which are capital intensive and require specific monitoring skills for attaining project objectives.

iv) NPA monitoring and credit risk management

One of the shocking revelations of the studies is that most of the RRBs have unreported NPAs at the branch level. These NPAs are affecting the long-term business and earning potentials of most of the bank branches. In the light of the above, there is a strong need to conduct NPA management programmes, if required, bank-wise on a customized basis, based on the asset portfolio and asset quality of the bank.

v) Remittance and fund management systems in RRBs

One of the superior features of the rural branch of a commercial bank, in comparison with a RRB branch, is its ability to provide money transfer and remittance facilities to the customer, based on his needs. Till amalgamation, the RRBs were either issuing bankers cheques for local needs or acting as agents of their sponsor banks, selling their DDs on shared commission basis. However, the accounting and management skills required, in this regard, are yet to be mastered by the RRB staff. This 5 day module provides the requisite inputs for branch banking officials in remittance and fund management, transfer and use of float funds, accounting and management systems, thus providing them the requisite skills to compete with commercial banks in the changing scenario.

vi) Funds and Investment Management

Till now, though most of the RRBs have sizeable funds, they have no treasury departments. Their funds are indirectly managed by their sponsor banks. Very few RRBs were imparted the treasury management skills by their sponsor banks. This programme attempts to impart the treasury management knowledge; skills and attitude required in managers, particularly in northward interest markets.

vii) Internal control systems - branch, controlling office and bank level

This programme is intended for the officers entrusted with the responsibility of Inspection function. Though some efforts were made by banks like SBI to bring in impersonal approach and professionalism in the function, most of the RRBs are still not able to attain qualitative functioning on account of the approach ‘fellow first, bank next’. This programme intends to provide both attitudinal and skill inputs.

viii) Computerised branch management

Most of the operations of RRB branches are yet to be computerised. This is mainly on account of the arrears in tallying of accounts, manually. This module prepares the staff from balancing of books to branch computerisation, day-to-day operations and closure (both front office and back office), report generation, disaster management and back up arrangements.

ix) Computerised branch audit

This programme would provide inputs to the branch inspectors on how to conduct audit of computerised bank branches.

x). Inspection compliance and closure

One of the weakest areas in RRBs functioning as on date is the process of inspection compliance. A large number of branches are not able to provide satisfactory compliance to the inspection findings. This often results in repetition of observations in successive inspections. Closure of inspection report is a process, which needs to be developed right from basics to the Managers and Officers working in RRB branches. This module would be for 5-6 days.

xi). Branch monitoring

Another weak area in the functioning of RRBs is the process of branch monitoring. This was on account of singular control by HO on account of smaller network. Even in banks with more than 100 branches, the area offices had limited functional responsibilities and contribution. Most of the area managers and senior managers were not aware of monitoring functions. This five-day programme would provide the requisite monitoring skills and attitudinal inputs to the branch controllers and senior managers for grooming them for monitoring function. Another variant of this programme would be run for senior managers taking care of planning and monitoring function in regional offices and head office of the bank. This would focus on information follow-up, data processing and analysis, providing feedback to top management for policy formulation and monitoring.

xii) Risk Management

Though risk management processes were made applicable to RRBs long ago (nearly 4 years); the banks are yet to appreciate the need and use of these techniques for designing business policy and strategy. This programme would make the participants identify the inbuilt risks in rural credit business and cover among other, credit risk, liquidity risk, market risk, operational risk and prepare the banks for adopting Basel-II norms at an early date. These inputs would build the requisite skills for adoption of risk based internal audit system by RRBs in due course.

xiii). <u>Programme on Human resources management and development</u>

Though the RRBs have functional HRD departments, these were not really geared for autonomy. In order to reduce the dependency, there is a need to provide basic inputs in HR management to RRB officers covering among others,- Industrial Disputes Act, Management of bank during strikes and non-cooperation, legal provisions of staff rules and HR management, statutory obligations through PF and Gratuity Acts, development and implementation of staff service conditions, right to information in RRBs, etc. This could be covered in a five-day module.

xiv) <u>New product development in changing environment</u>

Except for duplicating the products and services of sponsor bank, not much effort has been made in this area. This program, mainly addressing the managers handling planning function and branch managers would cover environmental analysis for product opportunity scouting, product development process and stages, product pricing and costing, product testing and launching and motivate the officers to innovate, introduce and improvise products and services for meeting the client needs particularly in rural areas.

xv) <u>Preparing for financial inclusion</u>

Despite network expansion, financial exclusion of resource poor is a reality in rural India. This could be on account of outreach limitations, resource limitations and others. RRBs have a greater role to play in providing banking services to the resource poor. This programme would provide requisite attitudinal and skill inputs to the branch managers in playing a meaningful role in the process of financial inclusion in the country.

xvi) <u>Organisation Development Initiatives</u>

NABARD facilitated ODI in 155 banks since 1994. The impact has been found to be useful by the participants and the banks. The programme may be redesigned and revived for the amalgamated banks.

The Regional Training College (RTC) of NABARD at Mangalore has also undertaken a study about the training needs of the RRBs in the amalgamated setup and have indicated a list of training programmes for all cadres of officers but also for the Top Management consisting of Chairman and GM.

The suggested training programmes are summarised below:

Level	Training requirements
Top Management (Chairman and GM)	i) Change Management ii) Leadership skills iii) Funds management iv) Business Development Strategies v) Asset Liability Management vi) Consortium Financing vii) Foreign Exchange Dealings
Level	Training requirements
Middle Management (Regional Managers/ Scale III/IV Officers)	(a) Change Management (b) Leadership skills (c) Management Development Programme (d) Team Building (e) Formulation, appraisal and monitoring of high value advances (f) Working Capital Assessment (g) Formulation of area Development Schemes (h) Funds Management (I) Business Development Strategies (j) Risk and Recovery Management and monitoring of advances (k) Internal Inspection & Control Systems (l) Foreign Exchange *
Junior Management (Scale I & II) and Branch Managers in Scale III	(m) Induction/Orientation programme (n) Challenges in Branch Banking including Branch control (o) Branch as a profit Center (p) Customer Relationship Management (q) Project Appraisal (r) Working Capital Assessment (s) Retail lending (t) Technology adaptation (u) How to compete in the new environment (v) Foreign Exchange *
For all	(w) Change Management (x) Leadership Skills

* As and when necessary

The sponsor banks may consider earmarking one of their training institutions in any State where the presence of their sponsored RRBs is substantial and organise training programmes as suggested in this report for staff/officers of the RRBs.

The Task Force has received various suggestions regarding amendment of service regulations. The suggestions may also be considered by the authorities which have been given at Annexure 5.1. The Task Force feels that adoption of the above recommendations will go a long way in equipping the banks in facing new challenges and honouring their core mandate of rural development through credit and financial services.

CHAPTER 6

When you do the Common things in life in an uncommon way, you will command the attention of the World-George Washington Carver

INTERNAL CHECKS AND CONTROL SYSTEMS

Introduction

6.01 A sound system of internal checks and control is the sine qua non for any business organization striving to attain success. The method of operations adopted by such organisations have to be in conformity with the standardised procedures and practices, not only to obviate the irregularities of omissions and commissions likely to arise in the course of daily business, but also to prevent their willful perpetration by the employees. A sound internal control system is even more essential to strengthen a bank's ability to meet its obligation of being a "trustee" of the depositors. The use of an internal checks and controls system in the banking industry is universally recognised as an indispensable part of the regulatory system. The Basle Committee expressed this need in various core principles, which are reproduced in Annexure 6.1

6.02 The policies and procedures laid down by directors and senior executives of a bank are intended to restrain risks, safeguard assets, control liabilities and provide accounting and other systems which record all transactions and commitments in real time while providing management with reports enabling it to identify and assess the risks of business. In order to be effective, internal controls need to be comprehensive, clearly documented, periodically reviewed, understood by those involved in the relevant activities or processes and enforced. The Basle Committee proposes three fundamental concepts: authorisation, reconciliation and segregation.

Authorisation refers to the need for senior management to determine and policy and procedures manuals to clearly set out the extent to which individual's or groups of individuals formally organised at various levels of seniority are empowered to commit the banks to transactions or obligations.

Reconciliation is the comparison of two independently prepared sets of information which cover the same ground and should in principle be identical, examples include reconciliation of nostro account statements with the bank's own records.

Segregation of duties limits the scope for staff to commit fraud by making successive steps in a process the responsibility of different individuals or departments.

Incidence of Frauds

6.03 As on 31 March 06, an amount of Rs. 5364.21 lakh was involved in frauds in 851 branches of 145 RRBs. The RRBs in UP accounted for the maximum involving an amount of Rs. 1006.88 lakh (18.77%) in 181 branches followed by Bihar (94 branches) involving Rs. 607.06 lakh (11.33%) and Andhra Pradesh (87 branches) involving Rs. 572.24 lakh (10.67%). Upto end of March 06, only an amount of Rs. 242.40 lakh (i.e. 4.52%) could be recovered. Inadequate internal checks and control system, arrears in internal inspections/ concurrent audit and inter branch adjustment accounts had resulted in the perpetration of their frauds.

6.04 The Audit Department should have clear and appropriate terms of reference, independence from line management, a direct reporting line to the Board and to have adequate resources. The lack of controls in a group with widespread international operations where a single 'rogue trader' in a non-bank subsidiary in Singapore perpetrated massive frauds leading to the closure of the bank. Various lapses in internal controls have come to the notice of NABARD as under:

(i) There was no effective concurrent audit.

(ii) There were no vigilance cells and preventive vigilance systems.

(iii) No system of test check of the statements submitted by the branches during the branch inspection.

(iv) No system of independent checking of previous day's entries in books of account from vouchers.

(v) No verification of cash and other securities, dead stock articles and security documents, etc.

(vi) Delays and deficiencies in compliance of inspection reports.

(vii) Some of the banks had not prepared Accounting Manual/ operational manuals.

(viii) There was no system of checking of the data entered into the computer systems.

(ix) Know Your Customer norms were bypassed.

(x) The bank had not introduced register of customer service complaints/grievances.

(xi) Ledgers not being balanced at frequent intervals.

(xii) There were huge arrears in reconciliation of Branch Adjustment account.

(xiii) The audit did not cover the HO and controlling offices.

(xiv) Internal audit did not pay attention to loan portfolio – appraisal, NPA classification, loan documents, etc.

(xv) The exercise of delegated powers, income leakages and expenditure control did not figure in branch inspection.

(xvi) The computer printouts at day end were not authenticated.

(xvii) There were arrears in reconciliation of link bank accounts.

(xviii) Many important registers like document register, loan application receipt and disposal register, DCB register, security stock register, insurance register, visit register, return control register, cash remittance register, etc., were not maintained by the branches.

(xix) In HO, loan application register was not maintained properly.

(xx) Though investment details were maintained at HO, the FDRs were kept at the main branches were not verified periodically.

(xxi) Many documents had become time barred.

(xxii) There was no system of surprise balancing of books. Because of this, fraud committed by staff could be detected only after inordinate delay.

(xxiii) The liquid asset register for maintenance of CRR & SLR was not maintained on daily basis. Though, it was maintained in the computer on weekly basis, it was not seen by the Chairman.

(xxiv) Visit registers were not maintained in some branches and there was no record of visits of HO officials to the branch. There was no system of surprise visit to branches by HO officials.

(xxv) Debit balances in deposit accounts.

(xxvi) The inter branch account reconciliation was not being monitored by the bank and not reviewed by the Board. Arrears in reconciliation of long pending entries under inter-branch adjustment account, subsidiary balances not tallied with general ledger balances, balances in respect of deposit accounts maintained with Sponsor Bank not tallied with the balances of Gramin Bank's books of accounts.

(xxvii) Security arrangements in some of the branches were not satisfactory.

(xxviii) Guarantees were issued to various parties without adequate security.

(xxix) The branches did not exchange/rotate the original keys of cash safes with the duplicate ones at periodic intervals to ensure that both sets of keys are usable.

(xxx) Not obtaining stock statements regularly from borrowers/units to whom CC limits have been sanctioned.

(xxxi) Non-maintenance of drawing power registers.

(xxxii) At the branches, the chart on interest rates on deposits and advances, salient features of the Banking Ombudsman Scheme-2002, Kisan Credit Card Scheme, Swarojgar Credit Card Scheme etc. were not displayed.

(xxxiii) Processing charges were not collected from the borrowers while financing working capital; cash credit limits and term loans.

Features of a Sound Internal Control System

6.05 The basic features of sound internal control system are as under:

(a) Active presence of a management, e.g. Board of Directors, Committees and senior mangers, sensitive to control culture prescribing ethical and integrity standards,

(b) Appropriate control culture with segregation of duties and standards of work, minimising potential conflicts and overlapping.

(c) Information/communication channels/systems encouraging smooth flow of reliable, constant, secured data/information / reports.

(d) Monitoring, processes / mechanisms and instruments facilitating ongoing review, reconciliation, verification / rectification of deficiencies.

(e) An effective, continuous and comprehensive risk recognition and assessment system to ensure proper safety and safe guarding assets.

(f) An alert and responsive external audit for constant evaluation of the system to suggest remedies, and

(g) Independent vigilance machinery for preventive vigilance.

Vigilance Machinery

6.06 Only 59 RRBs have established an exclusive Vigilance Cell, while the remaining RRBs have a set up where the work related to the Vigilance Cell is clubbed with other functions. Thus, arrangements to give undivided attention to Vigilance related cases are not obtaining in most of the RRBs. All RRBs should set up separate Vigilance Cell to carry out all interventions in conformity with the directions and guidelines of the CVC. All banks should effect this latest by 31 March 2007 and give a certificates in confirmation to NABARD and RBI.

Need for better Audit Systems

6.07 Concurrent Audit, regular internal inspection by the bank, management audit by the sponsor bank, statutory audit by the Statutory Auditor and statutory inspection by NABARD, are independent instruments of supervision. These should not be construed as overlapping as the perspective and focus of these systems are qualitatively different. All banks should be subjected to these processes. The audit machinery, methods/ tools, need to be upgraded and new audit classification norms may be introduced. The key officer-in-charge of the Supervision Cell of the bank must ensure that these are taken up in a coordinated manner.

Manual / Awareness Literature

6.8 Every RRB should have a Manual of Instructions for their IOs/ Auditors and it should be updated periodically. (a) The Manual on RRB's Internal Control Systems, and (b) Manual on Frauds/ Misappropriation both prepared by Deptt. of Supervision, NABARD could be used as references for the purpose and will be made available, on request.

Non-compliance to Section 42 (6) (a) (i) and 42(6) (4) (ii) of RBI Act, 1934

6.9 As on 30.6.06, 50 RRBs failed to comply section 42 (6) (1) of the Act, ibid and the total erosion in the value of assets of such banks was estimated at Rs. 2827.07 crore, of which, the accumulated losses alone amounted to Rs. 2384.67 crore. Deposits amounting Rs. 1753.58 crore were estimated to have been eroded in these banks. 58 RRBs were not complying with both Section 42 (6) (a) (i) and 42 (6) (a) (ii) of the Act, ibid and 138 RRBs were not complying with Section 42 (6) (a) (ii) of the Act, ibid. This indicates magnitude of deficiencies in the methods of operations of the banks.

Offsite Surveillance Statement - Submission of Statutory Returns to NABARD

6.10 During 2005-06, out of 196 RRBs, while 96 banks had submitted OSS returns in time, only 5 and 16 banks had submitted the returns with a delay ranging between 15 days and more than 1 month respectively. 49 RRBs continued to default. Thus, sizeable number of RRBs had violated the statutory provisions Section 27 (2) of B.R. Act, 1949 by not submitting the returns timely. The OSS introduced by NABARD in 1998 is still not stabilised and effective, primarily due to low level of computerisation, weak self-regulation, internal control system and poor response for data and returns in RRBs.

Inspection and Audit Wing

6.11 Based on feedback from the banks, employee groups and other stake holders the TF recommends an exclusive set up for audit and inspection with the following functions.

(i) To co-ordinate, guide, facilitate and focus all internal control measures including addressing external supervision issues in the bank.

(ii) To organise periodic inspection of the branches/ controlling office/ HO and follow up for appropriate compliance thereof;

(iii) To co-ordinate with concurrent auditor/ Management Audit Team of Sponsor bank and statutory auditor to facilitate smooth conduct of various types of audit and timely and satisfactory compliance thereto;

(iv) To co-ordinate with the DOS, NABARD to facilitate smooth statutory inspection and submission of timely and satisfactory compliance.

(v) To ensure submission of OSS and other statutory returns to NABARD and RBI and enable timely analysis and follow up;

(vi) To co-ordinate with ALCO, Audit Committee and facilitate enforcement of risk management measures.

(vii) To address various issues of supervisory concern emerging from the statutory inspection, internal inspection and audit, management audit, IRAC/ risk management study, etc.

Capacity Building

6.12 With a view to building up skill and competence of officers to be engaged in the Internal Control System, risk management, Vigilance, audit and inspection, the bank should put in place a proper HR policy. It would be necessary to build up human resources, particularly a cadre of internal auditors and IOs, having expertise and professional competence to identify, assess and monitor various risks in the functioning of the banks. Prudential regulations should be seen as minimum requirements and the banks should develop supervision plus approach by setting internal bench marks which are over and above those mandated by supervisors. The banks may ensure reasonable continuity (say 3 years) of the officers placed in the above Department. They should be given appropriate institutional training, field exposure and motivation. The training needs identification (TNI) to be prepared and training policy of the bank to be evolved/ implemented should focus on these areas. Sponsor Bank and NABARD may provide necessary support to the RRBs in the direction. DOS, of NABARD in collaboration with TEs of NABARD and sponsor bank may embark upon a crash sensitisation programme for the `Key officers' of each of the amalgamated RRBs for providing necessary inputs on internal control system, risk management, as also OSS, compliance to statutory inspection, supervisory rating, etc., within one year subsequent to the statutory inspection of the amalgamated RRBs, conducted by NABARD so as to prepare the banks to meet the emerging supervisory challenges. A senior officer should be identified as in-charge of supervision with due autonomy and mandate to spearhead the supervisory intervention on an ongoing and holistic way.

Audit Committee

6.13 All banks should constitute Audit Committees as an independent, exclusive and empowered Committee of the Board to give focused attention to inspection, supervision, audit and internal control system. The framework, focus and follow up to the Audit Committee should be evolved/ implemented, in conformity with the guidelines to be issued by NABARD. The Committee will have the following functions:

To decide policy and operational framework with regard to internal inspection/audit, internal control measures to improve efficiency and quality of the system and attendant results;

To review the findings of statutory supervisors/regulators, statutory auditors internal inspection, management audit, etc. and progress of compliance thereto.

To take necessary corrective action in pursuance of the above and to put in place Audit/Inspection Irregularities Eradication System [AIES] and

To report to the Board of Directors periodically.

Board of Directors - Oversight

6.14 All audit/ inspection reports and compliance thereto, viz., major findings of inspection and audit, the rectification, progress and strategies to address the deficiencies should be placed before BoD. The observations of Audit Committee should also be submitted to BoD for information. Finally, it is the responsibility of Board of Directors and top management to implement sound administrative controls comprising

(i) Codified responsibility areas of staff,

(ii) Specific job functions

(iii) Proper recruitment, grooming and growth of personnel

(iv) Developing loyalty standards

(v) Sound supervision and monitoring arrangements,

(vi) Staff accountability

(vii) Proper division/ distribution of supervisory responsibilities

(viii) System of periodical double checks

(ix) Regular rotation of duties

(x) System of authorisation at various level

(xi) Internal auditing and inspection and

(xii) Independent examination of system and procedures.

The Agenda issues as suggested by NABARD should be placed before BoD from time to time for information. The Agenda issues should be structured in such a way that all-important issues are covered in Board Meetings. Every RRB should have a Manual of instructions for their IOs/ Auditors and it should updated periodically. (a) The Manual on internal control systems, and (b) Manual on frauds/ misappropriation, prepared by DOS, NABARD could be used as a reference for the purpose.

Rating Mechanism

6.15 The mechanism for rating of branches, IRs and compliance may be developed for objective evaluation of the performance of branches, the quality of Inspection Reports and the Compliance Reports. The banks may put in place a health card for the branch, based on select parameters. The rating of banks, based on statutory inspection by NABARD need be communicated to the banks to enable the latter to take earnest steps for further improvement.

Reconciliation of Accounts

6.16 A Standing Task Force comprising the officers from Supervision, Finance and Administration & Establishment should be constituted in each bank, which would take steps to minimize the arrears in reconciliation of accounts (branch adjustments, sundry debtors, etc.). It is not just the number of unreconciled entries that matter, but the underlying reasons that require close attention.

Computerisation and MIS

6.17 In the context of rising, diversified loan/ investment portfolio, introduction of new banking products financial services, ALM, MIS needs, etc., rapid computerisation is a must. To meet the expectations under onsite inspection, OSS and to fulfill the objectives of new internal control measures, self-regulation system, compilation of statutory returns and other control returns, computerization is also needed. In the context of increasing computerization, the safeguards with regard to identification of erroneous processing, identifying consistent data, revalidation of data, safe back up of data, etc, should be given due focus. The banks should ensure constant, reliable system for inputting, processing and generation of output data. Efforts should be made to develop a team of competent and motivated EDP personnel. To facilitate processing of computer-based flow of data, appropriate software packages need to be developed.

Preventive Vigilance System

6.18 Apart from promptly reporting incidence of frauds to NABARD in the prescribed proforma, the banks should critically analyze the incidence of fraud and modus operandi, rectify the loopholes in the system and take preventive measures. The progress and trends in frauds and misappropriations should be periodically analyzed and placed before the Board from time to time.

Information - Disclosure

6.19 Proper communication and transparency are the hallmarks of good banking. The proper maintenance of register, timely and correct reporting in the prescribed returns, display of information in the branches and sharing with customers, systems for sanction and disbursement, explicit investment and loaning policy, etc are fundamental to internal control system. The banks should look ahead and put in place proper information sharing systems with the RBI, NABARD, banks and customers. The banks should take special steps to comply with the Rights to Information Act, 2005.

CHAPTER 7

"Technology can be a key business enabler in four areas: operational efficiency, customer management, product management, distribution and reach" –NR Narayan Murthy

MODERNISING RRB OPERATIONS

IT in Indian Banking

7.01 There has been a revolution in technology dissemination in every walk of life and the banking sector is no exception. It is foreseen that by 2012 almost every one will have a broadband connection and a cell phone. As the banking sector is undergoing a paradigm shift in its role and functions as a result of increased competition and growing consumer awareness, application of IT in banking has become important to face the challenges of tough competition from other players through better customer service with efficiency. With the expansion of and easy access to the digital communication across the country at an affordable cost, the customers' expectation, for efficient services in banking, has gained momentum. Commercial Banks have road maps of technology applications in banking in various areas through recommendations of number of committees appointed by RBI such as Working Group to consider feasibility of introducing MICR / OCR, Technology for cheques processing, Rangarajan committee, Committee on Communication networks in Banks, Committee of Payment System, Cheques Clearing, Committee on Electronic Fund Transfer and Electronic Payments, etc.

Application of IT in RRBs

7.02 With the spread of education and technical inputs among rural population, technology dissemination has gained momentum in rural areas also. Technology application is no longer the luxury it was thought to be but a necessity for client service and competitiveness.

As a part of RFIs, RRBs also cannot remain in isolation. Realising the above, specially in the context of vast branch network in rural areas and business volume of RRBs as a system which is comparable with any major commercial banks, Government of India and NABARD have already taken a timely step by advising the RRBs in July 2001 that RRBs should initiate immediate steps so that Head Office, Area Offices and a minimum of 50% of branches are computerized in a phased manner in the next 5 years. Sponsor banks have also been advised to formulate RRB-wise Action Plans, keeping in view the financial position of the RRBs, infrastructure facilities available in their command area and the business potential of the RRB branches. Necessary support to implement the above time-bound programme should also come from the sponsor bank.

7.03 NABARD made a beginning by extending support to select RRBs by providing PCs, peripherals, standard software packages as also customized MIS package and training inputs under the NABARD SDC programme. Almost after 5 years from the issue of above guidelines by NABARD in July 2001, a review of computerisation of RRBs was made. The progress of computerisation in RRBs, sponsor bank-wise are furnished in Annexure 7.1. The review brings home the reality that while a few RRBs have achieved 100% computerisation and others around 50%; most of them are lagging behind.

Need for computerisation in RRBs

7.04 Computerisation is no longer stand-alone systems. The networking has even more significance. While the primary data is generated in branches, computerization enables centralized processing, monitoring and feedback relieving the manpower in the field to creatively interact with the people rather than be buried in paper work. There is no limit to use of computers. They can take care of servicing deposits, loan processing, NPA monitoring, statutory and MIS returns, analysis, dissemination of knowledge, accounting, administration etc. The Indian Railways and private sector banks offer the best examples of user-friendly computerization with a combination of outsourcing the high-end tasks and training the staff for use of applications.

