Report of the Working Group on Umbrella Organization and Constitution of Revival Fund for Primary (Urban) Co-operative Banks

Reserve Bank of India
Urban Banks Department
Central Office
Mumbai

Working Group (WG) on Umbrella Organization and Constitution of Revival Fund for UCBs

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LETTER OF TRANSMITTAL

Chairman

Working Group on Umbrella Organization and
Constitution of Revival Fund for Urban Cooperative Banks

Dr. K.C. Chakrabarty
Deputy Governor
Reserve Bank of India
Mumbai

Dear Sir,

I have great pleasure in submitting the Report of the Working Group on Umbrella Organization and Constitution of Revival Fund for Urban Cooperative Banks (UCBs) constituted by the Reserve Bank of India vide Executive Order dated May 28, 2008 (copy attached).

2. The Working Group, inter alia, recommends setting up of an Umbrella Organization at the national level and Emergency Fund Facility Trusts at the state level. We are hopeful that the recommendations made by the Working Group would facilitate emergence of a mutual support system and strengthen the UCB sector.

3. On behalf of the members of the Working Group and on my behalf, I convey my sincere thanks for the opportunity given to us.

With kind regards,

Yours sincerely,

(V.S. Das)

(Dr.S.K.Goel) (Member)	**(J.P.Gupta)** (Member)	**(S.D. Indoria)** (Member)
(P.Vijaya Bhaskar) (Member)	**(A.K. Khound)** (Member)	**(K.D.Zacharias)** (Member)
(H.K.Patil) (Member)	**(Anandrao Adsul)** (Member)	**(Jyotindra Mehta)** (Member)

Mumbai
October, 2009

(S.S. Barik)
(Member Secretary)

<u>Reserve Bank of India</u>

Executive Order

<u>Deputy Governor</u>

Working Group on Umbrella Organizations for UCBs and Constitution of Revival Fund for UCBs-

There are a large number of Primary (Urban) Cooperative Banks (UCBs) in the country forming a heterogeneous group in terms of size and spread. Many of these banks are very small in size and reach. They compete with larger participants in the same banking space. Over the years, a number of UCBs have become weak and non-viable thus posing systemic risk to the UCB sector. They lack avenues for raising capital funds since they cannot go in for public issue of shares nor can they issue shares to members at a premium. At the same time, there are a number of UCBs in the sector that are financially strong and viable. Some sort of cooperative bonding and mutual support system could make the sector strong and vibrant. Looking at various successful federal models internationally, especially in Europe and USA, a need is felt for an umbrella organization that will be in a position to channelize their resources, aggregate their needs and also lend credibility through mutual support in the financial market. A Working Group constituted to examine issues relating to augmenting of capital of primary (urban) co-operative bank (UCBs) had also observed that it may be necessary to facilitate emergence of umbrella organizations for UCBs to enhance public confidence in the sector. In this backdrop, it has been decided to constitute a Working Group to suggest measures including the appropriate regulatory and supervisory framework, to facilitate emergence of umbrella organization(s) for the UCB sector in the respective states. Further, the Standing Advisory Committee for UCBs has opined that the Working Group may also look into the issues concerning creation of Revival Fund for the sector.

The Working Group shall comprise:

a)	Shri V.S Das, Executive Director, RBI ,	Chairman
b)	Joint Secretary & CRCS, Ministry Agriculture, Govt. of India	Member
c)	CGM-in-charge , RBI, DBOD, CO	Member
d)	CGM-in-charge, RBI, UBD, CO	Member
e)	Legal Adviser-in-Charge, RBI, Legal Dept, CO	Member
f)	Representative , Govt. of Maharashtra	Member
g)	Representative , Govt. of Gujarat	Member
h)	Representative, NAFCUB, New Delhi	Member
i)	Representative, Maharashtra Urban Co-op Bank's Federation.	Member
j)	Representative, Gujarat Urban Co-op Bank's Federation	Member
k)	General Manager, UBD, BPD, RBI , CO	Member Secretary

2. **The terms of reference of the Working Group may be as under:**

(i) To study the regulatory and supervisory structure of umbrella organizations of financial co-operative institutions/banks, as prevalent in other parts of the world, especially in relation to raising of capital and intra co-operative group support system.

(ii) To study the existing structure and legal framework for UCBs in India and to examine the need and scope for a federated structure/ umbrella organization for UCBs at the state level.