7.05 The present scenario of computerization is as under:

Level of computerisation is far behind schedule

Even RRBs of same sponsor banks although following the same technology, are at different levels of computerisation due to varied financial health, environment, local conditions which has become a problem when such RRBs have been amalgamated.

Computerisation needs both capital and recurring expenses which are beyond the capability of some of the banks.

RRBs, which have progressed well, have adopted a particular technology mainly of the sponsor bank and invested sizeable amounts.

Such amalgamated RRBs have grown bigger in size and volume of business is likely to grow further.

While there is much benefit in standardisation of technology application, it may not pose any problem for such RRBs which are in a nascent stage of development; for such of the RRBs which have progressed well in computerisation will face difficulties not only in financial implications, but also for switching over to new technology.

A few RRBs reaped the benefit of hosting their own website by way of mobilization of deposits from non traditional segments.

A few of them established direct links with money market operators for investments.

Internet facilities have been used for faster communication with techno savvy customers and other agencies.

Technology applications in RRBs

Specifically, the computerization can help the following processes;

Automatic Ledger Posting and customer accounts management

Customer Relations Management - Extension of online - remote access facility

Participation in National Payment System for transfer of funds

Participation in e-governance initiatives of State Govt.

Computer based integrated Data Base and MIS

Online trading linkages to Money markets and other agencies

Modules of House keeping

ATMs, Kisan and other credit cards

E-governance services

Action Plan

7.06 After an in-depth examination of the prevailing scenario in rural banking operations, expected role of RRBs, amalgamation of RRBs at State level, level of computerisation in various RRBs, financial health of RRBs and also future challenges before RRBs as a one-stop entire banking service provider, the Task Force recommends the following:

a) All RRBs need to take up computerisation of major areas of operations, MIS in branches, controlling offices and HO in the next 3 years by adopting an implementable Action Plan. Efforts should be made to introduce / adopt website, on line banking, ATMs, EFT, Networking of HO / branches, inter branch system network, remote account transaction / access facility, debit / credit card to the maximum extent.

b) To accomplish the above, RRBs should recruit IT professionals, if need be through lateral entry. Till such time, RRBs are in a position to recruit professionals; IT work and maintenance could be done by outsourcing. All future recruitment of employees and officers should be limited to computer-trained personnel.

c) Immediate assessment of training needs of all trainable employees / officers and also arrangements for regular / crash training programme. BIRD and RTCs of NABARD can draw up massive training programmes in various fields of operations of RRBs in computerised environment.

d) Action Plan - Module

(i) So far as the plan of action is concerned, the branch reorganisation may be undertaken by RRBs in such a manner that 8-10 rural branches in a contiguous area, are linked to a nucleus branch at a center endowed with comparatively better business prospects and infrastructure. The nuclear branch may be equipped with total-branch-automation systems as also the systems necessary for consolidation of information received in specified formats from the linked rural branches.

(ii) The rural branches may keep on feeding information to the nuclear branch on daily / weekly basis telephonically or by other modes of communication followed by a digital communication on weekly basis. The nuclear branch, in turn, may be provided with the facility of on-line linkage to the Head Office as also to the District Branch to provide them access to the branch-wise information of the linked branches, as also their own, on daily basis. The District Branches may similarly be provided with the total-branch-automation systems and the systems necessary for consolidation of their own information as well as information in respect of other branches in the district for necessary feedback to Head Office and for their own use.

(iii) The Head Office, in turn, may maintain, out of the data so received, a central data-base with various formats which may be accessible to the different departments in the H.O for the specific information only that may be relevant to them, through appropriate locking and filtration techniques for maintaining confidentiality and avoiding tampering of data. The information to be generated in Head Office may also be processed and achieved at the central database though various departments may be provided with a limited built-in facility to store certain confidential data within their own system.

(iv) The systems in the Head Office may be linked on a Local Area Network (LAN) and terminals / nodes thereof in a number as may be necessary may be installed. The requirements of the system-designs and the hardware in this regard may be worked out by RRBs carefully.

(v) The Head Office of each RRB may be provided with on-line access to the Sponsor Bank, other banks, NABARD, Money Markets, Banking Network, Infinet of RBI, State Government's e-governance network, NICNET and so on in order to maintain constant communication with them, on business issues. In order to keep confidentiality as also appropriate accounting of transactions with other agencies, the access of RRB's branches to any outside agency may be provided through Head Office only and the latter should be in a position to respond to the demands of branches on business matters expeditiously.

Within these broad and indicative norms, the RRBs may be given adequate autonomy to take their own decision on designing of their computerisation plan keeping in view the branch-specific requirements and local infrastructure etc. and they may seek guidance from their sponsor institutions wherever necessary. The decisions relating to configuration, environmental format and other technical specifications may need a host of technical guidance; the factors of compatibility have also to be kept in view.

The provision may also be made for converting data and information from one environment to the other so that the RRB is in a position to respond to the versatile demands, given the existence of a vast spectrum of computer technologies in use by different agencies with which RRB has to correspond, off and on. A considerable amount of work has to be done by each RRB in reviewing and developing the input and output formats for data flow between the different levels for ensuring an efficient and time saving system of data / work processing.

<u>Standardisation of software / hardware</u>

7.07 As regards development of standard application software packages, standardisation of hardware specifications as also data outputs by a centralised agency, for use by all RRBs, after examining various aspects, the conclusion arrived at is:

There is no standardisation of software platform even among sponsoring institutions and other agencies.

Level of computerisation in various RRBs is at different stages of implementation.

RRBs have already adopted sponsor banks' software which are different for each sponsor bank.

Some of the RRBs have achieved 100% computerization.

All RRBs have spent sizeable amounts according to their capacity for such technology.

Employees / officers are expected to be proficient in the particular technology.

Having regard to the above facts and the need for earliest completion of computerisation, the Task Force recommends that uniform standardisation of the hardware and software for all RRBs may not be feasible in the near term as the same will stall the pace of progress of computerisation besides financial implications and adaptability. The Task Force also recommends that software solutions should facilitate conversion of output information from one environment to another, to deal with the versatile demands of supply of information from various institutions. At the same time, standardisation of output parameters and formats from RRBs could be undertaken at the level of a centralised agency so that RRBs get these formats built in their software.

The Task Force however recommends that such of the RRBs, which are at the initial stage of computerisation, could adopt standardised hardware / software. Technology will remain the growth engine in rural banking in the years to come. The lack of uniformity in the software across RRBs or even within RRBs is another major issue to be resolved as they move along the path towards greater consolidation. In the context of the recommended repositioning of the role of sponsor banks, it is relevant that RRBs shun excessive dependency to the former, for IT related issues. At the same time, RRBs need to enjoy seamless inter-connectivity among themselves to evolve into a unique rural credit system that has technology and product delivery reach across the country.

Indian companies are world leaders in providing banking solutions. There are many standard solutions available in the market. RRBs can choose any of the solutions with components for turnkey implementation and training of staff. Government of India should consider subsidies for computerisation on the lines of the Vaidyanathan Committee recommendations for the cooperatives. Considering the difficulties involved in total computerisation at one stroke, primary data generated by branches under one regional office could be processed there and fed to the HO and the branches concerned. This is only a temporary solution. In the medium term all branches should be computerised and linked on-line or off-line. An extension of the computerisation process is the issue of smart cards to clients and hand held devices to capture and authenticate transactions in the field, which could extend outreach and financial inclusion.

CHAPTER 8

"If the farmer's hands slacken, even the ascetic's state will fail"-Thirukkural, 104:6

Regional Rural Banks in the North Eastern Region

8.01 Banking as a habit has yet to take firm roots in the North East. Over the years, due to implementation of development policies, an expectation of grants rather than credit has taken roots. The factors impeding economical financial development of the region, can be attributed to the following aspects:

Topography of the region

Sparse population settlements

Infrastructural bottlenecks such as transport, communication and power

Low level of commercial activity

Lack of entrepreneurship

Land tenure system especially in hilly areas not conducive for banking activities

Development strategy based on grants rather than on credit

Low network of branches

Lack of awareness of banking services

Experience of poor loan recovery by banks

Law and order conditions not conducive

Inadequate payments systems in place

8.02 Though the North Eastern region constitutes 8% of the geographical area, it accounts for nearly 3.73% of the population and the credit flow to the North Eastern Region for agriculture and allied sectors comprised less than 0.50% for the country as a whole during the years 2000-01 to 2004-05. The credit flow being low has to be seen in the context of the network of credit purveying agencies operating in the region. The Commercial Bank branch network is not very widespread. The only local credit agencies are the cooperatives and the RRBs. The cooperatives in the region are largely two-tiered and suffer from severe impairment and are virtually defunct.

8.03 There are eight RRBs in the region, two in Assam and one each in the remaining six States. There are no RRBs in the state of Sikkim. Five RRBs sponsored by SBI are in the States of Assam, Arunachal Pradesh, Meghalaya, Mizoram and Nagaland, while three RRBs sponsored by UBI are in Assam, Manipur and Tripura. Before amalgamation, there were 11 RRBs. The largest North-East

RRB, i.e. Assam Gramin Vikas Bank, having 354 branches, was formed on January 12, 2006 through amalgamation of four RRBs, viz. Cachar Gramin Bank, Lakhimi Gaonlia Bank, Pragjyotish Gaonlia Bank and Subansiri Gaonlia Bank, all sponsored by UBI in Assam, with its head office at Guwahati.

8.4 The RRBs, with a total network of 645 branches, cover 60 out of 79 districts in the region. The largest network of branches is in Assam with 399 branches followed by Tripura (87), Mizoram (54), Meghalaya (51), Manipur (29), Arunachal Pradesh (17) and Nagaland (8). There are 19 districts not covered by any RRBs in the region, 10 of which are in Arunachal Pradesh, six in Nagaland, three in Meghalaya and four in Sikkim. There is need for the districts to be allocated to the respective RRBs in the States at the earliest.

8.5 The performance indicators of RRBs in the region for the years 1999-2000 and 2004-05 are given below -

Table 8.1

Key Financial Parameters of RRBs in NER

(Amount in Rs crore)

Parameters	1999-2000	2004-05
Total Deposits	1323.78	2938.72
Total Advances	403.91	1223.48
C-D Ratio (%)	30.5	41.6
Total Investments	920.32	484.68
Recovery per cent (June) (%)	30.9	63.3
Gross NPAs	188.27	200.02
NPAs to Advances(%)	46.6	16.4
Accumulated Loss	264.03	254.86

(Source : Compiled)

During the period, total deposits and advances of RRBs in the region had registered compounded annual growth rate of 17.3 per cent and 24.8 per cent, respectively. The CD ratio rose from 30.5 to 41.6. Gross NPAs of the RRBs fell from 46.6 to 16.4 while loan recovery percentage was raised from 30.9 in 2000 to 63.3 percent in 2005. Thus, there has been a significant improvement in the operational parameters and accumulated losses have decreased mainly on account of increased business, better recovery and reduction in NPAs.

8.6 A review of the bank-wise performance (Annexure 8.1) reveals that where business levels have not been raised and /or where NPA ratios have not been reduced, the banks have not been able to improve the operational performance and their accumulated losses have increased. These include Langpi Dehangi Rural Bank, Arunachal Pradesh Rural Bank, Nagaland Rural Bank and Manipur Rural Bank. In the case of three banks viz. Arunachal Pradesh Rural Bank, Manipur Rural Bank and Nagaland Rural Bank, the level of NPAs at 60.3, 33.3 and 32.8 per cent, respectively and continued to be very high. The Langpi Dehangi Rural Bank in Assam covers only two backward hilly districts of Karbi Anglong and N.C. Hills and its poor financials are partly due to the limited scope for business. Langpi Dehangi Rural Bank, Manipur Rural Bank and Nagaland Rural Bank have low staff productivity levels (Rs. 77.6 lakh, Rs. 66.1 lakh and Rs. 73.9 lakh, respectively) and branch productivity levels (Rs. 322.9 lakh, Rs. 209.8 lakh and Rs.40.3 lakh, respectively) as compared with the average in the NER (staff productivity: Rs. 130.85 lakh and branch productivity: Rs 645 lakh). Incidentally, it is observed that except Assam Gramin Vikas Bank and Manipur Rural Bank, per staff business in the remaining RRBs is much less than the All India average (Annexure 8.2).

8.7 The share of RRBs in the regional credit flow was around 10-15% until 2003-04. However, the Government's policy of improving credit flow to agriculture has boosted the RRBs' share to 22%. In the context of the North Eastern Region, even this is felt to be inadequate and the RRBs need to cover at least 35-40% of the credit flow, due to the poor performance of cooperatives.

8.8 The problems of RRBs are compounded by inadequately trained staff, low level of motivation, etc. With localized recruitments attracting talent is a major challenge. The way ahead must comprise of short term contract appointments as a prelude to selective recruitment and appropriate training for staff. The problems faced by RRBs include lack of dynamism/ motivation of the CEO, inadequate interest taken by sponsor banks, sub-optimal size and restrictions on expenditure for business promotion due to accumulated losses. There is shortage of staff in many RRBs in the region even going by the present staffing norms of four per branch currently laid down by NABARD. The long-term solution in terms of economic operations to improve outreach and increase productivity would consist of using information technology as a key driver. Taking into consideration the entire gamut of issues, the following measures are recommended to improve the performance of the RRBs:

8.9 Recommendations for RRBs in North Eastern Region:

i.The Task Force examined the specific issues of RRBs in the NE Region. It endorses the recommendations of the Committee on Financial Sector Plan for North Eastern Region, set up under the chairmanship of Smt. Usha Thorat, Deputy Governor, Reserve Bank of India. The recommendations relating to RRBs, may be implemented at the earliest so as to strengthen the rural banking infrastructure as the rural cooperative credit structure is poor.

ii. The sponsor banks may consider giving more operational freedom to RRBs that are doing well in terms of incremental growth in business and incremental reduction of NPAs and are in the process of wiping out accumulated losses. The areas in which more freedom should be given include all policy matters such as using intermediaries, relationship managers, Post Offices as agents and other IT based solutions for increasing outreach as also staffing. The Boards may be empowered to decide on incentives on the basis of performance in cases where all accumulated losses are wiped out and business growth and the business model, warrants such incentives.

iii. The banks may achieve optimum financial inclusion through intensive SHG linkages, joint liability groups, issue of Kisan Credit Cards, Swarojgar Credit Cards and Grameen Cards.

iv. To solve the long term need for trained bank officials in the North Eastern Region for all Commercial Banks, RRBs, Financial Institutions including MFIs and NBFCs, it is suggested that the IIBM Guwahati may consider implementing a one-year course on Banking and Finance based on the NIBM, Pune syllabus.

v. In the RRBs for Arunachal Pradesh, the financial margin as on 31 March 2005 is negative (i.e., -1.6%) which leads to negative net financial margin. This is a matter of concern as regards the long term survival of the Bank and a viability study may be taken up specifically by SBI/SBIRD, Hyderabad to address the issues of operational viability of the Bank.

vi. In general, the loan recovery position of RRBs in North Eastern Region is substantially low and it is necessary that a robust NPA management system is given utmost priority. It is recommended that the Board members also be sensitised to this issue. The loan policy of the North Eastern RRBs may be revised/modified giving due importance to the schemes of Self Help Groups, Joint Liability Groups and Village Development Boards/Councils schemes, etc. analysing their advantages and disadvantages, in tune with local needs/norms. Village based/community finance schemes may be experimented with.

vii. RRBs may concentrate on projects involving exploitation of local natural resources, such as horticultural and bio-diesel species, bamboo, spices and aromatic plants which are available abundantly in the region and can be a good source of raw materials. Value added products can be thought of and suitable bankable schemes can be formulated. Therefore, the business policy of North Eastern Region RRBs may be prepared according to the local needs and local raw materials availability.

viii. The problem of mass unemployment especially of school educated/college graduates is a matter of serious concern in all N.E.States and needs to be urgently addressed. RRBs need to address the issues of underdeveloped rural economies and creation of self-employment opportunities especially in the cluster tourism and service sector. Development of inland fisheries, animal husbandry and especially the poultry sectors holds enormous promise for self-employment opportunities among the educated youth, in the absence of industries/SMEs. Agro-processing is another sector as also Micro-hydel power generation for the far-flung and remote villages, which could be developed by RRBs in coordination with the State Governments.

'Work for something because it is good, not just because it stands a chance to succeed'- Vaclav Havel

Summary and Recommendations

With a view to increasing the operational efficiency of RRBs, Reserve Bank of India vide its letter no.RPCD.CO.No.RRB.2584 /03.05.33 (F)/2006-07 dated 11 September 2006 set up a Task Force to deliberate on areas where more autonomy could be given to the Boards of RRBs, with broad Terms of Reference and additional areas to be covered. A brief summary of the report including background and important recommendations of the Task Force, is presented below:

Background:

Regional Rural Banks (RRBs) were conceived and created in 1975, following the recommendation of the Narasimhan Committee (1975) when the thrust of the country's banking policy laid emphasis on the three pillars of rural credit viz., expansion of branch banking infrastructure, directed lending and subsidised credit. The RRBs were envisaged as rural credit institutions that combined commercial orientation with the local feel. Under the multi agency approach, 196 new localised banks were set up between 1975 and 1988 based on the Ordinance in 1975 and the RRB Act passed by Parliament in 1976. These institutions succeeded in creating a formidable network of 14494 branches having total business of Rs.112274 Crore as on 31 March 2006. However, they had a chequered existence so far. Most of the

RRBs were hampered by viability issues and could not deliver fully on their promise, in terms of market share, introduction of new banking products and services, launching new banking technologies in the rural areas, etc. The concept of RRBs as low cost rural commercial banks and a source of cheap and directed credit to small and marginal farmers and other rural producers, etc. underwent policy reforms. These reforms were also supplemented by need-based capital strengthening programmes, partial consolidation of banks (limited to the same sponsor bank on a State-wise basis) to enable them to attain certain minimum critical mass, etc. These measures along with the formidable institutional capacity building initiatives mounted by GOI, RBI, NABARD and sponsoring banks, significantly improved the financial position of RRBs. In view of the large scope for further improvement in the performance of RRBs, the implementation of much needed reforms especially in the functioning of Board of Directors, HR practices, capacity building, resource mobilisation and deployment, IT initiatives, staff motivational levels, etc. have gained importance which resulted in the setting up of the Task Force by RBI.

Recommendations

1. As on date, out of 605 districts of the country, RRBs have been able to cover 525 districts. The Task Force recommends that the feasibility of covering the uncovered districts may be explored. (Para 1.20)

2. RRBs need to shed their earlier image of 'narrow' banks and consider providing a range of products for all financial needs and focus on financial inclusion through progressive use of technologies and low cost alternative delivery channels like business correspondents and business facilitators. (Para 1.21)

3. As they function in the same business and product market space, sponsor banks are sometimes perceived as competitors of RRBs. The relationship between sponsor banks and RRBs needs to be changed into a synergistic one, beneficial to both banks. Sponsor Banks are responsible for the performance of the RRBs sponsored by them. The Task Force recommends that an MoU be executed between the sponsor banks and the Govt. of India with regard to the performance of the RRBs under various key parameters (such as incremental growth in business, outreach, profitability, improvement in CD ratio, reduction in NPAs, etc.).In turn, sponsor banks, may, as usual, sign MoUs with their sponsored RRBs. (para 2.9)

4. The RRB Act, 1976 provides that the Central Government may increase the number of Directors on the Boards of RRBs Board up to 15. The Task Force feels that such a provision may be invoked on selective basis in case of large sized banks, created after amalgamation. In this exercise, due weightage may be given to

professionals. Presence of woman members on the Board may also be considered. (Para 2.17)

5. Section 11 of the RRB Act 1976 provides for the sponsor bank to appoint the Chairman of RRBs from among its officers. The Task Force recommends that the Chairman be selected on merit and appointed by the sponsor bank from amongst a panel of qualifying officers in coordination with NABARD. (Para 2.19)

6. To encourage the deputation of talented officers as Chairman of RRBs, it is recommended that the RRB Chairman be given due weightage for promotion to the next higher grade in the parent institution as and when they are eligible. The pay, allowances and incentives should be attractive so as to encourage performance. (Para 2 .19)

7. The RRB Act, 1976 does not prescribe any minimum period for appointment of a Chairman, though maximum period is stipulated. The Task Force recommends that Chairman may have a minimum service period of 2 years and up to a maximum of 5 years. (Para 2.19)

8. As of now, the term of nominee directors is two years and a nominee director continues to be in position till his successor is nominated. It is recommended that the term of nominee directors may be as long as prescribed by the institutions nominating them but in any case not exceeding two terms of two years at a point of time and no director may be nominated for more than two terms of two years each. (Para 2.20)

9. The RRB Act, 1976 provides for setting up of Committees within the bank or as sub-committee of the Board, as may be needed. It is, therefore, suggested that the Board of Directors of RRB may constitute such Committees as may be required by them for efficient operations of the respective Banks but they must necessarily have the following Committees: (i) Risk Management Committee (ii) Management Committee (iii) Investment, HR and IT Committee and (iv) Audit Committee (Para 2.21)

10. The Board of Directors are to be made more independent by providing them a broader policy framework within which the RRBs should develop their own operations and policies. It is recommended that each Bank's Board take total responsibility for business policies. As regards staffing pattern and HR issues, each Bank's Board can finalise the staff requirements of branch/controlling office within the prescribed ceiling, based on earlier experience as also efficiency and business requirements. Directors on the Board of RRBs should be free from any personal business or other relationship with the RRB that could interfere with their independent judgment. (Para 2.22)

11. The Agenda issues as suggested to the Board of Directors by GOI / RBI / NABARD should be placed before the Board from time to time for information. The Agenda issues as suggested in the calendar of meetings should be structured such that all-important policy and operational issues are covered in Board Meetings so as to ensure Board oversight and review of operational aspects of the RRB. (Para 2.23)

12. It is observed that sporadic efforts are being made for training of official and non-official directors of RRBs. However, there is a general impression that majority of such non official Directors on the Boards of RRBs need to be adequately oriented towards the functions of RRBs and their responsibilities as nominee Directors. (Para 2.31)

13. The Task Force suggests that the role of sponsor bank should be supportive and broadly confined only to: (i) Extending management support as required by RRBs. (ii) Nominating its share of members in the Board of Directors to provide expert advice to RRBs.(iii) Providing funds for which the RRBs may also have the freedom to choose from any bank/financial institutions. (iv) Providing expert guidance/ help in investment related issues for which RRBs may also have the freedom to choose from alternatives, if available from other banks/primary dealers and (v) Conducting management audit till alternative arrangements are made by the RRBs themselves. (vi) Assisting RRBs in all HR matters as may be referred to them by the RRBs. (Para 2.32).

14. The Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act 2002, (SARFAESI Act) which covers Commercial Banks, may also be extended to RRBs. (para 2.34).

15. As per Finance Bill, 2006 the provisions for exemption granted under section 80(P) of the Income Tax Act available to RRBs (treating them as deemed cooperative society) have been withdrawn. The Task Force is of the opinion that in

view of the high cost of operations in rural areas having significant business and default risks, low profit margins, need to finance at lower rates of interest to financially weaker sections of the rural society and that the RRBs as a separate rural credit system are yet to consolidate and are poised at a critical stage of take off, the provisions under section 80(P) of Income Tax Act may be continued for a further period of 5 years or till the restructuring process is completed, whichever is earlier.(Para 2.35).

16. The Task Force recommends that Chairmen of RRBs, should also be appointed as Members of the Empowered Committee (EC) constituted by RBI to bring in more efficiency in the functioning of RRBs. The Empowered Committee may ensure that no RRB is constrained in its business decisions by sponsor bank and that requisite support is forthcoming. (para 2.36).

17. The Task Force recommends that once the present process of amalgamation is over, the RRBs be subjected to the same level of safeguards and regulatory norms regarding capital adequacy as applicable to commercial banks. The RRBs, to start with, may strive to comply with a Capital to Risk weighted Asset Ratio (CRAR) requirement of 7%. The shareholders of RRBs may review the position after 3 years and consider recapitalisation wherever necessary so as to enable the RRBs to attain 7% CRAR. Further requirements of funds to elevate the CRAR to 9% in stages may be met through internal accretions of business surpluses by the RRBs themselves. (Para 3.03)

18. Due to the complexities of money market, locational disadvantages, non-availability of proper skilled staff, most RRBs have entrusted the trustee management to the Sponsor Banks. However, in the changed scenario RRBs should develop their own internal capacities including setting up of separate investment cells, risk evaluation system, positioning of trained personnel (if available within or accessing from market). The purchase and sale of government securities, may however, be done with the support of the sponsor bank. Till such time RRBs are able to nurture adequate levels of expertise within the institution, RRBs could take the help of sponsor banks, primary dealers and mutual funds. (Para 3.32).

19. The Task Force feels that there is considerable scope for enhancing treasury income of RRBs by adding depth to their investment portfolios. They may also be enabled to place their short-term surpluses for CBLO investments through any

Commercial Bank. Investments in STDRs and Inter Bank – Inter RRB deposits / Inter Bank Participatory Certificates, may also be permitted. Scope for investment under SLR could be considered for extension to GOI bond, State Government bond, Treasury bill, Central/State Govt. Guaranteed bonds and other approved securities. RRBs may also be allowed to deal in NRE / FC / NRB / FCRA, certificates of deposits, etc. in consortium with sponsor bank. Besides, RRBs should be given freedom to place their money in term deposits with any bank. (Para 3.32)

20. Savings products form the core services provided by RRBs. Next in order of importance are micro credit products and project finance, Housing, Education, Personal Loans which are a part of the credit portfolio. The RRBs may focus on enhancing incomes from other sources by way of Issue of Bank Guarantees. RRBs in consortium with sponsor bank may enter in to remittance services not only within the District/State but also across the country and in some cases to foreign countries, life and non-life insurance including crop insurance, animal insurance and health insurance, transacting in government securities, mutual funds and equities on behalf of clients, etc. Similarly, capital-gains deposit accounts, collection of taxes and other government business and salary disbursements are other service products that can boost RRBs income. (Para 4.12)

21. While 60% of the advances may be earmarked for the priority sector with a sub-limit of 40% for agriculture and agro processing, the banks may lend 40% for other commercial purposes. With the help of refinance the banks can increase the CD ratio to 80% in two years (Para 4.13)

22. The RRBs may be encouraged to play a credit-led leadership role by providing credit across the supply chain including storage, processing, transportation, marketing and retailing that can result in overall advantage for all participants in the rural sector. An important advantage of the approach is that credit disbursed to one segment will help in recovery of loans in another link in the chain. (Para 4.15)

23. There may be occasions when the rural bank would have opportunities to finance in excess of the exposure limits under regulatory norms or self-imposed norms by the Board of Directors. In such a case, RRBs may join in consortium finance arrangements on pari passu basis with Public Sector Banks/DFIs. (Para 4.16)

24. Credit becomes an effective instrument of development when it is coupled with relevant knowledge inputs. Farmers need both technological inputs and commercial information. The former will include soil and water management, agronomical practices, inputs management, organic farming, precision approach, etc. The latter is about demand and supply projection, price discovery, crop diversification, contract farming, organizing producer groups/companies, etc. The bank may arrange both

technical and commercial extension services with the help of professional agencies and technology platforms. (Para 4.17)

25. The banks may develop savings, credit and other products keeping in view the existing and potential requirements of the clientele. The credit products should address the needs of all those who want to help themselves through new ventures and improve/expand existing enterprises in all the three sectors (ISB), which appreciate the needs of the customer in a flexible way, depending upon the project life cycle. The bank has to review the total credit needs of the venture and not confine itself to certain components. Developing a continuing relationship in banking acts as a collateral substitute. RRBs need to build up rural banking skills and recognise acceptable banking risks so as to mitigate them in lending decisions. (Para 4.19).

26. The issue of Organisational Structure and staffing norms of RRBs need to be viewed in the context of the ongoing process of amalgamation. The structure should be conducive for decentralised decision-making without compromising on efficiency, accountability and controls. The Task Force recommends that matters relating to categorisation of branches, staffing norms and promotion policies and other HR matters may be studied in depth by a Committee/Task Force, set up for the purpose by RBI/GOI. (Para 5.08)

(i) Where banks have introduced a four-tier structure (with both Regional and Area Offices), they may revert back to the tree-tier structure of Head Office-Controlling Office – Branches (Para 5.10).

(ii) The delegation of powers should be such that about 75% of the sanctions are made at the branch level and upto 95% at controlling office level (Para 5.10).

27 **Human Resources Management**:

(i) The functioning of many RRBs is hampered by acute shortage of staff due to lack of staff recruitment. The Task Force recommends that the Board may initiate the process of recruitment of staff at various levels as per the status of vacancies after the banks make a comprehensive manpower assessment and keeping in view the sustainability of the business. However, the previously available institutions like Banking Services Recruitment Boards (BSRB), which the RRB Rules specifically provided for issues related to recruitment in RRBs is no more functional. The Task Force recommends that RRBs may be enabled to conduct written examinations for recruitment as well as promotions through reputed organisations like IBPS, etc. (Para 5.17,5.18)

(ii) The Task Force recommends that the RRBs may initiate need based promotion processes at all levels of staff as per the existing guidelines (Para 5.13).

(iii) Consequent to amalgamation of RRBs, the area of operation of many banks extends upto 10 to 12 districts, involving distances exceeding 600-700 Kms, Staff transfer is an issue which needs to be handled carefully and should be need based. (Para 5.15)

(iv) Non-monetary incentives successfully tested in many banks for recognition of officers for their performance like deputation for training programmes /exposure visits to foreign countries, performance awards, by way of having lunch with Chairman/GM, etc, merit certificates, transfers to places of choice, etc. may be considered for rewarding good performance. (Para 5.20)

(v) The RRBs may initiate the process of introducing a training cell within the Human Resources Management Department and put in place a training system for upgrading knowledge and skills, based on Training Needs Identification process (Para 5.22)

(vi) The sponsor banks may consider earmarking one of their training institutions in any State where the presence of their sponsored RRBs is substantial and organise training programmes as suggested in this report for staff / officers of the RRBs. (Para 5.23)

(vii) The Task Force has received various suggestions regarding amendment of service regulations. The suggestions for amendment in Service Regulations may also be considered by the authorities, which have been given at Annexure 5.1. (Para 5.26)

28. RRBs may set up an exclusive and dedicated Supervision Cell to attend internal control measures, address external supervision issues, organise periodic inspection of the branches/ controlling office/ HO and follow up, co-ordinate with concurrent auditor/ Management Audit Team of Sponsor bank and statutory auditor, facilitate smooth conduct of various types of audit and ensure timely and satisfactory compliance thereto, co-ordinate with the Department of Supervision of NABARD and facilitate smooth statutory inspection and submission of compliance thereof, to ensure submission of Off-site surveillance and other statutory returns to NABARD and RBI, co-ordinate with ALCO/Audit Committees and facilitate enforcement of risk management measures and decisions, etc. (Para 6.13)

29 All RRBs may set up a separate Internal Vigilance Cell to carry out interventions in conformity with the directions and guidelines of the CVC. Apart from promptly reporting incidence of frauds to NABARD, the progress and trends in frauds and misappropriations may be periodically analysed and placed before the Board on

an annual basis so that steps for recovery of funds and internal disciplinary action, as well as police action (for following up criminal cases against erring staff/fraudulent customers) can be initiated. All banks may ensure this and provide certificates to NABARD and RBI, in confirmation. (Para 6.06, 6.16)

30 Concurrent Audit, regular internal inspection by the bank, statutory audit by the Statutory Auditor and statutory inspection by NABARD are independent instruments of supervision and RRBs may be subjected to these processes. The audit machinery, methods/ tools, need to be upgraded and audit classification norms may be introduced. (Para 6.07)

31 RRBs should have a Manual of Instructions for their IOs/ Auditors and it should be updated periodically. (Para 6.08)

32 A mechanism for rating of branches, IRs and compliance may be developed for objective evaluation of the performance of branches, the quality of Inspection Reports and the Compliance Reports. The banks may put in place a health card for the branch, based on select parameters. (Para 6.15)

33 A working group comprising the officers from Supervision, Finance and Administration & Establishment may be constituted in each RRB, which would take steps to minimise the arrears in reconciliation of accounts (branch adjustments, sundry debtors, etc. (Para 6.16)

34. In the context of increased and diversified loan/ investment portfolio, introduction of new banking products/ financial services, ALM, MIS needs, etc., rapid data availability and computerisation is an imperative and RRBs may set up a computerised data processing system. (Para 6.17)

35. After an in-depth examination of the prevailing scenario in rural banking operations, expected role of RRBs, amalgamation of RRBs at State level, level of computerisation in various RRBs, financial health of RRBs and also future challenges before RRBs as a one-stop entire banking service provider, the Task Force recommends the following:

(i) RRBs need to take up computerisation of major areas of operations, MIS in branches, controlling offices and HO in the next 3 years by adopting an Action Plan. Efforts may be made to introduce / adopt website, on line banking, ATMs, EFT, Networking of HO / branches, inter branch system network, remote account transaction / access facility, debit / credit card to the maximum extent.

(ii) Within broad indicative norms, the RRBs may be given autonomy to take their own decision on designing of their computerisation process and they may seek guidance from their sponsor institutions wherever necessary.

36. Technology is likely to remain the growth engine in rural banking in the years to come. However, IT in RRBs is in a nascent stage. Though the K.P. Agarwal Committee had recommended the computerisation of 50% of branches by 31 March 2007, progress till date however, has not been satisfactory. The lack of uniformity in the software across RRBs or even within RRBs is another major issue to be resolved as they move along the path towards greater consolidation. (Para 7.07)

37. <u>Recommendations for RRBs in North Eastern Region</u>:

i. The sponsor banks may give more operational freedom to RRBs that are doing well such as using intermediaries, relationship managers, Post Offices as agents and other IT based solutions for increasing outreach as also in respect of staffing functions. The Boards may also be empowered to decide on issues relating to incentives on the basis of performance in cases where all accumulated losses are wiped out and if business model warrants such incentives. (Para 8.9- ii).

ii. To solve the long term need for adequately trained bank officials in the North Eastern Region for all Commercial Banks, RRBs, Financial Institutions including MFIs and NBFCs, it is suggested that the IIBM, Guwahati may consider implementing a one-year course on Banking and Finance on the lines of NIBM Pune syllabus. (Para 8.9 – iv)

iii. In Arunachal Pradesh RRB, the financial margin as on 31 March 2005 is negative (i.e., -1.6%). Therefore, a viability study may be taken up specifically by SBI/SBIRD, Hyderabad to address the issues of operational viability of the Bank. (Para 8.9-v)

iv. The Board Members need to be adequately sensitized about the fact of poor loan recovery position of RRBs in North Eastern Region. The loan policy of the North Eastern RRBs may be revised/modified giving due importance to the schemes such as Self Help Groups, Joint Liability Groups and VDC schemes, etc. (Para 8.9-vi)

v. The problem of mass unemployment, especially among educated youth, is a matter of serious concern in all N.E.States. RRBs need to address the issues of underdeveloped rural economies and creation of self-employment opportunities especially in sectors such as medicinal herbs and aromatics, bamboo, bio-diesel, horticulture and wasteland development. Development of inland fisheries, animal husbandry and poultry sectors holds enormous promise for self-employment opportunities among the educated youth, in the absence of industries/SMEs. Agro-processing is another sector as also Micro-hydel power generation for the far-flung and remote villages, which could be financed by RRBs. (para 8.9-viii)

ANNEXURE 1.1

MAJOR RECOMMENDATIONS OF VARIOUS COMMITTEEs / WORKING GROUPs ON REGIONAL RURAL BANKs

The issues relating to the RRBs have been deliberated upon in the past by various Committees / Working Groups. The recommendations of some other Committees and Working Groups, though not focussed exclusively upon the RRBs, has a bearing on the functioning of these banks as well. Some of these recommendations are relevant in the present day context of the efforts towards the strengthening of RRBs, more particularly the terms of reference of the present Working Group. The Task Force may, therefore, examined such recommendations and considered it appropriate to take the same into account while developing perceptions about the future role of RRBs. These recommendations are summarized below :-

Working Group On Rural Banks (Narasimham Committee, 1975)

- Rural Bank are to be a scheduled commercial bank, to be promoted by GOI, State Government, a commercial bank that may hold equity in proportion of 50:15:25 and other institutions / individuals, might hold balance 10%. Later on, 15% equity may be open to cooperative banks / societies, other local institutions and individuals so as to foster the spirit of local participation. In exceptional cases, more than one bank may jointly share 25% equity holding. To encourage local participation, a minimum guaranteed dividend be paid to be 15% 'other' shareholders.
- Board of Directors to comprise of 09 Directors : 4 by GOI including the Chairman, 2 by sponsor bank, 1 by State Govt., and rest 2 by GOI from amongst remaining shareholders.
- Sponsor Bank to provide managerial, financial and training support to the rural bank.
- Chairman to be appointed by GOI in consultation with RBI and sponsor bank with due regard to his professional competence, background and experience.
- Emphasis on viability with recognition that in initial years the rural bank might suffer losses.
- Rural bank to examine the ways of restructuring and reorganizing the productive activities of small borrowers so as to bring them to the level of generating surpluses for the purpose of reinvestment.
- A certain degree of flexibility of operation may be permitted with exemption in existing banking laws and regulations.

Committee on Rural Banks (Dantwala Committee, 1978)

- The qualitative and quantitative dimensions of the credit gap are so large that neither the commercial banks nor cooperative would be able to fill them up. RRBs are needed to made good some of the inadequacies in the existing rural credit system and they should become an integral part of rural credit structure.
- Commercial banks functioning in the area of operation of RRBs should progressively entrust the credit business of their rural branches to RRBs keeping in view the capacity of RRBs to shoulder the added responsibility.
- Initially the area of operation of RRB to be in one district but a flexible appraoch to be adopted in determining the area of operation of RRB.
- 60% of loans and advances of RRBs to be earmarked for the benefit of small farmers, rural artisans and rural poor.
- Operational aspects of RRBs to be looked after by RBI instead of Central Govt. (NABARD was not in existence by that time)
- Share Capital may be contributed by RBI (25%), Sponsor Bank(40%), State Govt (25%) and local bodies (20%)

- Board to have district developmental officials, persons with local knowledge, bank officials so as to have a proper mix of technical, banking and local needs / aspirations.
- Chairman to be appointed by the Board of RRB with concurrence of RBI.
- RBI relaxations / concessions may be retained for first 05 years of its existence.
- A separate institution for training needs of RRBs may be set up by sponsor banks.

Committee to Review Arrangements for Institutional Credit for Agriculture and Rural Development (CRAFICARD, 1981)

- The balance of advantage lies in encouraging commercial banks to transfer the eligible business of their rural branches to RRBs wherever possible. RBI should facilitate such transfer as and when such proposals were made.
- The losses incurred by a RRB should be made good annually by the shareholders in the same proportion of their shareholdings.
- In areas where the terrain is difficult, the accessibility is limited, the area itself requires further monetisation and particularly all families belonging to weaker sections as in North Eastern Regional (NER), the approach to RRB may have to be different and it may be allowed to cover larger areas and also finance all the categories of borrowers for all purpose.
- The recommendations of the Dantwala Committee for transfer of entire control, regulation as well as the promotional and developmental responsibilities relating to RRBs from GOI to the RBI, was endorsed and recommended with the modificaton that NABARD would take the place of the RBI in the new step.

Working Group on Regional Rural Banks (Kelkar Committee, 1984)

- RRBs be allowed to provide credit to select institutions such as SC/ST corporations, local bodies, housing boards etc. besides the target group. Such loans should be given only to financially sound institutions and for productive purposes alone.
- Small and uneconomic RRBs to be merged in the interest of economic viability.
- Accumulated losses of RRBs to be shared by the shareholders in the form of grants to RRBs in proportion to their equity holding.
- For meeting their SLR requirements, RRBs should invest in Govt. securities with support from sponsor bank.

Agricultural Credit Review Committee (ACRC, 1989)

- The Committee took note of the serious organisational problems of RRBs on account of the continuous decline in profitability, poor recoveries and problems relating to management and staff.
- The Committee noted that major factor which contributed to the erosion of RRBs' margins and high operating costs involved in handling of small loans. They did not have any scope of cross subsidization in the absence of loans that could yield higher returns. Wilful defaults, misuse of loans, lack of follow-up, wrong identification of borrowers, extension of denami loans, staff agitations etc. also led to poor recoveries in RRBs, noted the Committee.
- The objective of serving the weaker sections effectively could be achieved only by self-sustaining credit institutions. RRBs' structurally are not the institutions thatr could fulfill this role. The Committee noted that the logical and rationale which justified the setting up of RRBs did no longer exist. The weaknesses of the RRBs are endemic to the system and non-viability is built into it.
- The Committee also explored the possibilities of improving enlargement of the share capital, provision of bad debt reserve, providing large access to more resilient customers

and even giving them a subsidiary status to the commercial banks. But on closer examination, these alternatives were found to be unsatisfactory as, in the opinion of the Committee, the RRBs did not solve the problems of effective service to the rural poor.

- The Committee thought it proper taht the only feasible alternative would be to merge the RRB-structure and the branches with the concerned sponsor banks by making necessary amendments to the existing laws.

<u>Committee on Financial System (Narasimham Committee, 1991)</u>

- The problem of the RRBs is one of improving their viability without scarificing the basic objective for which they were set up.
- To impart viability to the operations of RRBs, they should be permitted to engage in all type of banking business and should not be forced to restrict their operations to the target groups.
- To improve their viability further, a mechanism be worked out under which the RRBs should be able to place their surplus funds with NABARD or with a special agency that might be set up for the purpose which should pay interest on such balances by investing or deploying these funds to the best advantage on behalf of RRBs.
- The solution lies in evolving a rural banking structure which would combine effectively the advantage of the local character of the RRBs and the strength and the organizational and managerial skills of commercial banks. The need is to establish a viable banking structure which could effectively meet rural credit needs. The Committee recommended that each public sector bank should set up one or more rural banking subsidiaries to take upon its all rural branches. It was left on the RRBs and their sponsor banks as to whether the RRBs should retain their separate identity or they should be merged with such rural subsidiaries.

<u>Committee on Restructuring of RRBs (Bhandari Committee, 1994)</u>

- Apart from identifying 49 RRBs for comprehensive restructuring, the committee made wide ranging recommendations relating, *inter-alia,* to the appointment of Chairman / CEO, delineation of roles and responsibilities of supervising agencies of RRBs, staff matters, improving returns on SLR and non-SLR investments and improving funds management, augmentation of share capital, expansion of the scope of business avenues, deregulation of interest and rationalization of branch licensing policy.
- Special emphasis was laid on skills up-gradation of the staff of RRBs.
- Professionals and not the politicians be nominated on the Boards of RRBs.
- Greater devolution of decision making powers to the Boards of RRBs in the matters of business development and staff matters.

<u>Working Group on Funds Management in RRBs (Misra Committee, 1995)</u>

- A graduated investment by RRBs in Govt. securities.
- Introduction of special deposit scheme of 15 days' maturity period for SLR investments of RRBs with sponsor banks with interest rate on such deposits being pegged at 0.50% less than the coupon rate on dated GOI securities as on date of such investments.
- Widening the scope for non-SLR investments of RRBs.
- Strengthening the Operational set up for Investment Management in RRBs.
- Pooling of surplus funds of all RRBs for investment through an asset-management group and a national center for exchange of information that could be managed by NABARD.
- Introduction of Guarantee Bond System for management of cash till consideration of currency chests in RRBs.

- General exemption to RRBs from Income Tax on the income from investment of their rural deposits.

Committee on Revamping of RRBs (Basu Committee, 1996)

- Apart from identifying 68 RRBs for restructuring under Second Phase, Base Committee made certain recommendations on operational matters as well.
- Introduction of Prudential Norms for RRBs with suitable modifications.
- Subsidising RRBs to the extent of the cost of DICCGCI premium in respect of loans below Rs.25000/- or allowing RRBs to pass on this cost to the borrower.
- Introduction of a Floating Rate Mechanism linked to the coupon rates for improving yields on SLR investments of RRBs.
- Need to redefine the role of shareholders of RRBs more precisely.
- Broad-basing the selection of Chairman of RRBs.
- Some of the RRBs might not be able to respond positively to the 'Stand Alone' Approach or any other revamping strategy; liquidation of such RRBs might be the only solution.

Expert Group on RRBs (Thingalaya Committee, 1997)

- Categorization of RRBs as per their viability status and size to provide appropriate policy treatment to them.
- Very weak RRBs to be viewed separately and possibility of their liquidation be recognized. They might be merged with neighbouring RRBs.
- Special package for RRBs in North-Eastern Sector.
- RRBs to be permitted to open branches at centres having high business potential.
- Adequate autonomy to Board of Directors for decisions on all matters relting to business without having to refer to apex authorities.
- Delegation of authorities as per the size and viability status of RRBs.
- Strengthening of Internal Inspection System and set-up in RRBs and introduction of Vigilance Cells.
- Realistic RRB - specific staff review and recruitment policy.
- Role overlap between RBI, NABARD and Sponsor Banks to be avoided.

Committee on Banking Sector Reforms (Narasimham Committee, 1998)

- Banking system should be in a position to build a credit culture and discipline by equipping itself to identify the eligible clients, based on the prescribed norms, in the government sponsored schemes so that full responsibility for all aspects of credit decision remains with it. This would also help improve the client-bank relationship instead of the present system of virtually imposed clientele.
- RRBs should reach a minimum of 8% of capital to risk weighted assets over a period of 5 years. A review of a capital structure of the RRBs should be undertakn with a view to enlarging public subscriptions and the sponsor banks be given greater ownership and responsibility in the operation of RRBs.
- The supervisory functions over rural financial institutions have been entrusted to NABARD. While this arrangement may continue for the present, over the longer term the Committee suggested that all regulatory and supervisory functions over rural credit institutions should vest with the Board for Financial Regulation and Supervision.
- Banking policy should facilitate the evolution and growth of micro-credit institutions including LABs which focus on agriculture, tiny and small scale industries, including such specialist institutions as may be promoted by NGOs for meeting the banking needs of the poor.

- NABARD to prepare a checklist of various recommendations of the Committees set up in the past on RRBs that remain unimplemented and positive steps be taken to bring the RRBs on the right path of efficiency, solvency, productivity and profitability without undermining the ultimate objectives of rural development.
- RRBs must rationalize and amend their loan policies and procedures so as to function as a development banker for the rural poor.
- RRBs must work in close coordination with the cooperative banks and rural branches of commercial banks to fill the credit gap in rural areas without any clash of mutual interests.
- While discharging their functions as purveyors of rural credit and mobilisers of rural savings, RRBs should not ignore the importance of financial viability and operational efficiency. The productivity, profitability and solvency of the RRBs must be maintained and sustained to enable them to function as an effective and efficient institution of rural credit.

<u>Committee on Manpower Norms in RRBs (Agrawal Committee, 2000)</u>

- Norms for staffing in RRBs be pegged at 4.20 per unit (HO/ Area Office / Branch being treated as one unit each), with relaxation for RRBs in North-Eastern Region and hilly and desert areas. Additional manpower to be available only for RRBs with CD Ratio exceeding 60% and NPAs lower than the industry average by 5% points.
- Staffing set-up of head office of RRBs has been suggested in four categories separately for RRBs with branches upto 50, those upto 100 branches, those with upto 150 branches and those having more than 150 branches.
- Area Offices for every 25 branches with its location in the field.
- One scale up-gradation of the posts of Chairman, General Manager and Area Managers / Senior Managers.
- Manpower surplus / shortages to be managed by deputation of staff from surplus RRBs to deficit RRBs, by opening new branches / closure of unviable branches, computerization, outsourcing, redeployment of staff etc.
- RRB-staff with due experience to be considered for the post of General Manager.
- Abolition of clerical cadre over a period of time by converting the staff into multi-purpose workers.
- RRBs to achieve computerisation in Head Office,Area Office and at least 50% of its branches in 5 years period.

<u>Expert Committee on Rural Credit (ECRC, 2001)</u>

- To find out some other willing party (sponsor banks, RRB Employees themselves or some non-banking financial companies) to take over the share of defaulting State Governments (along-with the right of nomination to the Board) at a fair price determined independently by a professional.
- The GOI to review its system of nominating non-official directors and nominate non-official directors from a panel of professionals recommended by NABARD, sponsor bank or even the RRB itself.
- Sponsor banks to review their own systems of support and monitoring of RRBs' performance and ensure that necessary autonomy in innovation of credit products as also credit and other portfolio management ystems are ensured for RRBs.
- GOI to recognise RRBs which do not carry forward any accumulated losses as Local Area Banks (LABs), convert them into banking companies and incorporate them as such in the Companies Act. They need strong, regionally oriented management and larger capital flow. For this purpose, strategic local partners in the private sector may be needed. Employeed of concerned banks may also be conisdered as a strategic partner. Such banks may also be allowed to access capital markets for initial public offerings of their shares particularly to meet capital adequacy requirements.

- No new LABs other than those converted from RRBs or sponsored by non-government or voluntary agencies need be set up in the private sector in future. We have to recognise that RRBs are already LABs in the public sector.
- As far as possible, sponsor banks' nominees on RRB boards should be from their Zonal or Head Offices, a little away from the area of operation of the RRB and help correct perceptions of RRB personnel regarding pressure from local controlling offices of the sponsor banks for various purposes.
- Sponsor banks are often not prompt in handling references from RRBs. Some of these remain pending with bodies such as NABARD, RBI or GOI. Sponsor Banks should accord urgency to such references to help RRBs find early solutions to their problems.