(iii) To suggest appropriate supervisory and regulatory framework to facilitate emergence of such umbrella organisation(s) for UCBs, taking into consideration the international experiences and systems.

(iv) To study and suggest modalities for setting up an appropriate mutual assistance / revival fund for urban co-operative banks and the nature of support that could be provided by such fund.

3. The Working Group will submit its Report within six months of its constitution. Urban Banks Department, Central Office of Reserve Bank of India will provide the necessary secretarial assistance to the Group.

--sd/--
(Usha Thorat)
May 28, 2008

LIST OF ABBREVIATIONS

AACS	As Applicable to Cooperative Societies
AGM	Assistant General Manager
ALM	Asset Liability Management
ATM	Automated Teller Machine
AP	Andhra Pradesh
APRA	Australian Prudential Regulatory Authroity
BCC	Branche di Credito Cooperative
CA	Chartered Accountant
CAMELS	Capital Adequacy, Asset Quality, Management, Earnings, Liquidity, Systems and Procedures.
CGM	Chief General Manager
CO	Central Office
CEO	Chief Executive Officer
CRCS	Central Registrar of Cooperative Societies
CRAR	Capital to Risk Assets Ratio
CRR	Cash Reserve Ratio
CSGL	Constituents Subsidiary General Ledger
CUSCAL	Credit Union Services Corporation Australia Limited
DBOD	Department of Banking Operations and Development
DCCB	District Central Cooperative Bank
DICGC	Deposit Insurance and Credit Guarantee Corporation
DIT	Department of Information Technology
DNB	Dutch Central bank
EPN	Entry Point Norms
FNCA	Federation Nationale du Credit Agricole
HP	Himachal Pradesh
IAS	Indian Administrative Service
IMF	International Monetary Fund
IRAC	Income Recognition and Asset Classification
ISA	Industry Support Agreement
IT	Information Technology
MD	Managing Director
MoU	Memorandum of Understanding
MCS	Membership Capital Shares
MP	Madhya Pradesh
NAFCUB	National Federation of Urban Cooperative Banks and Credit Societies
NBFC	Non Banking Finance Company
NCUA	National Credit Union Administration
NCUSIF	National Credit Union share Insurance Fund
NDS	National Depository Services
NDTL	Net Demand and Time Liabilities
NOC	No Objection Certificate
NPA	Non Performing Asset
OSS	Offsite Surveillance System
RBI	Reserve Bank of India

RRB	Regional Rural Bank
RTGS	Real Time Gross Settlement
RZB	Raiffeisen Bank
SLR	Statutory Liquidity Ratio
SCB	State Cooperative Bank
SCRA	Securities Contract Regulation Act
SEBI	Securities and Exchange Board of India
SGL	Subsidiary General Ledger
SPV	Special Purpose Vehicle
TAFCUB	Task Force for Urban Cooperative Banks
UBD	Urban Banks Department
UCBs	Urban Cooperative Banks
UK	United Kingdom
UO	Umbrella Organization
UP	Uttar Pradesh
USA	United States of America
WG	Working Group
WOCCU	World Council of Credit Union

Chapter 1

Introduction and Approach

1.1 Introduction

1.1.1 Primary (Urban) Cooperative Banks (UCBs) cater to the banking needs of lower/middle class people predominantly comprising businessmen, small traders, artisans, factory workers, salaried persons, etc. in the metropolitan, urban and semi-urban areas. The UCB sector with a population of 1,721 UCBs (as on March 31, 2009) is signified by heterogeneity and dichotomy of regulatory control. As many as 1,429 (83 percent) are small UCBs with deposits not exceeding Rs. 100 crore and operations confined to the same district or adjacent districts. They account for 23.6 percent of the deposits. The number of UCBs varies across the states, with Maharashtra, Gujarat, Andhra Pradesh, Karnataka and Tamilnadu accounting for 79 percent of the UCBs and 89 percent of total deposits. Some other states that have significant presence of UCBs are Uttar Pradesh, Kerala, West Bengal and Rajsthan. All other states have just a few banks. The sector has 53 UCBs whose names appear in the list of banks scheduled under the Reserve Bank of India Act, 1934. There are 40 UCBs which have multi-state operations and whose deposits account for 26 percent of the sector's deposits.