Advisory Committee on Flow of Credit to Agriculture and Related Activities (Dr.Vyas Committee, 2004)

- Mandate of RRBs has to continue, even as they need to be restructured into viable financial institutions, simultaneously retaining their regional character and rural tours.
- All RRBs in the North Eastern States be merged into a Zonal bank on stand alone basis, the equity of which is to be provided by NABARD, SBI and UBI in the ratio of 26:37:37 through a holding company. They newly constituted bank will function independently with CEO and a BOD and will be delinked from the sponsor banks.
- A two-step amalgamation of RRBs for the rest of the country, under first step, all RRBs of a sponsor bank in a state would be amalgamated into a single unit. Sponsor bank and NABARD will contribute to the equity of the RRB through a holding company in the ratio of 26:74. Under 2nd phase, state level rural bank will be formed by amalgamating all RRBs (amalgamated and stand alone). Thus 20 state level rural bank will emerge after 2nd phase.
- The State / Zonal RRBs may be permitted to seek cheaper funds through issue of certificate of deposits.
- Income tax exemptions granted to RRBs be continued to be newly formed State / Zonal RRBs.
- RRBs Act, 1976 may be repeated and replaced by a new Act with suitable provisions for functional autonomy to the restructured RRBs and professionalized of management and Board of Director

Annexure - 1.2

Performance of all RFIs in delivery of credit at the grass-root level.

Ground Level Credit Flow, Growth Rate and % share of various agencies for Agriculture Sector

(Rs. in crore)

Particulars/Agency	1997-98	Share	Growth	1998-99	Share	Growth	1999-00	Share	Growth	2000-01	Share	Growth	2001-2002	Share	CAGR	Growth
Co-operative Banks	13975	43.73	17.00	15870	43.05	13.56	18260	39.47	15.06	20718	39.22	13.46	23524	37.91	13.90%	13.54
RRBs	2040	6.38	21.14	2460	6.67	20.59	3172	6.86	28.94	4219	7.99	33.01	4854	7.82	24.20%	15.05
Commercial Banks	15831	49.54	23.84	18443	50.04	16.50	24733	53.46	34.11	27807	52.64	12.43	33587	54.13	20.69%	20.79
Other Agencies	110	0.34	0.00	87	0.24	-20.91	103	0.22	18.39	83	0.16	-19.42	80	0.13	-7.65%	
Grand Total (A+B)	**31956**	**100**	**21.00**	**36860**	**100**	**15.35**	**46268**	**100**	**25.52**	**52827**		**14.18**	**62045**	**100**	**18.04%**	**17.45**
Particulars/Agency	**2002-2003**	**Share**	**Growth**	**2003-2004**	**Share**	**Growth**	**2004-2005**	**Share**	**Growth**	**005-200**	**Share**	**Growth**	**2006-07(T)**	**CAGR**		
Co-operative Banks	23636	33.9793	0.47611	26875	36	13.7037	31231	36	16.20837	37252	22.204	19.27892	43000	0.161378		
RRBs	6070	8.726279	25.0515	7581	8.7157	24.8929	12404	9.899	63.61958	14076	8.3898	13.47952	16000	0.274186		
Commercial Banks	39774	57.17941	18.42082	52441	60.2902	31.8474	81481	65.02	55.37652	116447	69.407	42.91307	141000	0.372161		
Other Agencies	80	0.115009		84	0.09657		193	0.154								
Grand Total (A+B)	**69560**	**100**	**12.11218**	**86981**	**100**	**25.0446**	**125309**	**100**	**44.0648**	**167775**	**100**	**33.88903**	**200000**	**0.30217**		

Annexure 1.3								
			Regional Rural Banks					
	Number of Accounts (in lakh)				Amount Outstanding (Rs. crore)			
March 2005	**March**	**March 2003**	**March 2004**	**March 2005**	**March 2002**	**March 2003**	**March 2004**	**March 2005**
9	**10**	**11**	**12**	**13**	**14**	**15**	**16**	**17**
112475	5976228	6238697	6594951	8191901	8404.54	10260.64	11721.42	16709.4
67634	800005	151966	257096	322274	225.83	330.61	432.71	579.5
129984	2916895	3667570	3733342	3632449	5138.96	6033.95	8316.09	8787.62
310093	9693128	10058233	10585389	12146624	13769.33	16625.20	20470.22	26076.52
717304								
9720783.70					14205.44	16529.33	19338.89	21469.22

Annexure 2.1

Powers of Central Govt.

Enactment of the Act, Amendment if any

Sec.3(1) Incorporation under the above provisions CG if requested by sponsor bank by notification in the official Gazette establish - a RRB - Specify the local limits of operations

Sec.3(3)© - Central Govt. may either of its own motion or as per recommendation of NABARD extend period of support of sponsor bank on managerial and financial assistance.

Sec.4(1) - Central Govt. shall notify the place of Head Office of RRB

Sec 5 - Increase or reduce Authorized Capital

Sec 6(1) - Fix the issued capital in the first instance

Sec 6(2) – Contribute 50% of the issued capital

Sec 6(3) - Approval of increase of the issued capital

Sec 9(1)(a) - Appoint two directors

Sec 9(2) - Increase the number of members of the Board not exceeding fifteen

Sec 11(1)(b) - Appointment of Chairman if the individual is not an officer from Sponsor bank

Sec 11(1A)(b) - Termination of Chairman appointed under 11(1)(b)

Sec 11(4)(b) - Removal of chairman appointed under 11(1)(b)

Sec 11(6) - appointment of temporary chairman

Sec 12(e) - Disqualification of chairman

Sec 16(1) - Fixation of fees and allowances of directors of Board and members of the Committee

Sec 17(1) - Determine the remuneration of officers and other employees of RRBs

Sec 19(1) - Determine the date of closure of the account of RRB and appointment of Auditors

19(2) - Fixation of the remuneration of Auditors

Sec 20(2) - Place the Auditors report on the working and activities of each RRB in both Houses and Parliament

23A(1), (2), (3) – Amalgamation of RRB and issue of notification thereof

23(A)(4) - Place such notification in Parliament

24(1) & (2) – Direction to RRB on matters relating to policy involving public interest.

26 - Placing the RRB under liquidation

29(1) - Making Rules/ Notification in Board Meeting, Staff Rule etc.

29(3) - Laying before Parliament of such rules

30(1) - Approval of Regulation/ Notification

30(2) - Laying before Parliament of such Regulations

31 - Make order for removing difficulties in giving effect of any provision of the Act

Annexure 2.2

Role Played by Sponsor Bank

The following roles are played by Sponsor Bank in respect of RRB some of which are statute in the RRB Act, 1976.

1. Sponsor (promote) the RRB
2. Providing equity support to the extent of 35%
3. Deciding the place of Head Office/ change of Head Office
4. Extending Managerial and Financial support and training of the officials
5. Providing services of Chairman, General Manager and other officials as needed
6. Nomination of two official directors in the Board
7. The sponsoring Nominee Directors for Govt. of India
8. Providing refinance at concessional rate of interest and also to help maintaining liquidity of the RRB
9. Expert guidance / help in Investment
10. Conduct of Management Audit
11. Assisting assessment of manpower, creation of vacancy, recruitment and promotion.
12. Entering into MoU, preparation of DAP and Review and monitoring of performance
13. Guidance in Administrative matters, recovery, credit dispensation and legal advise
14. Liaisoning with Govt. of India/ RBI/ NABARD
15. Help for Computeration
16. Extension of Area of Operation
17. Fixation of other allowances
18. Fixing of inter-se seniority
19. Approval the categorization of branches

<u>Annexure 2.3</u>

A. Statutory Powers vested with NABARD as per provisions of RRB Act, 1976

S No	Relevant Section of Act ibid	Stipulation in the Act	Action at NABARD level
1	4(1)	RRB shall have its head office at such place as Central Government may after consultation with NABARD and Sponsor Bank specify by notification	Application for change of place of Head Office are scrutinized and recommended to GoI for approval and notification
2	5	Increase or decrease of authorized capital of RRB can be done by GoI in consultation with NABARD	In the context of amalgamation of RRBs, such proposals involving more than 5 RRBs, increase of authorized capital vis-à-vis subscribed capital are recommended by NABARD. In case of subscribed capital of amalgamated RRB which invariably goes up from the existing level is also recommended by NABARD under the above Section.
3	6(3)	Increase or decrease of subscribed capital to be approved by GoI in consultation with NABARD	
4	9(1)(i)	Composition of Board of Directors of RRBs	Guidelines for nomination of NABARD officials in RRB Board are formulated by us and officers are identified by respective Regional Office after vigilance clearance.
4	11	Sponsor Bank shall appoint /terminate Chairman of RRB in consultation with NABARD	❖ Devising norms for appointment of Chairman ❖ Scrutiny, approval or otherwise of the proposal ❖ Approval to premature withdrawal of Chairman ❖ Extension of tenure of Chairman
5	23 A	Central Government may after consultation with NABARD amalgamate two or more number of RRBs to form a single unit.	All amalgamation proposals are scrutinized and recommended or otherwise to GoI.
6	29	GoI in consultation with NABARD by notification makes Rules.	Any Rules, viz., Recruitment, Promotion, Board Meeting Rules etc are recommended by NABARD to GoI for approval and notification.
7	30	Board of RRB in consultation with NABARD/Sponsor Bank/GoI makes Regulations	Preparation of Model Staff Regulations, adoption, Notification and subsequently any modifications are recommended by NABARD.

B. Statement showing provisions in NABARD Act, 1981 as regards RRBs

Sl No.	Section no.	Provisions
1	Preamble	An Act to establish a development bank to be known as the National Bank for Agriculture and Rural Development for providing and regulating credit and other facilities for the promotion and development of agriculture small-scale industries, cottage and village industries, handicrafts and other rural crafts and other allied economic activities in rural areas with a view to promoting integrated rural development and securing prosperity of rural areas, and for matters connected therewith or incidental thereto.
2	21(1)	Provision of short term credit to RRBs
3	22	Conversion facilities to RRBs
4	23	Rescheduling of loans to RRBs
5	24	Provision of Investment credit - medium term
6	25	Provision of long term credit
7	30A.	Rediscounting of bills of exchange and promissory notes presented by regional rural bank
8	35.1	NABARD shall have free access to all such records of a borrower seeking to avail of any credit or other facilities from the National Bank
9	38(i).	The National Bank shall co-ordinate its operations and the operations of various institutions engaged in the field of rural credit and maintain expert staff to study all problems relating to agriculture and rural development and be available for consultation to the Central Government, the Reserve Bank, the State Governments and the other institutions engaged in the field of rural development ;
10	38(ii)	The National Bank may act as the agent for the Central Government or a State Government or the Reserve Bank in the transaction of any business in respect of loans and advances granted ……
11	38(iii)	The National bank may provide facilities for training, for dissemination of information and the promotion of research ……
12	38(iv)	The National Bank may provide technical, legal, financial, marketing and administrative assistance to any person engaged in agriculture and rural development activities
13	38(vi)	The National Bank may perform the functions entrusted to or required of the National Bank by any other law for the time being in force

Provisions of BR Act, 1949- Powers vested with NABARD vis-a vis RRBs

Sl No.	Section no.	Provisions
	23(4)(A)	Any RRB requiring permission of RBI for opening of new and transfer of existing places of business shall forward its application to the RBI through the National Bank which shall give its comments on the merits of the application and send it to the RBI.
	24(3)	Every RRB shall also furnish a copy of the return ensuring compliance of SLR provisions, to National Bank.
	25(2)	Every RRB shall also furnish a copy of the return on the assets maintained by it in India to National Bank
	26	Every RRB shall also furnish a copy of the return on the unclaimed deposits to National Bank
	27(3)	Every RRB shall submit a copy of the return on the assets and liabilities as at the close of business on the last Friday of every month, which it submits to the RBI, also to the National Bank and the powers exercisable by the RBI under subsection (2) viz., to call for information relating to the business or affairs of the banking company, may also be exercisable by the National Bank in relation to RRBs.
	28	The Reserve Bank or the National Bank, or both, if they consider it in the public interest so to do, may publish any information obtained by them under this Act in ,such consolidated form as they think fit.".
	31	A regional rural bank shall furnish balance sheet and auditor's report also to the National Bank..
	35(6)	Inspection - the powers exercisable by RBI in relation to RRBs may be exercised by the National Bank in relation to the RRBs…..

Annexure 2.3 (contd.)

A. Work being attended to by NABARD (by way of Secretarial Support)
As per GoI directives

S No	Stipulation in the Act	Action at NABARD level
1	Approval for notified area of RRBs by GoI by way of notification	Proposals for extension of area of operation (notified area) are examined and recommended to GoI for notification.
2	1. Implementation of NIT Award 2. Revision of pay and allowances of staff/officers of RRBs 3. All other allowances 4. Loans and Advances 5. Staff related issues	As per the direction of Government of India, every issue relating to these items are attended to by NABARD GoI acts on such issues based on the recommendations of NABARD All related clarifications required by Sponsor Banks/RRBs are provided by NABARD.
3	Inter-se seniority after amalgamation	As notified by GoI, these are finalized by NABARD in consultation with Sponsor Banks.
4	I. Appointment of staff/officers and terms thereto ii Promotion related terms	All work relating to these issues are attended to by NABARD and recommended to GoI for approval. Subsequently necessary circulars are also issued by NABARD.
5	Redeployment of staff among the RRBs of same Sponsor Banks as well as RRBs of different Sponsor Banks	Schemes were drawn by NABARD at the instance of GoI and provided guidance, clarification for the smooth implementation of the Scheme.
6	Court Cases	⇒ NABARD extends secretarial support to Government of India in most cases ⇒ Provides necessary guidance to sponsor banks on request ⇒ There are about 2700 court cases pertaining to RRBs pending with various High Courts/ Supreme Court ⇒ Besides defending NABARD's own position, guidance is provided to GoI, Sponsor Banks. ⇒ Arrangements for defending GoI by way of preparation of replies/para wise comments / finalisation of arrangements /advocates, etc
7	Appointment of Auditors for RRBs	➢ NABARD undertakes the entire exercise of identifying suitable audit firms for appointment as auditors in RRBs Terms and conditions of such appointed auditors are also recommended by NABARD for approval.

8	Coordinate operations and operations of various institutions engaged in the field of rural credit	➢ Helps frame guidelines in respect of policy issues and staff related issues of RRBs. Acts as the nodal agency for RRBs by taking up the issues of RRBs with GoI and the decision of GoI transmitted to Sponsor Banks/RRBs
9	Capacity Building Efforts	Provides training facilities to RRB officers in its training establishments and in establishments funded by NABARD
10	Maintenance of Database	NABARD maintains database in respect of RRBs. Prepares key statistics on RRBs. A review on the performance of RRBs is sent to GoI/ RBI annually.

B. As per the advice of RBI

S No	Particulars
1	Branch Licensing - Opening /closing /relocation of branches- processing and recommending to RBI - Extension of area of operations - processing & recommending to GoI - Applications for conduct of insurance business as Corporate Agents - processing of application and recommending to RBI. - GM of NABARD is also a member of Standing Advisory Committee to approve the list of Audit Firms for undertaking Statutory as well as Branch Audit of nationalized Commercial Banks, Financial Institutions and RRBs. RBI is the convenor of this Committee.

C. Miscellaneous- As provided in various Rules related to RRBs

1.	Appointment and Promotion rules- Relaxation, conduct of promotion process, ensuring reservation in promotion and recruitment and providing necessary clarification thereto.
2.	Special Leave due to accident while on duty - Powers to sanction
3.	Inter-se seniority as notified by GoI - Discussions held / being held for finalization

Annexure 2.4

Calendar for review by Board of Directors of RRBs

1. Funds Management

- Information about funds position of the bank
- Compliance with CRR/SLR requirements
- Details of investments in call deposits, non-SLR investments made, Securities traded and income earned / loss incurred, if any.
- Compliance with RBI instructions in regard to maintenance of investments in Government Securities.
- Details of borrowings availed of other financing agencies under various lines of credit limits.
- Position of deposits mobilised, amount invested in various avenues and advances made. The report should not be a fact sheet but should capture qualitative data on the important market trends, market developments, regulatory initiatives, etc. between the review periods and should stimulate constructive suggestions and discussions on critical appraisal of the strategies followed presently and the need for changes.
- Concurrent audit report by internal auditors and compliance report thereon (to be placed before the Chairman every month).

2. Loans and advances

- Review of various credit limits sanctioned by General Manager/ Chairman/ Executive Committee.
- Sanction of term loans and follow up.
- Participation in Consortium Finance.
- Adherence to exposure norms prescribed by RBI/ NABARD.

3. General

- Compliance in respect of outstanding observations of the Board.
- Review compliance with various Sections of Banking Regulation Act /RBI Act/ Rules & Regulations of GOI.
- Circulars received from Sponsor Bank,RBI, NABARD, GOI.
- Implementation of the instructions/directives/ guidelines issued by RBI/NABARD/Govt.
- Submission of Statutory & other returns to various organisations.

II. Quarterly

1. Business Plan: Targets and Achievements

- Performance reviews vis-a-vis business goals such as deposit mobilisation, credit disbursal, recovery of loans, etc. The reviews should be comprehensive and cover specifically the bank's structural / organisational requirement. It should lead to initiation of business strategies of growth and profitability. The review should also contain bank's performance under special programmes of credit assistance like SHG, SGSY, etc.

- Review of high yielding advances sanctioned by the bank.
- Review of progress in implementation of Government sponsored programmes.
- Recoveries effected under NPA accounts. The report should be comprehensive and cover requisite details on the deficiencies observed, systemic controls required for avoidance of incidence of NPAs, etc. The review should also look at loan policy caveats on exposure thresholds, borrower-wise/industry-wise, etc. and other credit risk management initiatives on ongoing basis.
- Details of OTS / waiver of irrecoverable loans / interest.
- Recovery under legal action.

2. Branch performance

- Branch-wise targets and achievements under various business parameters.
- Review of branch profitability with suggestions measures to improve the position of loss making branches. Need for branch expansion and branch rationalisation.
- Progress in inspection of branches and important observations of branch inspections.
- Review of discussions held during Branch Manager's review meetings.

3. Working Results

An analysis of the working results of the bank on a quarterly basis along with an analytical note and proposals for future course of action. The bank's comparative position should also be highlighted.

4. Others

- A comprehensive review of the Vigilance Cell including position of vigilance cases and disciplinary cases initiated against the bank's staff and secretaries of affiliated societies.
- Review of cases of frauds, misappropriations, embezzlements, defalcations, etc. together with action for recovery thereof. Review of cases of dacoities and security arrangements in the bank.
- A review of customer services rendered by the bank with analysis of complaints received and action taken.
- Review of Development Action Plan/ MOU with Sponsor bank.
- Progress in implementation of the Action Plan prepared for recompliance with Section 42 of RBI Act
- Observations of the Audit Committee.

III. <u>Half-yearly</u>

- Half yearly review of investment portfolio (as on 30 September and 31 March); copy of review report put up to the Board may be forwarded to RBI/NABARD by 15 November and 15 May.
- A review of operations of the bank's non-fund business.
- A review of the bank's Human Resources Development policy, training programmes, etc.

(Annexure 2.4 continued)

- Comprehensive status notes separately on Income Recognition, Asset Classification and Capital Adequacy regarding compliance with the policy guidelines laid down by RBI from time to time. The review should be a progress report on the steps initiated on the policy guidelines of RBI on prudential regulations, risk management, etc.
- Review of implementation of Risk Management guidelines in the bank.
- Review of all aspects relating to the computerisation of branches/Regional Office/Head Office and also look into Information Technology related needs.
- Review of cost of funds, yield on deployment of funds, interest rates revision, etc.
- Position of imbalance- society-wise.
- Review compliance of the Fair Practices Code and the functioning of Grievance Redressal Mechanism at various levels of controlling offices.

IV. Yearly

- Working results- Should include analysis of Balance Sheet prescribed by RBI.
- Audit Report- Long Form Audit Report (LFAR) of the bank along with bank's comments on the auditors observations.
- Review of all policies- An annual review of all policies formulated by the bank like Loan Policy, Investment Policy, Recovery Policy, Funds Management Policy, Risk Management Policy, ALM, etc.
- Corporate Budget- Review of budget proposals made for various expenditure vis-a-vis actual expenditure and reasons for large scale deviations, if any.
- Review of working of Head Office Departments.
- Statutory inspection Report and compliance report thereon (to be submitted to NABARD).
- Review of findings of inspection conducted by Sponsor Bank and action taken thereon.
- Review of reports submitted by Audit Committee and action taken thereon.
- Cash retention limits of HO and branches.
- Note on Man-power Planning and Development and periodical review in respect thereof. Policy relating to recruitment/promotion/transfer/staff welfare.

Annexure 3.1

Asset Liability Management (ALM) Guidelines for
Regional Rural Banks (RRBs)

Introduction

Regional Rural Banks (RRBs) are now operating in a fairly deregulated environment and are required to determine their own interest rates on deposits and on their advances which are subject to only the Minimum Lending Rate (MLR) prescription. The interest rates on banks' investments in government and other permissible securities are also now market related. Intense competition for business, involving both the assets and liabilities, together with increasing volatility in the domestic interest rates and foreign exchange rates, has brought pressure on the management of banks to maintain an optimal balance between spreads, profitability and long-term viability. The unscientific and ad-hoc pricing of deposits in the context of competition, and alternative avenues for the borrowers, results in inefficient deployment of resources. At the same time, imprudent liquidity management can put banks' earnings and reputation at great risk. These pressures call for a comprehensive approach towards management of banks' balance sheets and not just *ad hoc* action. The managements of RRBs have to base their business decisions on sound risk management systems with the ultimate objective of protecting the interest of depositors and stakeholders. It is, therefore, important that RRBs introduce effective Asset-Liability Management (ALM) systems to address the issues related to liquidity, interest rate and currency risks.

2. In the normal course, RRBs are exposed to credit, market, operational, reputational, etc., risks in view of the asset-liability transformation. With liberalisation in the Indian financial markets over the last few years and growing integration of domestic markets with external markets, the risks associated with banks' operations have become complex and large, requiring strategic management. Since the 'RRBs' is an integral part of the financial system and most of these banks are undertaking business as varied as in the case of commercial banks, there is an imperative need for RRBs in general, to put in place appropriate internal control and risk management systems. The recent events like, amalgamation of banks, etc., in the RRB sector reinforce the immediate need for introduction/adoption of sound risk management policies, practices and procedures.

3. As desired by the RBI, the NABARD has undertaken the task of framing suitable guidelines on Asset- Liability Management (ALM) for RRBs. The ALM guidelines devised by the NABARD have been sent to RBI for their formal approval and thereafter it would be discussed and explained extensively in the Workshops to be organised by NABARD. The draft ALM Guidelines prepared by NABARD are enclosed. Salient features of which are discussed hereunder.

4. RRBs are required to put in place an effective ALM System, as per the enclosed Guidelines, preferably, by 30 June 2007. The banks should set up an internal Asset-Liability Committee (ALCO), headed by the Chairman The Board should oversee the implementation of the system and review its functioning periodically.

5. Keeping in view the level of computerisation and the current MIS in many of the RRBs, adoption of a uniform ALM System by all banks may not be feasible. The enclosed Guidelines have been formulated to serve as a benchmark for those banks which lack a formal ALM System. Banks which have already adopted more sophisticated systems may continue their existing systems, but should ensure to fine-tune their current system to ensure compliance with the requirements of the ALM System suggested in the enclosed Guidelines. Other banks should examine their existing MIS and arrange to have an information system to meet the prescriptions of the ALM Guidelines.

6. To begin with, RRBs should ensure coverage of at least 60% of their liabilities and assets. As for the remaining 40% of their assets and liabilities, banks may include the position based on their estimates. It is necessary that banks set interim targets so as to cover 100 per cent of their business by April 1, 2008. Once the ALM System stabilises and banks gain experience, they should prepare to switch over to more sophisticated techniques like Duration Gap Analysis, Simulation and Value at Risk for interest rate risk management.

7. In order to capture the maturity structure of the cash inflows and outflows, the Task Force suggests that the Statement of Structural Liquidity, (Annexure-I to the Guidelines) should be prepared, to start with, as on the last reporting Friday of March/June/ September/December and put up to ALCO/Top Management within a month from the close of the last reporting Friday. It is the intention to put the reporting system on a fortnightly basis, with effect from April 1, 2008. The Statement of Structural Liquidity should be placed before the bank's Board in its subsequent meeting. Tolerance levels for various maturities may be fixed by the bank's Top

Management depending on the bank's asset - liability profile, extent of stable deposit base, the nature of cash flows, etc. In respect of mismatches in cash flows for the 1-14 days bucket and 15-28 days bucket, it should be the endeavour of the bank's management to keep the cash flow mismatches at the minimum levels.

The Task Force is of the view that to start with, the mismatches (negative gap) during 1-14 days and 15-28 days, in the normal course, may not exceed 20% each of the cash outflows during these time buckets. If a bank, in view of its structural mismatches, needs a higher limit, it could operate with higher limit with the approval of its Board, giving specific reasons on the need for such higher limit. The Task Force recommends that the NABARD/RBI may like to enforce the tolerance levels strictly with effect from April 1, 2008. It further suggest that in the Statement of Interest Rate Sensitivity (Annexure II to the Guidelines), only rupee assets, liabilities and off-balance sheet positions should be reported. The statement should be prepared as on the last reporting Friday of March/June/September/December and submitted to the ALCO / Top Management within a month from the last reporting Friday. It should also be placed before the bank's Board in its next meeting. The banks are expected to move over to monthly reporting system with effect from April 1, 2008. The information collected in the statement would provide useful feedback on the interest rate risk faced by the bank and the Top Management/Board would have to formulate corrective measures and devise suitable strategies wherever needed.

8. In order to enable the banks to monitor their liquidity on a dynamic basis over a time horizon spanning 1-90 days, an indicative format (Annexure III to the guidelines) has been prescribed by the Task Force. This statement of Short-term Dynamic Liquidity should be prepared as on each reporting Friday and put up to the ALCO/Top Management within 2/3 days from the close of the reporting Friday.

ASSET-LIABILITY MANAGEMENT GUIDELINES FOR REGIONAL RURAL BANKS - Guidelines

1. ALM in Regional Rural Banks (RRBs)

1.1 Considering their structure, balance sheet profile and skill levels of personnel of RRBs, RBI and NABARD found it necessary to provide technical support for putting in place an effective ALM framework. These Guidelines lay down broad framework for measuring liquidity, interest rates and forex risks. The initial focus of the ALM function would be to enforce the risk management discipline viz. managing business after assessing the risks involved. The objective of good bank management is to provide strategic tools for effective risk management systems.

1.2 RRBs need to address the market risk in a systematic manner by adopting necessary *sector– specific* ALM practices than has been done hitherto. ALM, among other functions, also provides a dynamic framework for measuring, monitoring and managing liquidity, interest rate and foreign exchange (forex) risks. It involves assessment of various types of risks and altering balance sheet (assets and liabilities) items in a dynamic manner to manage risks.

1.3 The ALM process rests on three pillars:

- ALM Information Systems
  - Management Information Systems (MIS)
  - Information availability, accuracy, adequacy and expediency

- ALM Organisation
  - Structure and responsibilities
  - Level of top management involvement

- ALM Process
  - Risk parameters
  - Risk identification
  - Risk measurement
  - Risk management
  - Risk policies and procedures, prudential limits and auditing, reporting and review.

2. ALM Information Systems

2.1 ALM has to be supported by a management philosophy which clearly specifies the risk policies and procedures and prudential limits. This framework needs to be built on sound methodology with necessary information system as back up. Thus, Information is the key to the ALM process. It is, however, recognised that varied business and customer profiles of RRBs do not make the adoption of a uniform ALM System for all banks feasible. There are various methods prevalent world-wide for measuring risks. These range from easy-to-comprehend and simple `Gap analysis' to extremely sophisticated and data-intensive `Simulation' methods. However, the central element for the entire ALM exercise is the availability of timely, adequate and accurate information. The existing systems in many RRBs do not generate information in the manner required for ALM. Collecting accurate data in a timely manner will be the biggest challenge before these banks taking full scale computerisation. However, the introduction of the essential information system for ALM has to be addressed urgently. As commercial banks have already been prescribed with ALM system and are in the process of adopting capital adequacy for market risk, it is imminent for RRBs to put in an efficient information system for initiating ALM process.

2.2 Considering the customer profile and inadequate support system for collecting information required for ALM which analyses various components of assets and liabilities on the basis of residual maturity (remaining term to maturity) and behavioural pattern, it will take some time for RRBs to get the requisite information.

The problem of ALM data needs to be addressed by following an ABC approach i.e. analysing the behaviour of asset and liability products in the sample branches accounting for significant business (at least 60-70% of the total business) and then making rational assumptions about the way in which assets and liabilities would behave in other branches. Unlike in the case of commercial banks which have large network of branches, RRBs are better placed in view of their compact area of operation and two-tier hierarchical structure to have greater access to the data. Further, in respect of foreign exchange, investment portfolio and money market operations, in view of the centralised nature of functions, it would be much easier to collect reliable data. The data and assumptions can then be refined over time as RRBs gain experience of conducting business within an ALM environment. The spread of computerisation will also help RRBs in accessing data at a faster pace.

3. ALM Organisation

3.1 Successful implementation of the risk management process would require strong commitment on the part of their Boards and senior management. The Board should have overall responsibility for management of risks and should decide the risk management policy and procedures, set prudential limits, auditing, reporting and review mechanism in respect of liquidity, interest rate and forex risks.

3.2 The Asset - Liability Committee (ALCO) consisting of the bank's senior management including CEO should be responsible for ensuring adherence to the policies and limits set by the Board as well as for deciding the business strategy (on the assets and liabilities sides) in line with the bank's business and risk management objectives.

3.3 The ALM Support Groups consisting of operating staff should be responsible for analysing, monitoring and reporting the risk profiles to the ALCO. The staff should also prepare forecasts (simulations) showing the effects of various possible changes in market conditions related to the balance sheet and recommend the action needed to adhere to bank's internal limits.

3.4 The ALCO is a decision-making unit responsible for balance sheet planning from risk-return perspective including the strategic management of liquidity, interest rate and forex risks. The business and risk management strategy of the bank should ensure that the bank operates within the limits / parameters set by the Board. The business issues that an ALCO considers, *inter alia*, includes pricing of both deposits and advances, desired maturity profile and mix of the incremental assets and liabilities, etc. In addition to monitoring the risk levels of the bank, the ALCO should review the results of and progress in implementation of the decisions made in the previous meetings. The ALCO's future business strategy decisions should be based on the banks views on current interest rates. In respect of the funding policy, for instance, its responsibility would be to decide on source and mix of liabilities or sale of assets. Towards this end, it will have to develop a view on future direction of interest rate movements and decide on funding mixes between fixed vs. floating rate funds, wholesale vs. retail deposits, short term vs. long term deposits etc. Individual RRBs will have to decide the frequency for holding their ALCO meetings.

4. Composition of ALCO

The size (number of members) of ALCO would depend on the size of each RRB, level of business and organisational structure. To ensure commitment of the Top Management and timely response to market dynamics, the CEO or the Secretary should head the Committee. The Chiefs of Investment/ Treasury including forex, Credit, Planning, etc can be members of the Committee. In addition, the Head of the Information Technology Division, if a separate division exists should also be an invitee for building up of Management Information System (MIS) and related IT network. RRBs may at their discretion even have Sub-committees and Support Groups.

5. ALM Process:

The scope of ALM function can be described as follows:

- Liquidity risk management
- Interest rate risk management
- Trading (Price) risk management
- Funding and capital planning
- Profit planning and business projection

The guidelines given in this note mainly address Liquidity and Interest Rate risks, as most RRBs are not exposed to forex risk.

6. Liquidity Risk Management

6.1 Measuring and managing liquidity needs are vital for effective operation of RRBs. By assuring a RRB's ability to meet its liabilities as they become due, liquidity management can reduce the probability of an adverse situation developing. The importance of liquidity problem of a RRB need not necessarily confine to itself but its impact may be felt on other RRBs/banks as well. RRBs should measure not only the liquidity positions on an ongoing basis but also examine how liquidity requirements are likely to evolve under different assumptions/scenarios. Liquidity measurement is quite a difficult task and can be measured through stock or cash flow approaches. The stock approach uses certain liquidity ratios viz credit deposit ratio, loans to total assets, loans to core deposits, etc. While the liquidity ratios are the ideal indicators of liquidity of banks operating in developed financial markets, the ratios do not reveal the real liquidity profile of Indian banks including RRBs, which are operating generally in an illiquid market. Experience shows that assets commonly considered as liquid like Government securities, other money market instruments, etc. have limited liquidity when the market and players move in one direction. Thus, analysis of liquidity involves tracking of cash flow mismatches (flow approach). The maturity ladder is generally used as a standard tool for measuring the liquidity profile under the flow approach, at selected maturity bands. The format of the Statement of Structural Liquidity under static scenario without reckoning future business growth is given in Annexure I.

6.2 The Maturity Profile as given in Appendix I could be used for measuring the future cash flows of RRBs in different time bands. The time bands, given the Statutory Reserve cycle of 14 days may be distributed as under:

- 1 to 14 days
- 15 to 28 days
- 29 days and upto 3 months
- Over 3 months and upto 6 months
- Over 6 months and upto 1 year
- Over 1 year and upto 3 years
- Over 3 years and upto 5 years

- Over 5 years

6.3 The investments in SLR securities and other investments are generally assumed as illiquid due to lack of depth in the secondary market and are therefore required to be shown under respective residual maturity bands, corresponding to the residual maturity. However, some of the RRBs may be maintaining few securities in the *trading book*, which are kept distinct from other investments made for complying with the Statutory Reserve requirements and for retaining relationship with customers. Securities held in the *trading book* are subject to certain preconditions such as :

- The composition and volume are clearly defined;
- Maximum maturity/duration of the portfolio is restricted;
- The holding period not exceeding 90 days;
- Cut-loss limit prescribed; (The level upto which loss could be ascribed by liquidating an asset. Illustrating , if a security bought at Rs. 100 is quoted in the market on a given day at Rs. 98 and the board of management fixed the maximum loss which may be incurred on this particular transaction at not more than Rs.2.00, the cut loss limit is placed at Rs.2.00 for this particular security. The cut loss limit varies from security to security based on bank's loss / risk bearing capacity).
- Defeasance period (product-wise) i.e. time taken to liquidate the position on the basis of liquidity in the secondary market is prescribed. The defeasance period is dynamic and in volatile environments, such period also undergo changes on account of product-specific or general market conditions;
- Marking to market on a weekly basis and the revaluation gain/loss absorbed in the profit and loss account; etc.

RRBs which maintain such *trading books* and comply with the above requirements are permitted to show the trading securities under 1-14 days, 15-28 days and 29-90 days time bands on the basis of the defeasance periods. The ALCO of the RRBs should approve the volume, composition, holding/defeasance period, cut loss, etc. of the *trading book*.

6.4 Within each time band, there could be mismatches depending on cash inflows and outflows. While the mismatches up to one year would be relevant since these provide early warning signals of impending liquidity problems, the main focus should be on the short-term mismatches viz., 1-14 and 15-28 days time bands. RRBs, however, are expected to monitor their cumulative mismatches (running total) across all time bands by establishing internal prudential limits with the approval of the Board. The mismatches (negative gap between cash inflows and outflows) during 1-14 and 15-28 days time bands in normal course should not exceed 20% of the cash outflows in each time band. If a RRB in view of its current asset-liability profile and the consequential mismatches needs higher tolerance level, it could operate with higher limit sanctioned by the RBI for a limited period.

6.5 The Statement of Structural Liquidity (Annexure I) may be prepared by placing all cash inflows and outflows in the maturity ladder according to the expected timing of cash flows. A maturing liability will be a cash outflow while a maturing asset will be a cash inflow. It would also be necessary for RRBs with AD licenses to take into account the rupee inflows and outflows on account of their forex operations. While determining the probable cash inflows / outflows, RRBs have to make a number of assumptions according to their asset - liability profiles. While determining the tolerance levels, the RRBs may take into account all relevant factors based on their asset-liability base, nature of business, future strategy, etc.

6.6 In order to enable the banks to monitor their short-term liquidity on a dynamic basis over a time horizon spanning from 1-90 days, RRBs may estimate their short-term liquidity profiles on the basis of business projections and other commitments for planning purposes. An indicative format (Annexure III) for estimating Short-term Dynamic Liquidity is enclosed.

7. Currency Risk

7.1 Floating exchange rate arrangement has brought in its wake pronounced volatility adding a new dimension to the risk profile of banks' balance sheets. The increased capital flows across free economies following deregulation have contributed to increase in the volume of transactions. Large cross border flows together with the volatility has rendered the banks' balance sheets vulnerable to exchange rate movements. Although RRBs predominantly confined to domestic operations, in view of few RRBs being ADs in foreign exchange, it is necessary to address forex risk also.

7.2 Managing currency risk is one more dimension of ALM. Mismatched currency position besides exposing the balance sheet to movements in exchange rate also exposes it to country risk and settlement risk. Ever since the RBI (Exchange Control Department) introduced the concept of end of the day near square position in 1978, ADs have been setting up overnight limits and selectively undertaking active day time trading. Following the introduction of "Guidelines for Internal Control over Foreign Exchange Business" in 1981, maturity mismatches (gaps) are also subject to control. Following the recommendations of Expert Group on Foreign Exchange Markets in India (Sodhani Committee), the calculation of exchange position has been redefined and banks have been given the discretion to set up overnight limits linked to maintenance of capital to Risk-Weighted Assets Ratio of 9% of open position limit.

7.3 Presently, the ADs are also free to set gap limits with RBI's approval but are required to adopt Value at Risk (VaR) approach to measure the risk associated with forward exposures. Thus, the open position limits together with the gap limits form the risk management approach to forex operations. For monitoring such risks banks should follow the instructions contained in Circular A.D (M. A. Series) No.52 dated December 27, 1997 issued by the Exchange Control Department.

8. Interest Rate Risk (IRR)

8.1 The phased deregulation of interest rates and the operational flexibility given to banks in pricing most of the assets and liabilities imply the need for the banking system to hedge the Interest Rate Risk. Interest rate risk is the risk where changes in market interest rates might adversely affect a bank's financial condition. The changes in interest rates affect banks in a larger way. The immediate impact of changes in interest rates is on bank's profits by changing its spread [Net Interest Income (NII)] . A long-term impact of changing interest rates is on bank's Market Value of Equity

(MVE) or Net Worth as the marked to market value of bank's assets, liabilities and off-balance sheet positions get affected due to variation in market rates. The interest rate risk when viewed from these two perspectives is known as 'earnings perspective' and 'economic value' perspective, respectively. The risk from the earnings perspective can be measured as changes in the NII or Net Interest Margin (NIM). There are many analytical tools for measurement and management of Interest Rate Risk. In the context of poor MIS, slow pace of computerisation and the absence of total deregulation, the traditional `Gap Analysis' is considered as a suitable method to measure the Interest Rate Risk in the first place.

8.2 The Gap or Mismatch risk can be measured by calculating Gaps over different time intervals as at a given date. Gap analysis measures mismatches between rate sensitive liabilities and rate sensitive assets (including off-balance sheet positions). An asset or liability is normally classified as rate sensitive if:

- within the time interval under consideration, there is a cash flow ; for instance, repayment of instalments of term loans etc.

- the interest rate resets/reprices contractually during the interval. For instance, charges made in the interest on CC accounts, term loan accounts before maturity.

- RBI changes the interest rates (i.e. interest rates on Savings Bank Deposits, Minimum Lending Rate(MLR), DRI advances, Refinance, CRR balance, etc.) in cases where interest rates are administered; and

8.3. The Gap Report should be generated by grouping rate sensitive liabilities, assets and off-balance sheet positions into time bands according to residual maturity or next repricing period, whichever is earlier. The difficult task in Gap analysis is determining rate sensitivity. All investments, advances, deposits, borrowings, etc. that mature/reprice within a specified timeframe are interest rate sensitive. Similarly, any repayment of loan instalment is also rate sensitive if the bank expects to receive it within the time horizon. This includes final principal payment and periodical instalments. Certain assets and liabilities receive/pay rates that vary with a reference rate. These assets and liabilities are repriced at pre-determined intervals and are rate sensitive at the time of repricing. While the interest rates on term deposits are fixed during their currency, the advance portfolio of the banking system is basically floating. The interest rates on advances could be repriced any number of occasions.

The Gaps may be identified in the following time bands:

- Upto 3 months
- Over 3 months and upto 6 months
- Over 6 months and upto 1 year
- Over 1 year and upto 3 years
- Over 3 years and upto 5 years
- Over 5 years
- Non-sensitive

The various items of rate sensitive assets and liabilities and off-balance sheet items may be classified as explained in Appendix - II and the Reporting Format for interest rate sensitive assets and liabilities is given in Annexure II.

8.4 The Gap is the difference between Rate Sensitive Assets (RSA) and Rate Sensitive Liabilities (RSL) for each time band. The positive Gap indicates that it has more RSAs than RSLs whereas the negative Gap indicates that it has more RSLs. The Gap reports indicate whether the institution is in a position to benefit from rising interest rates by having a positive Gap (RSA > RSL) or whether it is in a position to benefit from declining interest rates by a negative Gap (RSL > RSA). The Gap can, therefore, be used as a measure of interest rate sensitivity.

8.5 Each bank should set prudential limits on individual Gaps with the approval of the Board. The prudential limits should have a bearing on the Total Assets, Earning Assets or Equity. The banks may also work out Earnings at Risk (EaR) i.e. 20–30% of the last years NII or Net Interest Margin (NIM) based on their views on interest rate movements.

8.6 When the RRBs gain sufficient experience in operating ALM system, RBI may introduce capital adequacy for market risk in due course.

9. Behavioural Patterns

9.1 The classification of various components of assets and liabilities into different time bands for preparation of Gap reports (Liquidity and Interest Rate Sensitivity) as indicated in Appendices I & II is the benchmark. Banks which are better equipped to reasonably estimate the behavioural pattern of various components of assets and liabilities on the basis of past data / empirical studies could classify them in the appropriate time bands, subject to approval from the ALCO.

APPENDIX – I

Maturity Profile – Liquidity

Heads of Acc24	Classification into time bands
A. Outflows	
1. Capital, Reserves and Surplus	Over 5 years band.
2. Demand Deposits (Current and Savings Bank Deposits)	Savings Bank and Current Deposits may be classified into volatile and core portions. Savings Bank (10%) and Current (15%) Deposits are generally withdrawable on demand. This portion may be treated as volatile. While volatile portion can be placed in the first time band i.e., 1-14 days, the core portion may be placed in over 1- 3 years time band. The above classification of Savings Bank and Current Deposits is only a benchmark. Banks which are better equipped to estimate the behavioural pattern on renewals, premature closures, etc. on the basis of past data/empirical studies could classify them in the appropriate time bands, i.e. behavioural maturity instead of contractual maturity, subject to the approval of the Board/ALCO.
3. Term Deposits	Respective residual (remaining period to maturity) time bands. Banks which are better equipped to estimate the behavioural pattern on renewals, premature closures, etc. on the basis of past data/empirical studies could classify the retail deposits in the appropriate time bands on the basis of behavioural maturity rather than residual maturity. However, the wholesale deposits (deposits over Rs 15 lakh and inter-bank deposits) should be shown under respective residual time bands.
4. Certificates of Deposit, Borrowings and Bonds (including Sub-ordinated Debt)	Respective residual time bands.
5. Other Liabilities and Provisions	
i) Bills Payable	1-14 days time band.
ii) Branch Adjustments	The net credit balance may be shown in 1-14 days time band.
iii) Provisions other than for loan loss and depreciation in investments.	Respective time bands depending on the purpose.
iv) Other Liabilities	Respective time bands. Items not representing cash payables (i.e. guarantee fee received in advance, etc.) may be placed in over 5 years time bands.

B. Inflows

1. Cash	1-14 days time bands.
2. Balances with RBI/Public Sector Banks for CRR/ SLR purpose	While the excess balance over the required CRR/SLR may be shown under 1-14 days time bands, the Statutory Balances may be distributed amongst various time bands corresponding to the maturity profile of DTL with a time-lag of 28 days.
3. Balances with other Banks (i) Current Account (ii) Money at Call and Short Notice, Term Deposits and other placements	(i) Non-withdrawable portion on account of stipulations of minimum balances may be shown under over 1-3 years time band and the remaining balances may be shown under 1-14 days time band. (ii) Respective residual maturity time bands.
4. Investments (Net of provisions)	
(i) Approved securities	(i) Respective residual maturity time bands excluding the amount required to be reinvested to maintain SLR corresponding to the DTL profile in various time bands.
(ii) PSU bonds, CDs and CPs, Units of UTI (close ended), etc.	(ii) Respective residual time bands. Investments classified as NPAs should be shown under over 3-5 years time bands (sub-standard) or over 5 years time band (doubtful).
(iii) Equity of All India FIs, Units of UTI (open ended)	(iii) Over 5 years time bands.
(iv) Securities in the Trading Book<	(iv) 1-14, 15-28 and 29-90 time bands corresponding to defeasance periods.
5. Advances (Performing)	
(i) Bills Purchased and Discounted (including bills under DUPN)	(i) Respective residual maturity time bands.
(ii) Cash Credit / Overdraft (including TOD) and Demand Loan component of Working Capital.	(ii) Banks should undertake a study of behavioural and seasonal pattern of availments based on outstanding and the core and volatile portion should be identified. While the volatile portion could be shown in the near-term maturity time bands, the core portion may be shown under over 1-3 year time band.
(iii) Term Loans	(iii) Interim cash flows(instalments) should be shown under respective maturity time bands.
6. NPAs (Net of provisions, Overdue Interest Reserves and claims received from ECGC/DICGC)	
(i) Sub-standard	(i) Over 3-5 years time band.
(ii) Doubtful and Loss	(ii) Over 5 years time band.
7. Fixed Assets	Over 5 years time bands.
8. Other Assets (i) Branch Adjustments	The net debit balance may be shown in 1-14 days time band. Intangible assets and assets not representing cash receivables may be shown in over 5 years time band.
C. Contingent Liabilities / Lines of Credit committed / available and other Inflows / Outflows	
(i) Unavailed portion	(i) Banks should undertake a study of the behavioural and seasonal

of Cash Credit/ Overdraft / Demand loan component of Working Capital limits (outflow)	pattern of potential availments in the accounts and the amounts so arrived at may be shown under relevant residual maturity time bands within 12 months. ii) 1-14 days time band.
Letters of Credit/ Guarantees devolvement (outflow)	Based on past history, these should be distributed across time bands.
Repos / Bills Rediscounted (DUPN) (outflow / inflow)	Respective residual maturity time bands.
Interest payable / receivable (outflow / inflow) – Accrued interest which are appearing in the books on the reporting day	Respective time bands.

Note :

Liability on account of event cash flows i.e. short fall in CRR/SLR balance on reporting Fridays, wage settlement, capital expenditure, etc. which are known to the banks and any other contingency may be shown under respective maturity bands.
All overdue liabilities should be placed in the 1-14 days time band.
Interest and instalments from advances and investments, which are overdue for less than one month may be placed in over 3-6 months, time band. Further, interest and instalments due (before classification as NPAs) may be placed in over 6-12 months time band if the earlier receivables remain uncollected.
D. Financing of Gap :

In case the negative gap exceeds the prudential limit of 20% of outflows, (1-14 and 15-28 days time bands) the bank may show by way of a foot note as to how it proposes to finance the gap to bring the mismatch within the prescribed limits. The gap can be financed from market borrowings (call / term), Bills Rediscounting, Repos and deployment of foreign currency resources after conversion into rupees (unswapped foreign currency funds), etc.

APPENDIX - II

Interest Rate Sensitivity

Heads of Accounts	Rate sensitivity and time band
Liabilities	
1. Capital, Reserves and Surplus	Non-sensitive.
2. Current Deposits	Non-sensitive.
3. Savings Bank Deposits	Sensitive to the extent of interest paying (core) portion. This should be included in over 3-6 months time band. The non-interest-paying portion may be shown in non-sensitive band.
4. Term Deposits and Certificates of Deposit	Sensitive; reprices or resetting of interest rates on maturity. The amounts should be distributed to different time bands on the basis of remaining term to maturity.
5. Borrowings – Fixed	Sensitive; reprices on maturity. The amounts should be distributed to different time bands on the basis of remaining maturity.
6. Borrowings – Floating	Sensitive; reprices when interest rate is reset. The amounts should be distributed to the appropriate time band that refers to the resetting date.
7. Borrowings – Zero Coupon	Sensitive; reprices on maturity. The amounts should be distributed to the respective maturity time band.
8. Borrowings from RBI	Upto 3 months time band.
9. Refinances from other Agencies.	Fixed rate : As per respective Maturity. Floating rate : Reprices when Interest rate is Reset.
10. Other Liabilities and Provisions i) Bills Payable ii) Branch Adjustments iii) Provisions iv) Others	i) Non-sensitive. ii) Non-sensitive. iii) Non-sensitive. iv) Non-sensitive.
11. Repos / Bills Re-discounted (DUPN),	Sensitive reprices only on maturity and should be distributed to the respective maturity bands.
Assets	
1. Cash	Non – sensitive.
2. Balances with RBI	Interest earning portion may be shown in over 3 – 6 months time band. The balance amount is non-sensitive.
3. Balances with other Banks	
i) Current Account	i) Non-sensitive.
ii) Money at Call and Short Notice, Term	ii) Sensitive on maturity. The amounts should be distributed to the respective

Deposits and other placements		maturity bands.
4. Investments (Performing).		
i) Fixed Rate / Zero Coupon		i) Sensitive on maturity.
ii) Floating Rate		ii) Sensitive at the next repricing date
5. Shares of All India FIs/Units of UTI		Non-sensitive.
6. Advances (Performing)		
Bills Purchased and Discounted (including bills Under DUPN)		(i) Sensitive on maturity.
Cash Credits / Overdrafts (including TODs) / Loans repayable on demand and Term Loans		(ii) Sensitive; may be shown under over 3-6 months time band.
7. NPAs (Advances and Investments) *		
(i) Sub-Standard		(i) Over 3-5 years time band.
(ii) Doubtful and Loss		(ii) Over 5 years time band.
8. Fixed Assets		Non-sensitive.
9. Other Assets. Inter-office Adjustment Others		 Non-sensitive. Non-sensitive.
10. Other products (Interest Rate)		
(i) Other		(ii) Should be suitably classified as and when introduced.