1.1.2 UCBs are registered as cooperative societies under the provisions of State Cooperative Societies Acts or Multi State Cooperative Societies Act and licensed to undertake banking business under provisions of the Banking Regulation Act, 1949 (As applicable to cooperative societies). UCBs are cooperative societies at the primary level and represent a unitary structure. They operate on a standalone basis, unlike the three tier rural cooperatives credit structure, though loosely integrated to the higher financing agencies, such as District Cooperative Credit Bank (DCCB) and State Cooperative Banks (SCB). The status of UCBs registered under Multi State Cooperative Societies Act in the cooperative structure is not well defined. They are neither linked to any DCCB nor SCB on account of their presence in more than one state.

1.1.3 Over the years, there has been gradual erosion in the clientele of UCBs. In a competitive environment, commercial banks, including private sector banks, with their superior financial and technological resources, are also reaching out to the same set of clientele and banking space, as UCBs. Small UCBs with limited human, financial and technological resources at their command are finding it difficult to face the competition.

1.1.4 In recent times, fund management, risk management, asset liability management, etc. have assumed critical importance for any financial organization. UCBs, especially the smaller ones that lack professional competence, have problems in the aforesaid areas.

1.1.5 In India, only scheduled UCBs have direct access to liquidity support from the Reserve Bank under the provisions of the Reserve Bank of India Act, 1934. It is often observed that non-scheduled UCBs, which are very large in number, face considerable difficulties in arranging liquidity in times of need. One of the options available to them is to avail loans against SLR securities from DCCBs/SCBs. However, if the concerned DCCBs/SCBs are themselves financially unsound, they are unable to meet the liquidity needs of UCBs. The sale of SLR securities very often results in losses in distress situations. Thus, temporary liquidity problems snowball into solvency problems, in the absence of timely liquidity support.

1.1.6 UCBs have limited avenues for raising capital funds viz., membership shares, share contribution by members linked to the quantum of loans and advances availed by them and retained earnings. UCBs, being in cooperative sector, are not able to raise resources by way of equity and debts (bonds) from the capital market unlike their counterparts in the private sector, on account of the legal limitations. As per Securities and Exchange Board of India (SEBI) Act, 1992 and Securities Contract Regulation Act, 1956 (SCRA), for a financial instrument to be eligible to be listed in the Stock Exchange, it should be issued by a *body corporate* as defined under the Companies Act, 1956. A cooperative society is a body corporate as per the Cooperative Societies Acts, but not as per the Companies Act. As such, the financial instruments issued by UCBs cannot be listed in a stock exchange.

1.1.7 In the context of large number of weak and sick UCBs failing to maintain the prescribed CRAR, the Reserve Bank had constituted a Working Group (WG) to examine issues relating to augmenting of capital of UCBs (Vishwanathan Committee, 2006). The Working Group, while suggesting new instruments for raising of capital by UCBs, had observed that creating a legal framework for facilitating the emergence of umbrella organization(s) like those prevalent in many European countries, viz. Credit Agricole Group, Rabobank Group, Raiffeisen Bank Group, etc., appeared to be the only long term solution to enhance the public and depositors' confidence in the cooperative banking sector. This would, however, require amendments to the Cooperative Societies Acts and would also entail changes in the existing supervisory and regulatory framework. The Group had, therefore, recommended that the entire issue of creating an appropriate legislative and supervisory framework be separately examined, taking into consideration the international experiences and systems. Further, during the deliberations in the meeting of the Standing Advisory Committee for UCBs held on December 18, 2007, a view emerged that a Working Group may be set up to look into the issues concerning creation of rehabilitation/revival fund and the liquidity support that may be made available for the weak UCBs.

1.2 Constitution of the Working Group:

1.2.1 In the above context, it was felt that some form of cooperative bonding and mutual support system could make the sector strong and vibrant. Looking at various successful federated structures internationally, especially in Europe and USA, a need was felt for an umbrella organization that would support the UCB sector by channelizing their resources, aggregating their needs and also provide stability through mutual support.

1.2.2 Pursuant to above and as announced in the Reserve Bank’s Annual Policy Statement for the year 2008-09, a Working Group was constituted under the Chairmanship of Shri V.S Das, Executive Director, Reserve Bank of India.