Amounts to be shown net of provisions, Overdue Interest Reserve and claims received from ECGC / DICGC.

ANNEXURE - I

Name of the bank :

Statement of Structural Liquidity as on :

(Amounts in lakh of Rupees)

OUTFLOWS\INFLOWS	RESIDUAL MATURITY							
	1 to 14 days	15 to 28 days	29 days and upto 3 months	Over 3 months and upto 6 months	Over 6 Months and upto 1 year	Over 1 year and upto 3 years	Over 3 years and upto 5 years	Over 5 years	Total
1. Capital									
2. Reserves & Surplus									
3. Deposits	XXX	XXX	XXX	XXX	XXX	XXX	XXX	XXX	XXX
(i) Current Deposits									
(ii) Savings Bank									
(iii) Term Deposits									
(iv) Certificates of Deposit									
4. Borrowings	XXX	XXX	XXX	XXX	XXX	XXX	XXX	XXX	XXX
(i) Call and Short Notice									
(ii) Inter-Bank (Term)									
(iii) Refinances									
(iv) Others (specify)									
5. Other Liabilities & Provisions	XXX	XXX	XXX	XXX	XXX	XXX	XXX	XXX	XXX
(i) Bills Payable									
(ii) Branch Adjustments									
(iii) Provisions									
(iv)Others									
6. Unavailed portion of Cash Credit / Overdraft / Demand Loan component of Working Capital									
7. Letters of Credit / Guarantees									
8. Bills Rediscounted (DUPN)									
9. Interest payable									
10. Others (specify)									
A. TOTAL OUTFLOWS INFLOWS									
1. Cash									
2. Balances with RBI									
3. Balances with other Banks									
(i) Current Account									
(ii) Money at Call and Short Notice, Term Deposits and other placements and balances with other banks									
4. Investments (									
5. Advances (Performing)									
(i) Bills Purchased and Discounted (including bills									

OUTFLOWS\INFLOWS	RESIDUAL MATURITY								
	1 to 14 days	15 to 28 days	29 days and upto 3 months	Over 3 months and upto 6 months	Over 6 Months and upto 1 year	Over 1 year and upto 3 years	Over 3 years and upto 5 years	Over 5 years	Total
under DUPN)									
(ii) Cash Credits, Overdrafts and Loans repayable on demand									
(iii)Term Loans									
6. NPAs (Advances and Investments) *									
7. Fixed Assets									
8. Other Assets									
(i)Branch Adjustments									
(ii) Others									
10. Bills Rediscounted (DUPN)									
11. Interest receivable									
12. Others (specify)									
B. TOTAL INFLOWS									
C. MISMATCH (B-A)									
D. CUMULATIVE MISMATCH									
E. C as % To A									

* Net of provisions, interest suspense and claims received from ECGC/DICGC.

ANNEXURE - II

Name of the bank :

Statement of Interest Rate Sensitivity as on :

(Amounts in lakh of Rupees)

	INTEREST RATE SENSITIVITY							
LIABILITIES\ASSETS	Upto 3 months	Over 3 months and upto 6 months	Over 6 months and upto 1 year	Over 1 year and upto 3 years	Over 3 years and upto 5 years	Over 5 years	Non-sensi-tive	Total
LIABILITIES								
1. Capital								
2. Reserves & Surplus								
3. Deposits	XXX	XXX	XXX	XXX	XXX	XXX	XXX	XXX
(i) Current Deposits								
(ii)Savings Bank Deposits								
(iii) Term Deposits								
(iv) Certificates of Deposit								
4.Borrowings	XXX	XXX	XXX	XXX	XXX	XXX	XXX	XXX
(i) Call and Short Notice								
(ii) Inter-Bank (Term)								
(iii) Refinances								
(iv) Others (specify)								
5. Other Liabilities & Provisions	XXX	XXX	XXX	XXX	XXX	XXX	XXX	XXX
(i) Bills Payable								
(ii) Branch Adjustments								
(iii) Provisions *								
(iv) Others								
7. Bills Rediscounted (DUPN)								
8. Others (specify)								
A.TOTAL LIABILITIES								
* Excluding provisions for NPAs and investments								
ASSETS								
1. Cash								
2. Balances with RBI								
3. Balances with other Banks	XXX	XXX	XXX	XXX	XXX			
(i) Current Account								
(ii) Money at Call and Short Notice, Term Deposits and other placements and balances with other banks								
4. Investments								
5. Advances (Performing)	XXX	XXX	XXX	XXX	XXX	XXX	XXX	XXX
(i) Bills Purchased and Discounted (including bills under DUPN)								
(ii) Cash Credits, Overdrafts and Loans repayable on demand								

(iii) Term Loans								
6. NPAs (Advances and Investments) *								
7. Fixed Assets								
8. Other Assets	XXX	XXX	XXX	XXX	XXX	XXX	XXX	XXX
(i) Branch Adjustments								
(ii) Others								
10. Bills Rediscounted (DUPN)								
11. Others (specify)								
B. TOTAL ASSETS								
C. GAP (B-A)								
OTHER PRODUCTS (INTEREST RATE) **	XXX	XXX	XXX	XXX	XXX	XXX	XXX	
(i) FRAs								
(ii) Swaps								
(iii) Futures								
(iv) Options								
(v) Others								
D. TOTAL OTHER PRODUCTS								
E.NET GAP (C-D)								
F. CUMULATIVE GAP								
G. E AS % TO B								

* Amounts to be shown net of provisions, interest suspense and claims received from ECGC/DICGC.

** As and when RRBs are permitted to transact in these products.

ANNEXURE - III

Name of the Bank :

Statement of Short-term Dynamic Liquidity as on ……………..

(Amounts in lakh of Rupees)

A. Outflows				
	PARTICULARS	1- 14 days	15-28 days	29-90 days
1	Net increase in loans and advances			
2	Net increase in investments: Approved securities Money market instruments (other than Treasury bills) Bonds/Debentures /shares Others			
3	Inter-bank commitments			
4	Off-balance sheet items (bills discounted, etc.)			
5	Others			
	TOTAL OUTFLOWS			
	B. Inflows			
1	Net cash position			
2	Net increase in deposits (less CRR obligations)			
3	Interest on investments			
4	Inter-bank claims			
5	Off-balance sheet items			
6	Others			
	TOTAL INFLOWS			
	C. Mismatch (B - A)			
	D. Cumulative mismatch			
	E. C as a % to total outflows			

ANNEXURE 3.2

List of Primary Dealers and Mutual Funds

Illustrative List of Primary Dealers (PDs) and AMCs of Mutual Funds from whom expression of interest can be called. The Panel may be selected by a committee comprising officers from Ministry of Finance, GoI, RBI, NABARD and Sponsor Banks with active Treasuries like SBI, PNB, Syndicate Bank, Canara Bank etc.

PDs

1. ICICI Securities
2. IDBI Caps
3. SBI - DFHI
4. PNB Gilts
5. STCI
6. GSTC

AMC of Mutual Funds with total AUM more than Rs. 10,000 cr

Mutual Fund Name	AUM (Rs. in cr)
UTI Mutual Fund	34,755
Prudential ICICI Mutual Fund	30,210
Reliance Mutual Fund	28,648
HDFC Mutual Fund	25,638
Franklin Templeton M F	23,060
SBI Mutual Fund	15,101
Birla Sun Life Mutual Fund	14,615
Tata Mutual Fund	12,500
Standard Chartered Mutual Fund	11,764
DSP Merrill Lynch Mutual Fund	11,467
Kotak Mahindra Mutual Fund	10,950
Principal Mutual Fund	10,556
LIC Mutual Fund	10,277

ANNEXURE 4.1

Suggested Financial Services for rural clientele

4.1. Access to credit and other financial services such as savings and insurance products is increasingly considered as an important factor contributing to enhance welfare of the target clientele and their income growth.

4.2. Rural Banks on amalgamation have become bigger business entities and even those, which are yet to be amalgamated, have to strive to become big to withstand the competition. If the RBs have to make profit on a sustainable basis, they have to tread a new path with regard to their business portfolio. Some of the facts verifiable through published data indicate the RRBs / RBs are doing business at just 1/5th of their commercial bank peers. While their branch network & service area villages are almost equal to their counterparts.

4.3. Since the business portfolio needs an immediate push, these RFIs need to look at the gaps existing with regard to garnering the clients, coverage of the eligible adult population in their service area by opening at least one account.

4.4 (a) Every RRB has products to suit the customer's requirement. The RRBs are originally mandated for providing loans and advances to the weaker sections of the community. Presently their exposure is nominal in the high value loans. They have not ventured into financing high value loans, SMES etc.

(b). RRBs may be permitted to take up issuance of Bank guarantee, extending financial assistance to the trade and services sector, extending financial assistance for housing, village infrastructure, participation in the consortium advances etc.

(c) The restrictions for financing only target groups may have to be removed. This requires amendment to Section-18 of chapter –IV of the RRB Act 1976. The RRBs may have to keep exposure norms for the various kinds of activities. It is recommended that 60% of the RRB advances may be channalised to the priority sectors and at least 40% of aggregate credit shall go for the agricultural purposes. 40% of the advances in the RRBs can go to non-priority sector including commercial lending. The RRBs may be advised to increase the CD ratio to 80% by 2008. While there is no need to fix the exposure limit for Agricultural and SSI, exposure limit for trade, infrastructure etc. may have to be fixed. Lot of emphasis may have to be given for providing financial assistance for education of the individual and for setting up of Educational institutions in the rural areas.

4.5 It is disturbing to see that in majority of the states whose population aggregates more than 60% of the nation's population, the coverage of adult population is less than the National average of 59% as evidenced below:

State/ Union Territory	Current Accounts	Savings Accounts	Total Population	Adult Population (Above 19 years)	Total No. Of accounts	Acc/100 population
Rajasthan	689657	12139302	56473122	28473743	12828959	45
Arunachal Pradesh	10538	209073	1091117	544582	219611	40
Assam	378729	5071058	26638407	14074393	5449787	39
Manipur	12514	200593	2388634	1222107	213107	17
Meghalaya	24305	458779	2306069	1088165	483084	44
Mizoram	3441	117885	891058	476205	121326	25
Nagaland	13819	195452	1988636	995523	209271	21
Tripura	33257	638241	3191168	1784212	671498	38
Bihar	464511	13225242	82878796	40934170	13689753	33
Jharkhand	166007	5834341	26909428	13737485	6000348	44
Orissa	228160	7030004	36706920	21065404	7258164	34
Sikkim	4097	125365	540493	288500	129462	45
West Bengal	942733	21544753	80221171	45896914	22487486	49
Chhattisgarh	192067	3346898	20795956	11209425	3538965	32
Madhya Pradesh	553381	11731918	60385118	31404990	12285299	39
Uttar Pradesh	1324509	45804350	166052859	82229748	47128859	57
Andhra Pradesh	1156405	23974580	75727541	44231918	25130985	57
ALL INDIA	16552856	304349534	1027015247	541031553	320902390	59

Irony is the existence of very large number of RRBs / RBs branches in these states amounting to approximately 70% of the total RRB branches as detailed below:

Assam	2	27	397
Manipur	1	9	29
Meghalaya	1	4	51
Mizoram	1	8	54
Nagaland	1	5	8
Tripura	1	4	87
Bihar	5	38	1475
Jharkhand	6	21	387
Orissa	8	30	836
Sikkim	0	0	0
West Bengal	9	20	876
Chhattisgarh	5	17	429
Madhya Pradesh	19	47	1034
Uttar Pradesh	20	71	2852
Andhra Pradesh	8	23	1170
Total	96	364	10716
Total excluding North Eastern states	88	301	10073

This has brought out the fact that if these RFIs have to make progress, they should in the immediate future raise their coverage beyond national average and should go all out to reach 100% coverage levels.

4.6 Ensuring coverage of all eligible would improve the Deposit portfolio of the RRBs / RBs since their share is languishing at 7% for more than two decades. Intensive efforts could therefore, be initiated in 301 districts of the country, covering nearly 80,000 -100,000 villages (coverage reckoned @ 8-10 villages per branch). Even if 100 families or 200 adults per village are brought into the banking stream, they may add 80 - 100 lakh new accounts and 160 to 200 lakh new customers. This is equivalent to a new business of around Rs. 10,000 crore at the initial levels of operation.

4.7 ADVANCES PORTFOLIO

With regard to advances portfolio, majority of the RRBs/ RBs have a skewed portfolio tilted towards low earning activities (though they pertain to the mandate) and also easy businesses which can be done without any effort like loans for retail trade, small business, housing repairs, salary earners (especially State Govt. employees). If substantial part of the advances portfolio pertains to agriculture, approximately 90% of the same is in the crop loan category earning 7%. Despite the directives, even while doubling the credit during the past 2 years, the diversification portfolio remained at a meager 16% as evidenced below:

AGENCY	2005-06 (Amount Rs Crores)		
	Crop loan	Term loan	Total
Com Bks	93309 (88%)	12842 (12%)	1,06,151
Coops	32697 (88%)	4554 (12%)	37,252
RRBs	11768 (84%)	2308 (16%)	14,076
TOTAL			1,57,479

4.8 FACTORS AFFECTING THE PORTFOLIO

While studying the characteristics that differentiate Good & Bad RRBs, it was observed by BIRD that Good RRBs who had a very strong advances portfolio have adopted some good practices like:

1) Surveying the operational area for potential
2) Going through NABARD' PLPs and identifying various feasible activities
3) Looking into backward & forward linkages of various activities to decide on the financial feasibility and bankability
4) Preparing a perspective budget for the ensuring year and allocating the same branch-wise, sector –wise
5) Making a difference even in Generic products like KCC & SHG financing by putting some frills or some more attractive features

Besides the above, the Good performing RRBs have also attempted Market and Client segmentation to make a differentiation in the product offered. These practices had endeared even high net worth clients to the RRB and the ability to borrow higher amounts for diversified activities had enabled the banks to get higher yields on advances and resultant higher spread/ financial margin.

Diversifying the portfolio and also improving its quality has a direct correlation with HR practices since the Good performing RRBs have

- Participatory approach while deciding on the product, designing the features and launching it

- Since the product evolved out of consensus, staff could do the Credit Marketing with conviction
- Delegation of sanctioning powers had given further fillip to their beefing up a qualitative portfolio

RBs / RRBs have to fight for a space since the Commercial Banks which were in existence for quite sometime had loyal clientele as they were there in SPECTRUM – SCARCE AGE when it was much easier to make a lasting impression on consumers mind. But the RBs / RRBs which were neither existing nor had any impact in the initial years have to CO-CREATE BRANDS / PRODUCTS by collaborating with their customers if they have to survive in the current economic context. In view of this they may need to look into every conceivable opportunity to become a one-stop-all entity. The areas, which they can look for business, some of them might not have been touched hitherto, are: -

4.9 CROP LOANS

KCC has become a major instrument for delivering the crop loans. However, RBs/ RRBs may take care that their crop loan portfolio did not have an excessive slant towards Fine Cereals since they are not only losing their sheen as default proof advances due to progressive dismantling of MSP and also the recent non-hesitancy on the part of Government in importing food grains mainly to keep the consumer happy. In that event, with the stagnant productivity in those crops, the excessive loaning given may prove to be futile and the advances may turn NPAs. This situation coupled with the environmental disaster gaining momentum due to overdraft of ground water for cultivation of paddy & sugar cane (water guzzlers) may jeopardize the long-term interest of the RFIs if Crop Loan portfolio is again skewed towards one or two crops.

In view of this, RBs may encourage financing the crops whose Water Use Efficiency is high and at the same time have marketability.

In order to get returns on sustainable basis, the RRBs may look into the following activities also.

HORTICULTURE

POMOLOGY

1) Fruit orchards
2) Grape gardens
3) Straw berry fields
4) Citrus fruits in non- traditional areas
5) High Density Mango

OLERICULTURE

1) Regular vegetables
2) Hybrid varieties
3) Exotic vegetables
4) Export oriented vegetables
5) Green house for productivity & quality
6) Mushroom – industrial scale

FLORICULTURE

1) Traditional culture
2) Shade net / Poly house for domestic consumption
3) Green house & State –of –the – art Technology for export

AGRO & FARM FORESTRY

1. Poplar
2. Eucalyptus
3. Bamboo
4. Jatropha
5. Acacias
6. Bixa
7. Medicinal & Aromatic plants

FISHERIES

Inland

1) Fresh water fisheries
2) Fresh water Prawns
3) Fresh water Pearl culture

Brackish & Marine

4) Brackish water – extensive
5) Brackish water – intensive
6) Trawlers, Bay liners & Purse seines

ANIMAL HUSBANDRY

1) Dairy Farms
2) Sheep Farms
3) Horse Breeding farms
4) Poultry Farms – Integrated
5) Exotic birds – Emu & Ostrich

OTHER SCHEMES

1) Lift Irrigation Schemes
2) Sugar mill financing - Cogeneration, Ethanol refineries
3) Cold storages & Reefer Containers
4) Rural Godowns
5) Agri Marketing Infrastructure schemes
6) Watershed development
7) Rural Infrastructure
8) AEZ & Contract farming

PROCESSING INDUSTRY

1) Cereal milling & Marketing
2) Fruit & Vegetable processing
3) Fresh fruits & vegetables export
4) Cold chain & CA containers
5) Fish processing
6) Dairy Milk route, Bulk coolers, Chilling plants, Processing & Exporting Units
7) Poultry meat processing units
8) Egg powder units
9) Ready to eat snacks/ wafers

OTHER INDUSTRIES

1) Paper & Rayon industries
2) Ply wood
3) Biomass based power
4) Eco friendly industries
    a) Neem based
    b) Microorganism based (*Trichoderma viridi)*
    c) TBOs
5) Seed Industry

Other Innovative areas

1. SHGs for outreach
2. Micro enterprises
3. MLFV
4. JLG
5. ITES related

To develop a qualitative portfolio, the banks may also think of offering some innovative products like:

4.10 **Rural credit cum debit card**:

While it may take a few weeks to months for the bank to come out with a new product or refinements and revisions in the existing products (based on customer needs) on account of various stages involved in new product development or product refinement; the bank will be able to offer immediately two products to the client. While one of them could be a *no frill savings bank account* (to meet the thrift needs of a client), the other could be a *General Credit card* (to meet his emerging credit needs) or the bank could club both these products in to a single instrument, where the bank could pay interest on credit balances at SB rates and the customer could pay interest on net debit balance. In the initial stages, this could be a pass book to be operated through cheque leaves and withdrawal slips in the branch. With the computerisation of the branch and introduction of PDAs, the bank could graduate this product to a biometrics based smart card This could not only reduce the cost of intermediation, but would also provide unlimited services to the client.

4.11 PORTFOLIO COMPOSITION

In order to have an orderly growth and also withstand the shocks, the RBs / RRBs may have portfolio composition as detailed below:

S.No	ACTIVITY / SECTOR	% of Portfolio	Interest rates
1	Crop Loan Small land holders (<0.5 acre), Tenant Farmers & Agrl. laborers (minimum 20% of total)	40%	7%
2	ATL / AATL	15%	10 -12%
3	RNFS	5%	10 -12%
4	SHGs	5%	10%
5	OPS	5%	10%
6	Rural Credit –cum-Debit card	10%	12%
7	NPS	20%	12%
	TOTAL	100%	

By having a portfolio on the above lines, the RBs / RRBs are meeting their mandated obligations by advancing almost 60% of loans to agriculture & allied and NPS not more than 20%. Further, balancing the portfolio on the above lines would given even higher Financial Yields and thereby increase the profitability.

4.12 NON –CREDIT PORTFOLIO

RRBs may have to seriously look into the non-fund based income generating portfolio like:

1. Demand Drafts on 100% commission basis (Tie up with New Generation Banks)
2. Bank Guarantees
3. As insurance agent
4. As an e-seva entity where all bills can be collected on a commission basis

(iv) RRBs may consider introduction of “Floating Rate Deposits” where in the interest rate on deposit would be linked to a bench mark’ or anchor interest rate. Floating rate deposits are unlike fixed interest rate deposits which are in vogue today. Fixed rate instruments are damaging to depositors if subsequent to making the deposit, the market interest rates rise(depriving the depositor of the benefit of higher interest rate) and to the banker if rates subsequently fall. For tackling such interest rate volatility, floating rate deposits are considered appropriate especially for deposits of long maturity- generally 5 years. In case of RRBs, the appropriate bench mark could be the rate for the relevant products of the most important competitor.

(iii) There is a need to reorient the traditional products and redesigning of existing products. Some of the suggestions in the regard are as under:

? Loan against deposit:

- Introduction of a new product of Over draft limit’ against deposit which will have a cheque book facility. The interest rate on the overdraft amount could be 3-4% higher than the deposit (instead of 2% in case of demand loan). Thus the customers will have flexibility to withdraw and repay as per their convenience. There will be no restriction on withdrawals or any such condition that one has to repay the old out standings first to avail any further withdrawals. For this, the customers will have to pay a nominal interest rate extra (1-2%). Since loan against deposit is a very popular product, this facility will make it much more customer friendly and at the same time a more viable proposition for the bank.
- The above product would be in addition to the existing system of demand loan

? Crop loan

- Treat Primary Agricultural Co-operative Societies (PACS) as the closest competitors in this segment of business and not the commercial banks.
- Introduce cash credit limit for the borrowers who show good repayment behavior. This could be on the lines of `Kisan Credit Card’ being introduced by many commercial banks.
- The above mentioned cash credit limit would be in addition to the existing system of crop loan

? Tractor loan

- This segment is also equally sensitive to non-financial factors like location of branches, time taken for disbursement, etc. Hence the banks need to address these issues.

- This product needs redesigning with regard to margin money requirement, security (informal) deposit mobilization, etc. It is felt that borrowers may be willing to pay extra interest (which would basically be risk cost) for relaxation on some of the requirement

? Consumer durable advance
- Provide over draft limit to employees to the extent of say 75-80% of their salary especially if they deposit salary with the bank
- The interest rate should not be too exorbitant to scare away good customers.

? Staff loan
- Besides the existing subsidized loan schemes for specific items, there is a need for providing liberal and non-subsidised loan to the staff. It is felt that the staff would be too willing to avail loan facility as per the normal procedure and interest rate applicable to consumer advance for general customers.

Similar exercise could be attempted for other products of the banks.

Experience from other Countries

Many countries have tried to provide variety of financial services to their rural clientele. The agricultural and rural sectors ,particularly in developing countries are usually characterized by having a lower, often much lower access to financial services compared to urban population and other economic sectors. Some of the products which have been tried in African countries like are listed as under;

1) Credit Guarantees: The introduction of credit guarantee funds (CG) has been widely advocated by DFIs' management's and ultimate client interest groups to overcome credit rationing and collateral requirement that couldn't be met adequately by such clientele. In particular the use of such guarantees were once considered by many as instrumental in assisting small scale farmers, rural micro enterprises and other who were shut out of the formal credit markets due to the high administration costs required to cover the risk of their small loan demands. Six arguments that are frequently voiced to support the introduction and subsidizing of credit guarantee : re listed below :

- Overcoming collateral constraints
  - Offsetting the "excessive" credit risk in lending to small farmers
  - Addressing information constraints,
  - Compensating for low profit margins
  - Modifying intrinsic characteristics of small businesses and
  - Inducing learning and generating lending's additionally

The performance of many CGs, however, increasingly gave rise to counter-arguments on theoretical and practical grounds, mainly underscoring that the CGs' performance reflects a waste of scarce public resources that could more effectively assist development in many other ways. The counter-arguments against the CGs also highlight the lack of similarity between banks in developed and developing countries when the latter have often preferred "inside lending" related to firms that their owners possess and exploit the CG resources in maintaining the inside lending and bailing - out their subsidiaries and deteriorating loan portfolios. CGs were evaluated as costly to operate and that their related additionality is either doubtful or very costly to maintain (including the economic cost of crowding out of other clients that eventually don't receive credit due to the bias and direction of credit attributed to the CGs).

A pivotal issue in assessing the efficacy of CGs is whether they have an improved way to assess and price risks compared to the banks that benefit from the guarantees. If the answer to that crucial question is negative - which likely reflects the actual situation in many countries - then the verdict is unambiguous, pointing at no sound value added on one hand, and inflated aggregate administrative costs (of the CG and the guaranteed banks combined) on the other, thereby adversely impacting on availability of resources planned to finance (rural) development. In contrast, in the few known cases when the CG has distinctive superior knowledge related to assessment of risks, it could serve in disseminating knowledge to the banks on "how to do banking" - when banking is defined primarily as pooling and managing risks. The latter scenario obviously requires an exit plan when the FIs that benefit from the CGs maturely absorb the relevant know how and become capable of independently assessing credit risk.

Moreover, when the CG has no comparative advantage in assessing risks, there is a risk that banks would engage in opportunistic behavior that could further erode an already shaky financial discipline that leads to poor loan collection performance. Most operating, "development" related CGs price their products in a way that costs are not fully covered and the net worth of the CG is gradually eroded or replenished by the State or the donors. In a world that is increasingly under pressure to cut or to eliminate subsidies, the subsidizing of CG operations is a convenient tool to proceed subsidizing the target clientele because it is more difficult to track and quantify the (economic) subsidies involved in the CG operations and therefore it is also rarely done.

The crucial difficulty in assessing the effectiveness of the CG hinges on whether additionality is actually created. Measurement of additionality is extremely difficult even when only directed credit without CG operations is involved. When directed credit is involved, the generated additionality is not easy to quantify because there is no clear indication how much of the directed, concessionary loans would have been granted without direction and how many of the investments financed by the directed loans would have materialized without such loans. When the CG entered the arena, the additionality namely how much of the investments' value and the related loans would have materialized without the existence of the CG ?

Myers and Nagarajan studied several credit guarantee funds operating in Africa in the last decade and concluded that several CGs were terminated after extending very few guarantees and where CGs remain active, only little impact could be traced. Additionality was hardly noticed and almost no borrowers "graduated" to emerge as non-guaranteed borrowers.

2) Inventory Finance and Warehouse Receipts :

In developed countries inventory credit plays an important role in providing access to credit to agricultural producers and it serves effectively in overcoming credit constraints. Credit extended against commodities stored in bonded warehouses is a mainstay in developed countries where the prerequisites for facilitating such financial transaction (legal, enforcement, skills requirements and the like) are met. In contrast, in many developing countries these unmet prerequisites reflect the rudimentary level of development of the financial sector in general and that of credit inventory sub-systems in particular including transportation and storage facilities.

Appropriate inventory finance contributes not only directly to an increase in access to credit of producers but also indirectly to reduce the instability of inter-seasonal commodity prices.

Warehouse receipts constitute an effective instrument in ensuring loan security and consequently could add to credit enhancement and transforming of poor and low income farming households from non-creditworthy to creditworthy ones.

An Expanded Range of Collateralisable Assets :
Warehouse Receipts and Inventory

Warehouse receipts refer to the practice of depositing a finished good or agricultural product in a warehouse and receiving a receipt certifying deposit of the good. The receipt can then be used as collateral, with the advantage that the collateral has a high commercial value and can be easily liquidated. Three parties are involved in the transaction the farmer, who takes his goods to the warehouse, the warehouse operator, who classifies the goods and determines their value, and the bank or MFI, who issues a loan based on the receipt issued by the warehouse operator.

In order to ensure a successful warehouse receipts program, it is important to ensure that there is discipline and trust in the warehouse, the operations are on a sufficiently large scale, that there is a thorough understanding of annual price cycles that permits proper valuation and pricing of a stored product at any given moment, proper handling of the product and appropriate oversight.

Creditors gain from warehouse receipts by decreasing their risk, by reducing seasonal price variability, and by increasing liquidity. The drawback to warehousing is the cost of working with a establishing a warehouse. Entrepreneurs gain from warehousing by increasing profitability, price transparency, and food stability. The drawbacks for entrepreneurs are the increased tendency towards speculation associated with warehousing, the shortage of small-scale drying or preservation technologies for agricultural products, an unreliable supply or shortage of storage chemicals, and the costs associated with transporting goods to the warehouse

The Different Forms of Financing Inventory:

When the production marketing and financial "chain" includes an FI, a warehouse and a borrower, it is possible that the borrower would be a large farmer, a cooperative, a miller or a trader. Inventory credit may therefore include:

A. Cash crops for export
B. Imported produce
C. Inventory of stock for domestic consumption could involve borrowing against a presentation of warehouse receipt within the framework of a line of credit. At the harvest time the grain are deposited at the warehouse as security for the bank's loan. If the borrower defaults with respect to the loan repayment the bank will foreclose on the grain and sell it to a third party. This is a relatively simple arrangement that requires, however, meeting several conditions that in many developing countries are not easily met. The establishment of inventory finance requires, a profound understanding of the legal and enforcement framework, based on which reforming the legal system can take place so as to insure that the interests of the parties involved are well considered.

Commodity Price Risk Management provides tools that focus on insuring against downsized price risk by providing a minimum price for agricultural commodities to farmers based on market related instruments, namely put options that are purchased by individual farmers, cooperative of farmers, traders or (and possibly preferable FIs that extend credit to producers/marketers and related cooperative). The bank is motivated to be engaged in such activity by the likelihood of higher loan recovery and improved quality of its loan portfolio that would result from eliminating or reducing substantially the involuntary loan defaults.

Large scale producers in developed countries can choose from a variety of hedging instruments relying on their collateral that constitutes a prerequisites for credit. In contrast, small producers in developing countries are not able to use such hedging instruments (i.e. collars) because their performance risk is perceived as too high or they lack the collateral needed for purchasing the insurance using credit. As a result available strategies used by small scale producers are limited, leading them to opt for a minimum price embedded in a straight put option. Coupling the put option with an established loan agreement as a joint product substantially reduces the transaction costs for the creditor and insured borrower.

This hedging instrument - the use of the put option - is limited, however, to commodities that are traded in a liquid exchange and for commodities the farm gate prices of which are highly correlated with the prices in the liquid international exchanges. This, in turn, would clearly exclude agricultural commodities the prices of which are supported by the state. Also this instrument is not a panacea to a long term trend to price decline of a specific agricultural commodity as the duration coverage of the put option is limited for only few months.

Lessons learnt in the recent years suggest that organizing small scale, low-income farmers is, however, not an easy task. The African banks that lend for coffee and cotton for example have not been found, by large, eager to internalize the advantages associated with introducing this instrument in light of their often conservatism and lack of will to acquire the specific skills needed for introducing this insurance. Possibly, the advantages of introducing this instrument could be discussed at the highest level of the Ministry of Finance of some developed countries and not only with the FIs managements in the region, in light of the embedded benefits that could accrue to the financial and agricultural sectors including the capacity to lay off risk out of the country concerned.

Index Based Yield Insurance provides an incentive-compatible alternative to standard crop insurance schemes, assisting farmers in mitigating their production risks. In essence, the sale of this insurance can be similar to the way lottery tickets are sold, with contracts involving payment of an actuarially calculated premium that result in a payout under the scheme in the event of specific clear outcomes (i.e. when a given number triggers indemnity, such as when rainfall below a given critical predetermined amount during say, 50 days is not reached, or when yields over a given area-but not on a specific farmer's field fall substantially below long term average values).

4) Trade Credit to Farmers - Traders, input suppliers, processors and exporters, alongside to money lenders, are the main source of credit to poor, low-income farming households. The delivery of this credit is carried out as integral part of the inputs purchase and outputs sales. These traders/creditors succeed to overcome or mitigate many of the difficulties that stand in the way of normal creditors namely, asymmetric information, repayment enforcement, high operational costs, high transaction cost imposed on the borrower/client when credit is delivered as a separate, singled out transaction, compared to a small fraction of additional costs

that are needed when the credit is extended as a joint product of sale of inputs or purchase of agricultural produce and credit. These advantages allowed the traders to expand their operations to areas characterized by thin financial intermediation and unavailability of formal credit or formal credit that is offered only for much larger denominated and traditionally secured loans.

The variety of products and the duration of credit that is provided by the suppliers of inputs (fertilizers, seed and pesticides) and purchasers of agriculture produce are limited to short-term seasonal credit and advances. For many farming households this source presents the only option available for credit even when the credit terms reflect high, imputed interest rates that can be derived from comparing buying and selling inputs and produces on cash to their equivalent on credit terms. When the traders possess market power both the prices of the inputs he supplies or the price he paid for the produce, as well as the interest rate associated with the trade finance would reflect the lack of competition. Enhancing competition and organizing farmers to present higher purchasing/selling capacity and better negotiating terms in inputs purchase and marketing cooperative could mitigate the monopoly power exerts by some trade creditors.

Banks may often rightly prefer to lend to these traders when the traders need external finance to supplement their own equity because it may generate substantial saving on transaction and monitoring cost compared to bank's lending directly to a substantially larger number of tiny loans to farmers. Moreover, usually a trader/creditor knows better than the bank the ultimate users of the interlocked credit, how industrious they are and is more effective in ensuring loan repayment particularly when such credit is "self liquidated" and its repaid by subtracting its value and interest from sales to the trader himself. The trader/creditor would usually have the capacity to offer better security to the bank involved than the low-income farmers.

CGAP's mapping of agriculture markets in Mozambique found that lending arrangement between farmers and commodity trading companies are widespread and a critical source of finance. In Zimbabwe Gordon and Goodland found that the number of smallholders that receive input loans from Cotton, a large cotton ginner, exceeds the number of clients of any MFI operating in the country. Cotton and sugar are typical commodities whereby the cotton ginnery and the sugar refinery can easily facilitate advances to growers as they possess local monophony power and it wouldn't pay to a producer to market his produce to a competing processing plant because the transportation cost would be prohibitive. In contrast, commodities like coffee whereby, first stage processing is easy and are less bulky and more expensive per unit of weight or volume are more susceptible to 'side selling' when advances are extended by the trader.

The duration of trade credit vary and can last from few days to all season. Rates of interest also vary as well. Several studies indicate that 5 percent per month as popular benchmark in some countries but only 2 to 4 percent per month for rice farmers in India. Such rates are determined by other factors such as availability of credit from other sources particularly moneylenders, competition among traders, cost of capital and inflation.

Annexure 5.1

Proposed amendments in Service Regulations of RRBs

The Task Force has received various suggestions regarding amendment of service regulations. The following suggestions for amendment in service regulation may also be considered by the authorities.

A. Regulation no. 11-

It is suggested that Special Review Committee to be constituted shall have the following specific Directors:

a. Director Nominated by NABARD.
b. Director Nominated by RBI.
c. Directors Nominated by Sponsor Bank.

This Subcommittee may review the performance of each of the officer or employee and make recommendations to the Chairman for continuation of service or otherwise.

B. Regulation no. 23-

This regulation is not clear whether the officer or employee has to stay at his place of posting. In view of the changing scenario, the dual responsibility of key has to be carried out for security reasons and proper formalities for key handing over should be followed. In view of this ,it is felt that this regulation may be amended to the extent that an officer or employee shall reside at the place of posting and shall obtain prior permission for leaving the headquarters from the competent authority.

C. Regulation no. 27-

The return of assets and liabilities shall be made mandatory for the employees also.

D. Regulation 28-

This regulation is silent in the case of an officer of employee has extramarital relationship. A sub-Clause may be added stating that no officer or employee shall have illicit relationship or extramarital relationship with any of the persons.

E. Regulation 29-

The figure 44 printed in the 17th line in page no. 24 should be read as "Regulation No. 45."

F. Regulation no. 38 (Penalties)-

There is no clear distinction between minor misconduct and major misconduct in respect of officers and employees. A clear distinction may be made with regard to type of misconduct and included under regulation no. 38 (1) (a) & (b) and 38 (2) a & b (Page 30 and Page 33).

G. Regulation no. 38 page no. 33-

In respect of penalties on major misconduct for workmen staff, the Disciplinary Authority cannot reduce more than 1 stage for a period of 2 years. This does not appear well where an employee has committed major misconduct. It is suggested that the restriction of reduction in stage for a period of 2 years may be deleted.

H. <u>Regulation no. 38</u>-

Under regulation no. 38 in the case of workmen staff, there are no provisions to recover the financial loss incurred by the bank in respect of the misconduct committed. It is suggested that one more clause may be added so that recovery of financial loss may be awarded by the Disciplinary Authority.

I. <u>Regulation no. 43</u>-

This regulation permits the employee to engage a legal practitioner for defending his case with the prior permission of the Competent Authority. This regulation may be amended and it may be made clear that “for the purpose of inquiry, the officer or employee shall not engage a legal practitioner” however, he may engage his own colleague in the Bank to defend his case.

Annexure 6.1

PRINCIPLES OF INTERNAL CONTROLS - BASLE COMMITTEE

Principle 1

The Board of Directors should have responsibility for approving and periodically reviewing the overall business strategies and significant policies of the bank; understanding the major risks run by the bank, setting acceptable levels for these risks and ensuring that senior management takes the steps necessary to identify, measure, monitor and control these risks; approving the organisational structure and ensuring that senior management is monitoring the effectiveness of the internal control system.

The BoD is ultimately responsible for ensuring that an adequate and effective system of internal control system is established and maintained.

Principle 2

- Senior Management should have responsibility for implementing strategies and policies approved by the Board, developing processes that identify, measure, monitor and control risks incurred by the bank; maintaining an organisational structure that clearly assigns responsibility, authority and reporting relationships ensuring that delegated responsibilities are effectively carried out; setting appropriate internal control policies and monitoring the adequacy and effectiveness of the internal control system.

Principle 3

- The BoD and senior Management are responsible for promoting high ethical and integrity standards and for establishing a culture within the organization that emphasizes and demonstrates to all levels of personnel the importance of internal controls. All personnel at banking organization need to understand their role in the internal controls process and be fully engaged in the process.

Principle 4 – Risk Recognition and Assessment

- An effective internal control system requires that the material risks that could adversely affect the achievement of the bank's goals are being recognised and continually assessed. This assessment should cover all risks facing the bank and the consolidated banking organisation (credit risk, market risk, interest rate risk, liquidity risk, operational risk, legal risk and reputation risk). Internal controls may need to be revised to appropriately address any new or previously uncontrolled risks.

Principle 5

- Control activities should be an integral part of the daily activities of a bank. An effective internal control system requires that an appropriate control structure is set up with control activities defined at every business level. These should include:

Top level reviews

- appropriate activity controls for different departments or divisions
- Physical controls
- Checking for compliance with exposure limits and follow-up on non-compliance
- A system of approvals and authorisations; and
- A system of verification and reconciliation

Principle 6

An effective internal control system requires that there is appropriate segregation of duties and that personnel are not assigned conflicting responsibilities. Areas of potential conflicts of interest should be identified, minimised and subject to careful, independent monitoring

Principle 7 – Information and Communication

An effective internal control system requires that there are adequate and comprehensive internal financial, operational and compliance date, as well as external market information about events and conditions that are relevant to decision making.
Information should be reliable, timely, accessible and provided in a consistent format.

Principle 8

An effective internal control system requires that there are reliable information systems in place that cover all significant activities of the bank. These systems, including those that hold and use data in an electronic form, must be secure, monitored independently and supported by adequate contingency arrangements.

Principle 9

An effective internal control system requires effective channels of communication to ensure that all staff fully understand and adhere to policies and procedures affecting their duties and responsibilities and that other relevant information is reaching the appropriate personnel.

Principle 10

The overall effectiveness of the bank's internal controls should be monitored on an ongoing basis. Monitoring of key risks should be part of the daily activities of the bank as well as periodic evaluations by the business lines and internal audit.

Principle 11

There should be an effective and comprehensive internal audit of the internal control system carried out by operationally independent, appropriately trained and competent staff. The internal audit function, as part of the monitoring of the system of internal controls, should report directly to the BoD or its audit committee and to senior management.

Principle 12

Internal control deficiencies whether identified by business line, internal audit or other control personnel, should be reported in a timely manner to the appropriate management level and addressed promptly. Material internal control deficiencies should be reported to senior management and the BoD.

Regardless of size, every banking organisation should have an effective system of internal controls that is consistent with the nature, complexity and risk inherent in their ON and OFF Balance Sheet activities and that responds to changes in the bank's environment and conditions.

Progress of Computerisation in Regional Rural Banks

Sl. No	Name of the RRB	Branches	Sponsor Bank	State	Whether Computerisation & Internet Services provided	Status of Computerisation upto 31.12.2004		Details thereof till present date	If not, when to be provided	Whether any Target in this respect Fixed	If so, details of achivements
						Head Office	Branches				
1	2	3	4	5	(a)	(b)	(c)	(d)	(e)	(f)	(g)
1	BHAGIRATH GI	107	ALLAHAB	UTTAR PRAD	Yes	HO fully	56	65 branches	Another 15	Full	As on 31.7.2005,
2	CHHATRASAL	84	ALLAHAB	UTTAR PRAD	Yes	HO fully	40	40 branches	Another 20	Total 60	As on 9.8.2005, 47.06%
3	SARAYU GB	41	ALLAHAB	UTTAR PRAD	Yes	HO fully	41	41 branches	Already	Full	As on 9.8.2005, 100%
4	SHARDA GB	59	ALLAHAB	MADHYA PRA	Yes	HO fully	13	17 branches	Total 21 by	Total 21	As on 31.3.2005,
5	SRAVASTI GB	89	ALLAHAB	UTTAR PRAD	Yes	HO 80%	12	22 branches	32 branches by	Total 32	As on 31.3.2005,
6	TULSI GB	78	ALLAHAB	UTTAR PRAD	Yes	1 Dept.	14	14 branches	26 branches by	Total 26	As on 31.3.2005,
7	VINDHYAVASIN	46	ALLAHAB	UTTAR PRAD	Yes	HO fully	7	7 branches computerised	8 branches by	Total 15	As on 31.3.2005,
8	CHAITANYA GE	51	ANDHRA	ANDHRA PRA	25 branches	HO fully	25	25 branches	By 2005-06 all	Yes	Target (31.3.2005) = 26,
9	GODAVARI GB	33	ANDHRA	ANDHRA PRA	25 branches	HO fully	25	25 branches	By 2005-06 all	Yes	Target (31.3.2005) = 25,
10	RUSHIKULYA G	75	ANDHRA	ORISSA	18 branches	HO fully	18	18 branches	By 2005-06 all	Yes	Target (31.3.2005) = 25,
11	ALLAHABAD K	91	B.O.B	UTTAR PRAD	108 are fully computerised, 64 partially computerised. Computer and Internet in Hos. No Internet in branches	HO fully	3	2 branches partially	In respect of all these RRBs sponsored by BoB, 560 branches to be computerised by 3 1.03.2006	50% of total	4 branches fully
12	ARAVALI KGB	60	B.O.B	RAJASTHAN		HO fully	3	5 branches fully		50% of total	5 branches
13	BAREILLY KGB	81	B.O.B	UTTAR PRAD		HO fully	7	9 branches fully		50% of total	11 branches
14	BHILWARA-AJI	53	B.O.B	RAJASTHAN		HO fully	8	10 branches fully		50% of total	16 branches
15	BUNDI-CHITTO	63	B.O.B	RAJASTHAN		HO fully	8	10 branches fully		50% of total	10 branches
16	DUNGARPUR-E	38	B.O.B	RAJASTHAN		HO fully	4	1 partially computerised		50% of total	6 branches
17	FAIZABAD KGE	67	B.O.B	UTTAR PRAD		HO fully	7	9 branches fully		50% of total	9 branches
18	FATEHPUR KG	51	B.O.B	UTTAR PRAD		HO fully	1	1 branch fully		50% of total	1 branch computerised
19	JHABUA-DHAR	90	B.O.B	MADHYA PRA		HO fully	9	4 partially computerised		50% of total	11 branches
20	KANPUR KGB	96	B.O.B	UTTAR PRAD		HO fully	5	3 partially computerised		50% of total	7 branches
21	MARUDHAR K	55	B.O.B	RAJASTHAN		HO fully	2	2 branches fully		50% of total	8 branches
22	NAINITAL-ALM	59	B.O.B	UTTARANCH		HO fully	1	3 branches fully		50% of total	4 branches
23	PANCHMAHAL	48	B.O.B	GUJARAT		HO fully	48	47 branches partially		50% of total	48 branches
24	PRATAPGARH	71	B.O.B	UTTAR PRAD		HO fully	1	3 branches fully		50% of total	4 branches
25	RAEBARELI K	69	B.O.B	UTTAR PRAD		HO fully	2	4 branches fully		50% of total	4 branches
26	SHAHJAHANPU	36	B.O.B	UTTAR PRAD		HO fully	4	6 branches fully		50% of total	10 branches
27	SULTANPUR K	94	B.O.B	UTTAR PRAD		HO fully	2	1 branch partially		50% of total	4 branches
28	SURAT-BHARU	34	B.O.B	GUJARAT		HO fully	11	6 branches partially		50% of bank's	13 branches
29	VALSAD-DANG	37	B.O.B	GUJARAT		HO fully	16	18 branches fully		50% of bank's	18 branches
30	AVADH GB	118	B.O.I	UTTAR PRAD	Yes	HO fully	100	100 branches	Already	120 branches will	120 branches will be
31	BAITARANI GB	96	B.O.I	ORISSA	Yes	--- do ---	42	42 branches	All RRBs to	All RRBs to	42 branches
32	BARABANKI GE	92	B.O.I	UTTAR PRAD	Yes	--- do ---	14	14 branches	All RRBs to	All RRBs to	100% by 31.3.2005
33	BHANDARA GE	45	B.O.I	MAHARASHT	Yes	--- do ---	29	29 branches	All RRBs to	All RRBs to	31 branches
34	CHANDRAPUR	60	B.O.I	MAHARASHT	Yes	--- do ---	12	12 branches	All RRBs to	All RRBs to	12 branches
35	DEWAS-SHAJA	56	B.O.I	MADHYA PRA	Yes	--- do ---	36	36 branches	All RRBs to	All RRBs to	38 branches
36	FARRUKHABAI	81	B.O.I	UTTAR PRAD	Yes	--- do ---	59	59 branches	All RRBs to	All RRBs to	48 branches
37	GIRIDIH KGB	27	B.O.I	JHARKHAND	Yes	--- do ---	9	9 branches computerised	All RRBs to	All RRBs to	13 branches
38	HAZARIBAGH K	30	B.O.I	JHARKHAND	Yes	--- do ---	14	14 branches	All RRBs to	All RRBs to	18 branches
39	INDORE-UJJAI	36	B.O.I	MADHYA PRA	Yes	--- do ---	29	29 branches	All RRBs to	All RRBs to	29 branches
40	NIMAR KGB	70	B.O.I	MADHYA PRA	Yes	--- do ---	24	24 branches	All RRBs to	All RRBs to	24 branches
41	RAJGARH-SEH	44	B.O.I	MADHYA PRA	Yes	--- do ---	35	35 branches	All RRBs to	All RRBs to	35 branches
42	RANCHI KGB	78	B.O.I	JHARKHAND	Yes	--- do ---	7	7 branches computerised	All RRBs to	All RRBs to	7 branches
43	RATNAGIRI-SII	39	B.O.I	MAHARASHT	Yes	--- do ---	39	39 branches	All RRBs to	All RRBs to	All 39 branches