1.2.3 The members of the Working Group are as under:

a)	Shri V.S Das, Executive Director, Reserve Bank of India	Chairman
b)	Dr.S.K. Goel, IAS, Principal Secretary (Co-operation and Marketing) Govt.of Maharashtra	Member
c)	Shri J.P Gupta, IAS Commissioner for Commercial Tax Government of Gujarat	-do-

d) Shri S.D Indoria, Chief Director, Ministry of Agriculture and Co-operation, Government of India	Member
e) Shri Vijaya Bhaskar, * Chief General Manager-in-Charge Department of Banking Operations & Development Reserve Bank of India, Central Office	-do-
f) Shri A.K Khound, Chief General Manager-in-Charge Urban Banks Department, Reserve Bank of India, Central Office	-do-
g) Shri K.D Zacharias, Legal Adviser-in-Charge Legal Dept, Reserve Bank of India, Central Office	-do-
h) Shri H.K. Patil,** President National Federation of Urban Co-operative Banks and Credit Societies Ltd.(NAFCUB)	-do-
i) Shri Anandrao Adsul, Chairman Maharashtra Urban Co-operative Bank's Federation	-do-
j) Shri Jyotindra Mehta, Chairman Gujarat Urban Co-operative Bank's Federation	-do-
k) Shri S.S Barik, General Manager Urban Banks Department, Reserve Bank of India, Central Office	Member Secretary

* Due to Shri Prashant Saran relinquishing the position in RBI & joining SEBI, he was substituted by Shri P. Vijaya Bhaskar
** Due to the unfortunate demise of Shri Vijaykumar, he was substituted by Shri H.K. Patil, President, NAFCUB

Shri D.Krishna, Chief Executive, NAFCUB, Shri G. Rama Moorthy, Chairman, AP State Coop Urban Banks Federation and Shri M. Santhanam, Director, Karnataka State Coop Urban Banks Federation participated in the deliberations of the Working Group as special invitees.

1.2.4 The terms of reference of the Working Group are as under:

(i) To study the structure of umbrella organizations of financial co-operative institutions/banks, as prevalent in other parts of the world, especially in relation to raising of capital and intra co-operative group support system.

(ii) To study the existing structure and legal framework for UCBs in India and to examine the need and scope for a federated structure/ umbrella organization for UCBs at the state level.

(iii) To suggest appropriate supervisory and regulatory framework to facilitate emergence of such umbrella organization(s) for UCBs, taking into consideration the international experiences and systems.

(iv) To study and suggest modalities for setting up an appropriate mutual assistance / revival fund for urban co-operative banks and the nature of support that could be provided by such fund.

1.3 Approach adopted by the Group

1.3.1 The Group held seven meetings and met a cross section of Urban Cooperative Banks and their representative associations in various regions of the country to ascertain their views on the design of the umbrella organization and setting up of the proposed Relief Fund. The names of organizations /banks which were consulted are given in Annex 1.

1.3.2 The Group also deliberated at length on the existing legal framework governing UCBs. It recognized the limitations confronting UCBs with respect to augmentation of capital. Further, the Group also took into account the fact that a significant chunk of the sector is beset with financial and operational problems which render such banks fragile and vulnerable. Lack of professionalism in smaller UCBs is yet another cause of concern.

1.3.3 The form of the proposed umbrella organization also engaged the Group's attention. A common sentiment that was well-articulated and shared throughout in the deliberations and interactions with UCBs and their representative bodies was that the umbrella organization should have a cooperative form. The Group's approach was to be sensitive and respectful towards this view. At the same time, it realized that given the legal constraints, although it is possible to conceive of a cooperative body as an umbrella organization, it would not be possible for such a cooperative to raise capital from the market for the member UCBs and it would compromise the very objective for setting up of an umbrella organization. Therefore, the Group had to consider other available options and try giving it a cooperative flavour and character.

1.3.4 The Group studied the prominent and successful umbrella organizations abroad. It had a close look at the models in Australia, Canada, Finland, France, Italy, Netherlands and USA. Some members also had the opportunity of visiting Australia, France and Finland where they had detailed discussions with the regulators and officials of the umbrella organizations and sector representatives. As a consequence, the Group was able to get useful insights into the functioning of umbrella organizations in these countries. A common feature of these bodies is that they provide a range of services to their member organizations, with some acting even as their bankers (Australia). Most umbrellas also have schemes which facilitate emergency liquidity support to their members. In the countries studied, the member institutions and, umbrella organizations were found to be financially strong and well regulated. There was also an element of self-regulation through the discipline prescribed by the umbrella body which contributed to sector's stability. The Group, after studying the various models abroad concluded that the UCB sector in India had its own uniqueness in terms of the legal framework, structure, size, and infirmities, besides sensitivities. While there is, indeed, a need for such an arrangement to be put in place in India, for which one could draw lessons from the institutional arrangements abroad, the model that the Group would like to recommend should be suited to our own setting. The Group recognized the fact that bringing about legal amendments is a long drawn process, and hence we may look at a design within the existing legal framework, or at least one which required minimal legal changes.