44	SINGHBHUM K	76	B.O.I	JHARKHAND	Yes	--- do ---	12	12 branches	All RRBs to	All RRBs to	12 branches
45	SOLAPUR GB	33	B.O.I	MAHARASHT	Yes	--- do ---	20	20 branches	All RRBs to	All RRBs to	20 branches
46	AURANGABAD	56	B.O.M	MAHARASHT	All 56 branches	--- do ---	Complete	Computerised since	No internet	NA	NA
47	MARATHWWAI	245	B.O.M	MAHARASHT	Of 245, no	--- do ---	Not Done -	NA	Computerisatio	Computerisation	76 branches selected in
48	THANE GB	21	B.O.M	MAHARASHT	18 branches	--- do ---	Partial	18 branches	No internet	Out of remaining	Data Entry is in
49	MEWAR AGB	58	B.O.RAJ.	RAJASTHAN	Yes	--- do ---	Yes	1 Internet connection	In remaining	Yes	March '06
50	AKOLA GB	47	C.B.I	MAHARASHT	All HO of RRBs computerised with internet facility. No internet is provided to branches.	8	24	24 branches	Remaining 23	Remaining 23	24 branches
51	BALLIA KGB	87	C.B.I	UTTAR PRAD		7	12	12 branches	50% branches	50% branches to	12 branches
52	BULDHANA GB	24	C.B.I	MAHARASHT		4	24	All 24 branches	NA (All	NA (All branches	All 24 branches
53	CHAMBAL KGB	33	C.B.I	MADHYA PRA		4	33	All 33 branches	NA (All	NA (All branches	All 33 branches
54	CHAMPARAN K	143	C.B.I	BIHAR		3	NIL	NIL	50% branches	50% branches to	NIL
55	CHHINDWARA-	61	C.B.I	MADHYA PRA		7	40	40 branches	Remaining 21	Remaining 21	40 branches
56	ETAWAH KGB	50	C.B.I	UTTAR PRAD		2	10	10 branches	50% branches	50% branches to	10 branches
57	GOPALGANJ K	59	C.B.I	BIHAR		10	7	7 branches computerised	50% branches	50% branches to	7 branches
58	GWALIOR-DAT	30	C.B.I	MADHYA PRA		3	22	22 branches	Remaining 8	Remaining 8	22 branches
59	HADOTI KGB	80	C.B.I	RAJASTHAN		8	46	46 branches	Remaining 34	Remaining 34	46 branches
60	KGB HOSHANG	80	C.B.I	MADHYA PRA		8	25	25 branches	50% branches	50% branches to	25 branches
61	KOSI KSH GB	164	C.B.I	BIHAR		8	NIL	NIL	50% branches	50% branches to	NIL
62	MADHUBANI K	89	C.B.I	BIHAR		3	NIL	NIL	50% branches	50% branches to	NIL
63	MANDLA-BALA	54	C.B.I	MADHYA PRA		8	18	18 branches	50% branches	50% branches to	18 branches
64	MITHILA KGB	79	C.B.I	BIHAR		3	8	8 branches computerised	50% branches	50% branches to	8 branches
65	RATLAM-MAND	40	C.B.I	MADHYA PRA		12	40	All 40 branches	NA (All	NA (All branches	All 40 branches
66	SARAN KGB	64	C.B.I	BIHAR		2	2	2 branches computerised	50% branches	50% branches to	2 branches
67	SHAHDOL KGB	42	C.B.I	MADHYA PRA		5	12	17 branches	50% branches	50% branches to	12 branches
68	SIWAN KGB	71	C.B.I	BIHAR		1	16	16 branches	50% branches	50% branches to	16 branches
69	SURGUJA KGB	83	C.B.I	CHHATTISGA		8	40	40 branches	Remaining 43	Remaining 43	40 branches
70	UTTAR BANGA	114	C.B.I	WEST BENGA		11	1	1 branch computerised as	50% branches	50% branches to	1 branch computerised.
71	VAISHALI KGB	188	C.B.I	BIHAR		1		NIL	50% branches	50% branches to	NIL
72	YAVATMAL GB	23	C.B.I	MAHARASHT		2	18	18 branches	Remaining 5	Remaining 5	18 branches
73	ALIGARH KGB	86	CANARA	UTTAR PRAD	Yes	4	25	25 computerised as on	55 branches to	55 branches to	25 computerised.
74	CHITRADURGA	91	CANARA	KARNATAKA	Yes	4	26	26 computerised as ib	61 branches to	61 branches to	26 computerised.
75	ETAH GB	58	CANARA	UTTAR PRAD	Yes	3	10	10 computerised as on	25 branches to	25 branches to	10 computerised.
76	JAMUNA GB	39	CANARA	UTTAR PRAD	Yes	3	39	39 computerised and 3	-	-	39 computerised and 3
77	KOLAR GB	61	CANARA	KARNATAKA	Yes	3	44	44 computerised as on	17 branches	17 branches be	44 computerised.
78	SAHYADRI GB	29	CANARA	KARNATAKA	Yes	1	27	27 branches	2 branches to	2 branches to be	27 computerised
79	SOUTH MALAB	210	CANARA	KERALA	Yes	9	62	62 computerised and 3	75 branches to	75 branches to	62 computerised and 3
80	TUNGABHADR	162	CANARA	KARNATAKA	Yes	8	4	4 computerised and 4 HO	59 branches to	59 branches to	4 computerised and 4
81	CHICKMAGALU	50	CORPN	KARNATAKA	Computerisatio	1	6	6 branches and HO fully	40 branches to	40 branches to	1 Head Office and 7
82	BANASKANTHA	68	DENA	GUJARAT	61 branches	Computerised	54	61 branches	All branches by	Yes	All the 68 branches by
83	DURG-RAJNAN	101	DENA	CHHATTISGA	20 branches	Computerised	19* (*	20 branches	60 branches till	Yes	Cumulative Target: 2005-
84	KUTCH GB	34	DENA	GUJARAT	25 branches	Computerised	25* (*	25 branches	All branches till	Yes	Cumulative Target: 2004-
85	SABARKANTHA	27	DENA	GUJARAT	All 27 branches	Computerised	27* (*	All 27 branches	All the	Not applicable.	Not applicable.
86	DHENKANAL G	52	I.O.B	ORISSA	Yes	Computerised	50	50 branches	Remaining	Remaining	50 branches
87	PANDYAN GB	165	I.O.B	TAMILNADU	Yes	Computerised	123	All 165 branches	NA	NA	
88	PURI GB	113	I.O.B	ORISSA	Yes	Computerised	44	50 branches	Remaining	Remaining	50 branches
89	ADHIYAMAN G	24	INDIAN	TAMILNADU	Head Offices of RRB were computerised with internet	HO computerised.	All 24	All 24 branches	NA	NA	100%
90	KANAKADUGR	29	INDIAN	ANDHRA PRA		HO computerised.	All 29	All 29 branches	NA	NA	100%
91	SHRI VENKETE	75	INDIAN	ANDHRA PRA		HO computerised.	67	67 branches	Within the first	Remaining 8 *	100%
92	VALLALAR GB	24	INDIAN	TAMILNADU		HO computerised.	All 24	All 24 branches	NA	NA	100%
93	JAMMU RB	90	J&K	JAMMU & KAS	Branches not	Partially	NIL	Branches not	5 branches and	5 branches and 3	Branches not
94	KAMRAZ RB	78	J&K	JAMMU & KAS	Branches not	Partially	NIL	Branches not	4 branches to	4 branches to be	Branches not
95	FARIDKOT-BHA	22	P&S BK	PUNJAB	All branches	Partially	All 22	All 22 branches and 1 HO	NA	NA	All 22 branches and HO

96	ALWAR-BHARA	88	P.N.B	RAJASTHAN	Computerisatio	Yes	45	45 branches	-	of branches, HO ar	45
97	AMBALA KURU	39	P.N.B	HARYANA	Computerisatio	Yes	39	39 branches	-	of branches, HO ar	39
98	BHOJPUR ROH	157	P.N.B	BIHAR	Computerisatio	Yes	66	66 branches	-	of branches, HO ar	66
99	DEVI PATAN K	75	P.N.B	UTTAR PRAD	Computerisatio	Yes	38	38 branches	-	of branches, HO ar	38
100	GURDASPUR-A	60	P.N.B	PUNJAB	Computerisatio	Yes	36	36 branches	-	of branches, HO ar	36
101	HARYANA KGB	90	P.N.B	HARYANA	Computerisatio	Yes	45	45 branches	-	of branches, HO ar	90
102	HIMACHAL GB	108	P.N.B	HIMACHAL PR	Computerisatio	Yes	53	53 branches	-	of branches, HO ar	53
103	HINDON GB	22	P.N.B	UTTAR PRAD	Computerisatio	Yes	6	6 branches computerised	-	of branches, HO ar	9
104	HISSAR-SIRSA	50	P.N.B	HARYANA	Computerisatio	Yes	45	45 branches	-	of branches, HO ar	50
105	KAPURTHALA-	46	P.N.B	PUNJAB	Computerisatio	Yes	45	45 branches	-	of branches, HO ar	46
106	KISAN GB	55	P.N.B	UTTAR PRAD	Computerisatio	Yes	17	17 branches	-	of branches, HO ar	17
107	MAGADH GB	165	P.N.B	BIHAR	Computerisatio	Yes	32	32 branches	-	of branches, HO ar	32
108	MUZAFFARNAG	25	P.N.B	UTTAR PRAD	Computerisatio	Yes	15	15 branches	-	of branches, HO ar	15
109	NALANDA GB	66	P.N.B	BIHAR	Computerisatio	Yes	20	20 branches	-	of branches, HO ar	20
110	PATALIPUTRA	19	P.N.B	BIHAR	Computerisatio	Yes	10	10 branches	-	of branches, HO ar	10
111	RANI LAKSHMI	43	P.N.B	UTTAR PRAD	Computerisatio	Yes	10	10 branches	-	of branches, HO ar	10
112	SHEKHAWATI	108	P.N.B	RAJASTHAN	Computerisatio	Yes	53	53 branches	-	of branches, HO ar	93
113	SHIVALIK KGB	41	P.N.B	PUNJAB	Computerisatio	Yes	22	22 branches	-	of branches, HO ar	24
114	VIDUR GB	41	P.N.B	UTTAR PRAD	Computerisatio	Yes	40	40 branches	-	of branches, HO ar	41
115	BIKANER KGB	27	S.B.B.J	RAJASTHAN	NO	NIL	NIL	NA	2005-2006 HO	HO + 12	3 branches
116	MARWAR GB	135	S.B.B.J	RAJASTHAN	NO	NIL	NIL	NA	2005-2006 HO	HO + 67	6 branches
117	SRIGANGANAG	43	S.B.B.J	RAJASTHAN	NO	NIL	NIL	NA	2005-2006 HO	HO + 23	4 branches
118	GOLCONDA GB	23	S.B.H	ANDHRA PRA	Only in few	No	16	16 branches	HO &	7 branches to be	16 branches
119	SHRI SATHAVA	46	S.B.H	ANDHRA PRA	Only in few	No	10	10 branches	HO & remaining	35 branches to	10 branches
120	SRI SARASWA	70	S.B.H	ANDHRA PRA	Only in few	No	8	8 branches computerised	HO & 50	50 branches to	8 branches
121	SRIRAMA GB	27	S.B.H	ANDHRA PRA	Only in few	No	6	6 branches computerised	HO & 21	21 branches to	6 branches
122	ALAKNANDA G	45	S.B.I	UTTARANCHA	237 computerised	Yes	2	237 computerised as on 2.8.05.	Computerisation of 157 branches in process	Each RRB has drawn out a five year plan for computerisation	Each RRB has drawn out a five year plan for computerisation
123	ARUNACHAL P	17	S.B.I	ARUNACHAL		Yes	Nil				
124	BASTAR KGB	55	S.B.I	CHHATTISGA		Yes	6				
125	BASTI GB	105	S.B.I	UTTAR PRAD		Yes	5				
126	BILASPUR-RAI	137	S.B.I	CHHATTISGA		Yes	Nil				
127	BOLANGIR AG	156	S.B.I	ORISSA		Yes	1				
128	BUNDELKHAN	83	S.B.I	MADHYA PRA		Yes	Nil				
129	DAMOH-PANNA	71	S.B.I	MADHYA PRA		Yes	20				
130	ELLAQUI DEHA	98	S.B.I	JAMMU & KAS		Yes	Nil				
131	GANGA-YAMUN	39	S.B.I	UTTARANCHA		Yes	Nil				
132	GORAKHPUR K	200	S.B.I	UTTAR PRAD		Yes	21				
133	KAKATHIYA GB	40	S.B.I	ANDHRA PRA		Yes	All				
134	KALAHANDI AG	77	S.B.I	ORISSA		Yes	3				
135	KHASI JAINTIA	51	S.B.I	MEGHALAYA		Yes	5				
136	KORAPUT PAN	90	S.B.I	ORISSA		Yes	1				
137	KRISHNA GB	106	S.B.I	KARNATAKA		Yes	21 (12 in				
138	LANGPI DEHAN	43	S.B.I	ASSAM		Yes	Nil				
139	MANJIRA GB	64	S.B.I	ANDHRA PRA		Yes	34				
140	MIZORAM RB	54	S.B.I	MIZORAM		Yes	2				
141	NAGALAND RB	8	S.B.I	NAGALAND		Yes	Nil				
142	NAGARJUNA G	147	S.B.I	ANDHRA PRA		Yes	35				
143	PALAMAU KGB	75	S.B.I	JHARKHAND		Yes	Nil				
144	PARVATIYA GB	27	S.B.I	HIMACHAL PR		Yes	Nil				
145	PITHORAGARH	25	S.B.I	UTTARANCHA		Yes	4				
146	RAIGARH KGB	60	S.B.I	CHHATTISGA		Yes	1				
147	SAMASTIPUR K	73	S.B.I	BIHAR		Yes	Nil				

148	SANGAMESHW	73	S.B.I	ANDHRA PRA		Yes	36				
149	SANTHAL PAR	103	S.B.I	JHARKHAND		Yes	Nil				
150	SHIVPURI-GUN	58	S.B.I	MADHYA PRA		Yes, Partially	5				
151	SRI VISAKHA G	163	S.B.I	ANDHRA PRA		Yes	35				
152	VIDISHA-BHOP	23	S.B.IND	MADHYA PRA	Back office	Compilation work is	Back	Back office	Front office	Front office	Software has been
153	CAUVERY GB	125	S.B.M	KARNATAKA	50 branches	4	50	40 branches	86 branches by	86 branches by	50 branches as on 2004-
154	KALPATHARU (	79	S.B.M	KARNATAKA	40 branches	11	40	40 branches	10 branches by	29 branches by	50 branches as on 2004-
155	MALWA GB	41	S.B.P	PUNJAB	Head Office &	NIL	NIL	No branch computerised	Head Office &	All remaining 31	Head Office & 10
156	JAMNAGAR GR	53	S.B.S	GUJARAT	All the branches	1	53	All 53 branches and HO	NA	NA	All 53 branches and HO
157	JUNAGADH-AM	39	S.B.S	GUJARAT	All the branches	1	34	All 34 branches and HO	NA	NA	All 34 branches and HO
158	SURENDRANA	43	S.B.S	GUJARAT	All the branches	1	43	All 43 branches and HO	NA	NA	All 43 branches and HO
159	BIJAPUR GB	91	SYNDICA	KARNATAKA	Computerisatio	Computerised	70	70 branches	100%	100%	70 branches
160	GURGAON GB	121	SYNDICA	HARYANA	Computerisatio	Computerised	78	78 branches	100%	100%	78 branches
161	MALAPRABHA	243	SYNDICA	KARNATAKA	Computerisatio	Computerised	218	218 branches	100%	100%	218 branches
162	NETRAVATI GE	22	SYNDICA	KARNATAKA	Computerisatio	Computerised	All 22	All 22 branches	NA	NA	All 22 branches
163	NORTH MALAB	152	SYNDICA	KERALA	Computerisatio	Computerised	All 152	All 152 branches	NA	NA	All 152 branches
164	PINAKINI GB	101	SYNDICA	ANDHRA PRA	Computerisatio	Computerised	100	100 branches	100%	100%	100 branches
165	PRATHAMA BA	170	SYNDICA	UTTAR PRAD	Computerisatio	Computerised	125	125 branches	100%	100%	125 branches
166	RAYALSEEMA	148	SYNDICA	ANDHRA PRA	Computerisatio	Computerised	All 148	All 148 branches	NA	NA	All 148 branches
167	SREE ANANTH	81	SYNDICA	ANDHRA PRA	Computerisatio	Computerised	80	80 branches	100%	100%	80 branches
168	VARADA GB	31	SYNDICA	KARNATAKA	Computerisatio	Computerised	30		100%	100%	30 branches
169	CACHAR GB	44	U.B.I	ASSAM	Yes, Without	Partly with 2	3	HO-2 computers		6 branches by	HO - 3computers - Br-7
170	GAUR GB	146	U.B.I	WEST BENGA	Yes, with	Parly computerised	5	HO partly operational -		5 branches by	HO partly - Br-ALPM
171	LAKHIMI GB	102	U.B.I	ASSAM	Yes, with	Computerised and	8	HO operational -		To cover 43	HO, Area Office and 14
172	MALLABHUM G	179	U.B.I	WEST BENGA	Yes, with	Partly with LAN	Complete	HO-CM,GM Office and 7		10 branches by	HO-CM,GM Office and 7
173	MANIPUR RB	29	U.B.I	MANIPUR	Partly at HO	3 Computers with	3	HO - 2 PC with LAN -		1 branch by 2005-	HO - 2 PC with LAN -
174	MURSHIDABAD	40	U.B.I	WEST BENGA	Yes at HO	Partly (1 Deptt. At	2	HO - 1 Deptt. Partially		7 branches by	HO - 1 Deptt. Partially
175	NADIA GB	67	U.B.I	WEST BENGA	Yes - Internet at	Computerised	8	HO computerised - 8		26 branches by	HO computerised - 8
176	PRAGJYOTISH	165	U.B.I	ASSAM	Yes- Internet at	Computerised	12	HO computer installed in		30 branches by	HO computer installed in
177	SAGAR GB	115	U.B.I	WEST BENGA	HO fully	Computerised	5	HO - 7 Computers -		3 branches by	HO operational - 2
178	SUBANSIRI GB	45	U.B.I	ASSAM	Yes with	All 5 Deptt.s are	4	HO computerised - 4		11 branches by	HO computerised -11
179	TRIPURA GB	87	U.B.I	TRIPURA	Partly	HO not	4	HO - PCs arrived not yet		20 Branches by	HO - 2 PCs installed - 3
180	BALASORE GB	62	U.C.O	ORISSA	Yes	Yes	NIL	Head Office only	2004-05	Head office	Head Office
181	BARDHAMAN G	90	U.C.O	WEST BENGA	Yes	Yes	NIL	Internet at H.O.	2004-05	Head office and	Head Office
182	BEGUSARAI KG	21	U.C.O	BIHAR	Yes	Yes	Yes	6 branches and Head	2004-05	Head office and	6 branches and H.O
183	BHAGALPUR-B	24	U.C.O	BIHAR	Yes	Yes	NIL	Head Office.	2004-05	Head Office and	Head Office
184	CUTTACK GB	121	U.C.O	ORISSA	Yes	Yes	NIL	4 PC in H.O as on 4.8.05.	2004-05	Head Office	Head Office
185	HOWRAH GB	59	U.C.O	WEST BENGA	Yes	Yes	NIL	Internet at H.O.	2004-05	Head Office, 2	Head Office
186	JAIPUR NAGAU	144	U.C.O	RAJASTHAN	Yes	Yes	Yes	5 Area Office, 6 branches	2004-05	16 Branches, 5	6 branches, 5 Area
187	MAHAKAUSHA	42	U.C.O	MADHYA PRA	Yes	Yes	Yes	19 branches and HO as	2004-05	Head Office and	19 branches & H.O
188	MAYURAKSHI (	65	U.C.O	WEST BENGA	Yes	Yes	Yes	2 branches and Internet	2004-05	Head Office and	2 branches and H.O
189	MONGHYR KGI	106	U.C.O	BIHAR	Yes	Yes	Yes	5 branches and Internet	2004-05	Head Office and	5 branches & H.O
190	THAR AGB	66	U.C.O	RAJASTHAN	Yes	Yes	NIL	Internet at H.O.	2004-05	Head Office and	Head Office
191	KSHETRIYA KI	63	U.P.S.C.B	UTTAR PRAD	No branch	Not yet been done	Not yet	As of 6.8.05	UPCB advised	No	NA
192	GOMTI GB	84	UNION	UTTAR PRAD	35 branches	Head Office & 2	35 + 1	35 branches and 1	2004-05 and	Yes	Target (March 06) = 84
193	KASHI GB	82	UNION	UTTAR PRAD	59 branches	Head Office	59	59 branches partially	Remaining 23	Yes	Target (March 06) = 82
194	REWA-SIDHI G	82	UNION	MADHYA PRA	18 branches	Nil	18	18 branches partially	By 2005-06, 41	Yes	Target (March 06) = 41
195	SAMYUT KGB	168	UNION	UTTAR PRAD	100 branches	Head Office & 6	100	100 branches partially	By 2005-06,	Yes	Target (March 06) = 168
196	VISVESHWAR	25	VIJAYA	KARNATAKA	Partially	Partially	24	24 branches have been	7 more	7 more branches	Proposed to fully

Annexure 8.1

Financial Indicators of RRBs in NER

(Amount in Rs. Crore)

Name of the RRB	Year	Productivity (Dep + Adv)	Branch Prody (Rs lakh)	Staff Prody (Rs lakh)	Profit/ Loss	Gross NPA (#)	Accumulated losses
PGB	2000	561.7	-	-	1.7	61.9 (51.5)	41.0
	2005	1364.5	826.9	144.4	20.2*	70.5 (15.2)	7.8
LGB	2000	195.6	-		1.4	6.5 (27.0)	31.6
	2005	513.6	503.5	-107.2	3.2	5.7 (4.0)	21.8
CGB	2000	100.0	-	-	1.3	1.5 (7.8)	12.9
	2005	277.5	630.7	161.3	3.2	6.4 (8.7)	4.3
SGB	2000	87.3	374.2	94.1	0.7	5.4 (39.7)	11.1
	2005	168.4			0.3	3.4 (9.7)	6.5
LDRB	2000	53.2	-	-	(-)0.8	6.6 (56.4)	16.5
	2005	138.8	322.9	77.6	(-)2.4	2.5 (5.5)	24.8
APRB	2000	52.5	-	-	0.5	6.0 (21.0)	1.0
	2005	97.9	576.1	155.5	(-)4.7	20.7 (60.3)	29.2
Mani RB	2000	28.4	-	-	(-) 0.5	3.7 (50.7)	10.6
	2005	54.8	209.8	66.1	(-)1.7	8.0 (33.3)	17.3
Ka Bank	2000	117.6	-	-	(-)0.8	10.6 (57.0)	16.5
	2005	274.1	537.6	149.8	1.5	14.9 (27.5)	-
Mizo RB	2000	68.1	420.9	132.9	0.3	7.8 (44.3)	6.4
	2005	227.3			0.3	9.5 (11.8)	5.5
NRB	2000	6.1	-	-	0.07	0.7 (50.0)	1.5
	2005	19.2	40.3	73.9	(-)1.1	2.0 (32.8)	3.1
TGB	2000	416.1	-	-	(-)6.7	77.2 (75.5)	131.2
	2005	1019.9	1172.3	147.4	0.5	56.1 (21.4)	134.5

*The bank has received repayment of an amount to the tune of Rs. 9.71 crore from the Govt. of Assam under the Misguided Youth Scheme

Figures in parentheses indicate NPA ratio

Annexexure 8.2

Staff Productivity of RRBs in NER

(as on March 31, 2005)

Name of RRB	Total Staff	No. of deposit account	No. of advances account	Per staff deposit and advances a/c
AGVB	1778	1956458	199781	1212*
LDRB	179	108124	14637	686
APRB	62	54395	4655	952
Mani RB	92	94495	11355	1150
Ka Bank	183	124454	27083	828
Mizo RB	171	72622	15672	516
NRB	26	7384	2404	376
TGB	694	453296	169623	898
Total RRBs of NER	3185	2871228	445210	1041
All India RRBs	65753	57688827	14167354	1093

* Figures from one of the constituents namely SGB are not available

Abbreviations

ALM	Asset Liability Management
ALPM	Automatic Ledger Posting Machine
ATM	Automatic Teller Machine
BIRD	Bankers Institute of Rural Development
BIS	Bureau of Indian Standard
BOD	Board of Directors
BOS	Board of Supervision
BSRB	Banking Services Recruitment Boards
CDR	Credit Deposit Ratio
CEO	Chief Executive Officer
CRAR	Capital to Risk Weighted Asset Ratio
CRR	Cash Reserve Ratio
CVC	Central Vigilance Cell
DAP	Development Action Plan
DOS	Department of Supervision
EDP	Entrepreneurship Development Programme
EFT	Electronic Funds Transfer
EOQ	Economic Order Quantity
FD	Fixed Deposit
GOI	Govt. of India
G-Sec.	Government Security
HR	Human Resource
IBPS	Institute of Banking and Personnel Services
IDR	Investment Deposit Ratio
IFR	Investment Fluctuation Reserve
IRAC	Income Recognition and Asset Classification
IT	Information Technology
KCC	Kisan Credit Card
LT	Long Term
MIS	Management Information System
MOU	Memorandum of Understanding
MT	Medium Term
NDTL	Net Demand and Time Liabilities
NER	North Eastern Region
NSLR	Non Statutory Liquidity Ratio
ODI	Organisational Development Intervention
OSS	Off-site Surveillance System
PACS	Primary Agriculture Coop. Societies
RBI	Reserve Bank of India
RRBs	Regional Rural Banks
RTCs	Regional Training Centers
SARFAESI Act	Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act
SCC	Swrojgar Credit Card
SHG	Self Help Group
SHPI	Self Help Promoting Institution
SLR	Statutory Liquidity Ratio
ST (OSAO)	Short term (Other than Seasonal Agriculture operations)
TEs	Training Establishments
TNAs	Training Need Assessments
VRS	Voluntary Retirement Scheme