1.3.5 The Group examined the need for setting up of a Revival Fund for UCBs in distress and a Relief Fund that would provide liquidity to member UCBs in an emergency. Recommendations in this regard are set out in Chapter 6 of the report.

1.4. Acknowledgements

The members of the Group would like to place on record their gratitude to Dr Y.V. Reddy, former Governor and Smt Usha Thorat, Deputy Governor, Reserve Bank of India for providing an opportunity to be a part of Working Group and for giving valuable suggestions and guidance during the course of the working of the Group. The Group place on record the contributions made by Shri Prashant Saran and Late Shri Vijaykumar, former members of the Group. The Group is also grateful to Shri D.Krishna, Chief Executive, NAFCUB, Shri M. Santhanam, Director, Karnataka State Cooperative Urban Banks Federation, Shri G. Rama Moorthy, Chairman, AP State Coop Urban Banks Federation Ltd and Shri Aravind Deshpande, Secretary, Maharashtra Urban Coop Banks Federation for sharing their insightful thoughts on Umbrella Organization, during the course of the discussion of the Group.

The Group would also place on record its gratitude for the valuable thoughts, suggestions and information shared by Mr. Dave Grace, Vice President, World Council of Credit Union, (WOCCU), Mr. Brandon Khoo, Ex. General Manager, Australian Prudential Regulatory Authority (APRA), Mr. Gary Eggert, CEO, CUFSS, Australia, Mr Andy Poprawa, CEO and President, Deposit Insurance Corporation of Ontario ,Toronto, Canada , Ms. Kim Andres, Vice President, Business Development and Strategic Solutions at Central 1,Vancouver, Canada, Mr. Mike Mercer, Chief Executive, Georgia Credit Union Affiliates and Mr. Fabio Bernasconi, Banca d'Italia, Italy on the subject.

The Group would also like to thank the senior officials and funcitionaries of the UCBs and their Fedeartions/Associations for making it convenient to attend the meetings of Group at Mumbai, Bengaluru and Lucknow and sharing their thoughts on the Umbrella Organization. The Group is also thankful to the Regional Directors, UBD heads and other officers/staff of Bengaluru and Lucknow offices of RBI for hosting two of its meetings. The Group is also thankful to DIT CO, RBI for making necessary arrangements for the teleconference with the credit union officials at Canada.

The Group is especially thankful to Mr S.S Barik, Member Secretary and Shri Anup Kumar, AGM, UBD CO for providing important background material, presentations on the subject and in preparation of the first draft Report of the findings of the Group.

The Group is also thankful to Smt. Uma Shankar, CGM and Smt. Monisha Chakraborty, DGM, UBD,CO for participating in the deliberations and Dr. Pradip Bhuyan, AGM, UBD, CO for providing the necessary data for the Report. Lastly, the Group would also thank Shri Ravi Shankar, Manager, UBD CO for providing the necessary secretarial assistance during the course of the working of the Group.

Chapter 2

Profile of the UCB Sector

2.1 Introductory

2.1.1 Primary (Urban) Cooperative Banks (UCBs) are the offshoots of the cooperative movement in India which gained momentum with the passage of the Cooperative Societies Act, 1904. The first urban cooperative society was registered in Canjeevaram town in the then Madras province in October 1904. However, the urban cooperative credit movement did not pick up till the Maclagan Committee (1912) recognized the importance of these institutions. The movement got a fillip when the banking laws were made applicable to cooperative societies in 1966 in order to protect the interests of the depositors and to provide insurance cover under the provisions of the Deposit Insurance and Credit Guarantee Corporation Act, 1961.

2.1.2 Profile of UCBs as on March 31, 2009

(Amounts in Rs. Cr)

Table 1: Brief profile of UCBs as on end-March , 2009 *

	Scheduled	**Non Scheduled**	**All**
1.No. of UCBs	53	1668	1721
of which			
(i) Tier I	Nil	1429	1429
of which			
Unit Banks	Nil	830	830
(ii) Tier II	53	239	292
of which			
Multi State	25	15	40
2. Assets	85,895	1,10,500	1,96,395
3. Deposits	67,929	90,804	1,58,733
4. Loans and Advances	42,234	55,684	97,918
5. Investments	29,210	34,961	64,171
6. Total number of Deposit Accounts (March 2008)	1,44,87,941	3,91,43,063	5,36,31,004
7. Total number of Borrowal Accounts (March 2008)	11,38,934	67,61,846	79,00,780

** Provisional data*

2.2 Mushrooming Growth

2.2.1 In the year 1966, when the Banking Regulation Act,1949 was made applicable to UCBs, there were about 1,100 UCBs with deposits and advances of Rs.167 crore and Rs.153 crore, respectively. The UCBs continued to grow at a fast pace till 2003, when their number increased to 1,941 and their deposits and advances increased to Rs. 1, 01,546 crore and Rs. 64,880 crore respectively. The liberal licensing policy followed by the Reserve Bank pursuant to the recommendations of the Marathe Committee (1992) led to the proliferation in the sector. However, the ban on licensing of new UCBs since 2004 and encouragement to voluntary amalgamation and consolidation in the sector has resulted in decline in the number of UCBs to 1,721 in 2009 with total deposits of Rs. 1,58,733 crore and advances of Rs. 97,918 crore. The growth profile since the 1990s is given in Table 2 below.

Table 2: Growth of Urban Cooperative Banks (UCBs)

(Amounts in crores of rupees)

Year ended March 31,	*Number of UCBs*	*Deposits*	*percent growth*	*Advances*	*percent growth*
1991	1307	10157		8003	
1992	1311	11108	9.4	8713	8.9
1993	1306	13531	21.8	10132	16.3
1994	1305	16769	23.9	12172	20.1
1995	1300	20101	19.9	14795	21.5
1996	1327	24165	20.2	17908	21.1
1997	1355	30714	27.1	21550	20.3
1998	1502	40692	32.5	27807	29.0
1999	1590	52681	29.5	34214	23.0
2000	1645	71189	35.1	45995	34.4
2001	1618	80840	13.6	54389	18.2
2002	1854	93069	15.1	62060	14.1
2003	1941	101546	9.1	64880	4.5
2004	1926	110256	8.6	67930	4.7
2005	1872	105021	-4.7	66874	-1.6
2006	1853	114060	8.6	71641	7.1
2007	1813	121391	6.4	79733	11.3
2008	1770	138496	14.1	88981	11.6
2009 *	1721	158733	14.6	97918	10.0

***** provisional data

2.3 Market share of UCBs in the banking sector

2.3.1 As discussed above, UCBs are important purveyors of credit to socially underprivileged and deprived sections of the urban and semi urban populace. The sector has over 79 lakh borrowers and 5.36 crore depositors. The market share of UCBs is given in the Table 3 and 4 below. It may however, be observed from the tables that the market share of UCBs have come down from peak of 6.6 % in end-March, 2000 to 3.7 % in end-March, 2008.

Table 3 : Market share of deposits of All Bank Groups to Total Deposits

(Market Share in Percentage)

Year ended March 31,	Urban Co-op. Banks (UCBs)	Rural Co-op. Banks (DCCB & State CBs)	Regional Rural Banks (RRBs)	Commercial Banks
1996	4.5	7.2	2.5	85.8
1997	4.9	7.6	2.6	84.9
1998	5.3	7.7	2.8	84.2
1999	5.6	7.8	2.8	83.8
2000	6.6	7.7	2.8	82.9
2001	6.3	7.2	2.9	83.6
2002	6.4	7.2	3.0	83.4
2003	6.3	7.0	3.0	83.7
2004	5.8	6.6	3.1	84.5
2005	5.3	6.3	3.1	85.3
2006	4.6	5.4	2.9	87.2
2007	4.0	4.7	2.7	88.6
2008*	3.7	4.1	2.7	89.5

* Provisional data (Share of RCBs arrived on the basis of projections as their total deposits as on 31.3.2008 is not available)

Table 4: Deposits of the UCBs vis-à-vis other banking entities.

	Deposits (Amount in Rs. Cr)			Share (%)		
	2006	2007	2008	2006	2007	2008
UCB	1,14,060	1,21,391	1,38,496	4.6	4.0	3.7
SCB	21,64,681	26,96,936	33,20,054	87.2	88.6	89.5
RRB	71,329	83,144	99,095	2.9	2.7	2.7
Rural co-op (DCCB + SCB) *	1,32,937	1,43,089	1,52,247	5.4	4.7	4.1
Total	24,83,007	30,44,560	37,09,892	100.0	100.0	100.0

* Provisional data (Share of RCBs arrived on the basis of projections as their total deposits as on 31.3.2008 is not available)

2.4 Heterogeneity in UCB Sector

2.4.1 UCBs are unique among banks in the sense that there is high degree of heterogeneity among the banks in this sector in terms of size (deposits, assets and branches), geographical distribution and financial health. Further, some UCBs have also been organized for specific needs of certain communities, underprivileged class of society, Mahila banks, etc. As on March 31, 2009, while there were 1,721 UCBs in total, there were 1,668 non scheduled banks, 79 Salary Earners' Banks, 108 Mahila banks and 6 SC/ST Banks.

2.4.2 Tier-wise Distribution of UCBs

There were 1,429 Tier I UCBs (83 percent of total UCBs) that accounted for 23.9 percent of deposits and 23.4 percent of advances. On the other hand, 292 banks classified as Tier II (including all scheduled banks) accounted for 76.1 percent of deposits and 76.6 percent of advances of the sector (Table 5).

(Amount in Rs. Crore)

Table 5: Tier-wise Distribution of UCBs and their Deposits & Advances as on end-March 2009*

Tier	UCBs		Deposits		Advances	
	No.	% to total	Amount	% to total	Amount	% to total
Tier I	1429	83.0	37,937	23.9	22,913	23.4
Tier II	292	17.0	1,20,796	76.1	75,005	76.6
Total	1721	100.0	1,58,733	100.00	97,918	100.00

** Provisional data*

2.4.3 Size of deposit, advance and asset

Apart from a few large scheduled UCBs, most of the banks are of small and medium in size as shown in the deposit, advances and asset-wise frequency distribution (Table 6,7 and 8):

Table 6: Deposit-wise Distribution of UCBs (End-March 2009)*

Deposit Size	No of Banks	No of banks (% to total)	Deposits (Rs in Cr)	Deposit (% to total)
< Rs 10 crore	464	27.0	2975	1.9
Rs. 10 Cr. & above but < Rs. 25 crore	452	26.3	7621	4.8
Rs 25 Cr. & above but < Rs. 50 crore	317	18.4	11757	7.4
Rs 50 Cr. & above but < Rs.100 crore	196	11.4	15069	9.5
Rs100 Cr. & above but < Rs. 250 crore	189	11.0	28526	18.0
Rs 250 Cr. & above but < Rs. 500 crore	56	3.3	20754	13.1
Rs 500 Cr. & above but < Rs1000 crore	27	1.6	18749	11.8
Rs 1,000 crore & above	20	1.2	53281	33.6
Total	1721	100.0	158733	100.0

**Provisional data*

Table7: Advance wise Distribution of UCBs (End-March 2009) *				
Advance Size.	**No of banks**	**No of banks (percent to total)**	**Advances Amount (Rs in Cr)**	**Advances (percent to total)**
< Rs 10 crore	710	41.3	3831	3.9
Rs. 10 Cr. & above but< Rs. 25 cr	441	25.6	7279	7.4
Rs 25 Cr. & above but < Rs. 50 cr	236	13.7	8658	8.8
Rs 50 Cr. & above but <Rs 100 cr	154	8.9	11634	11.9
Rs 100 Cr & above but<Rs 250 cr	116	6.7	17721	18.1
Rs 250 Cr & above but<Rs 500 cr	37	2.1	12668	12.9
Rs 500 Cr. & above but <Rs1000 cr	16	0.9	11093	11.3
Rs 1,000 crore & above	11	0.6	25033	25.6
Total	1721	100.0	97918	100.0

**Provisional data*

Table 8 : Asset wise Distribution of UCBs (End-March 2009) *		
Asset Size	**Number (percent to Total)**	**Assets (percent to total)**
< Rs 15 crore	28.6	2.3
Rs. 15 Cr. & above but < Rs. 25 cr	16.6	2.6
Rs 25 Cr. & above but < Rs. 50 cr	19.5	5.9
Rs 50 Cr. & above but < Rs. 100 cr	14.2	8.3
Rs. 100 Cr. & above but < Rs. 250 cr	13.1	17.1
Rs 250 Cr. & above but < Rs. 500 cr	4.2	12.4
Rs 500 Cr & above but < Rs. 1000 cr	2.3	13.5
Rs 1000 Cr& above but < Rs. 2000 cr	0.6	6.3
Rs 2,000 crore & above	0.9	31.7
Total	100.0	100.0

** Provisional data*

As may be seen from the table 6 above, 27.0 percent of UCBs had deposits less than Rs.10 crore as at end March 2009. However, these banks accounted for only 1.9 percent of total deposits at the end of March 2009. At the other end of the spectrum, there were 20 UCBs with deposits of Rs.1000 crore and above accounting for 33.6 percent of deposits of the sector. Further, 83 UCBs (i.e. 4.9 percent of the total number) with deposits of Rs. 250 crore and above but less than Rs 1000 cr accounted for 24.9 percent of the total deposits. 64 UCBs (i.e., 3.6 percent of the total number) having advance of Rs. 250 crore and above accounted for 50.8 percent of the total advances (table 7). This reflects the skewed distribution of deposits and advances in the sector. Similarly, the skewed distribution pattern is reflected in the asset wise distribution and 38.0 percent of the assets is concentrated in only 1.5 percent of the UCBs having asset of Rs 1000 crore and above (Table 8).

2.4.4 **Unit Banks**

Another unique but significant characteristics of the sector is the presence of large number of unit banks, *i.e.*, banks which function as head office-cum-branch. Of the 1721 UCBs at end-March 2009, 830 were unit banks (55.5 percent Maharashtra (including Goa), Gujarat and Karnataka had the highest number. (Table 9)

Table 9: State wise Distribution of UCBs as on end-March 2009 *

States	Total Number of Reporting UCBs	Total number of Unit UCBs	Total number of branches (including head office cum branches)	Total number of Extension Counters
Andhra Pradesh	114	82	234	7
Assam/ Manipur/ Tripura /Meghalaya/ Mizoram	17	13	28	1
Bihar/Jharkhand	5	4	6	1
Chattisgarh	13	10	21	2
Gujarat	260	134	886	10
Jammu & Kashmir	4	1	16	4
Karnataka	273	146	828	9
Kerala	60	16	332	2
Maharashtra	583	219	4148	165
Madhya Pradesh	55	41	84	0
New Delhi	15	6	62	1
Orissa	13	1	50	4
Punjab/Haryana/Himachal Pradesh	16	8	40	3
Rajasthan	39	19	149	3
Tamil Nadu/Puducherry	130	58	310	0
Uttarakhand	5	1	49	2
Uttar Pradesh	70	42	189	28
West Bengal/Sikkim	49	29	100	2
Total	1721	830	7532	244

** Provisional data*

2.4.5 Financial health of banks

As part of on-site inspection, Reserve Bank has adopted a system of categorizing banks into four grades (since April 2003) based on objective parameters relating to capital adequacy, asset quality, earnings, compliance with CRR / SLR requirements and adherence to RBI guidelines and / directives. While Grade I represents banks with no major supervisory concerns, the other three grades would indicate supervisory concerns in varying degree. The Grade-wise and center -wise position is given below (table 10 and 11):

Table 10 : Grade wise Distribution of UCBs as on end-March 2009 *

Grade	Number of banks	Number of banks (percent to total)	Deposits (percent to total)	Advances (percent to total)
I	845	49.1	65.2	64.2
II	484	28.1	19.5	19.7
III	219	12.7	5.1	5.6
IV	173	10.1	10.3	10.5
Total	1721	100.0	100.0	100.0

**Provisional data*

Table 11 : Centre & Number wise Distribution of UCBs in every Grade as on end March 2009 *

Centre	Gr. I	Gr. II	Gr. III	Gr.IV	Total UCBs.
1. Ahmedabad	116	100	16	28	260
2. Bangalore	128	82	47	16	273
3. Bhopal	13	25	12	5	55
4. Bhubaneshwar	3	4	3	3	13
5. Chandigarh	10	2	1	3	16
6. Chennai	88	34	3	5	130
7. Dehradun	4	0	1	0	5
8. Guwahati	7	8	1	1	17
9. Hyderabad	75	25	6	8	114
10. Jaipur	25	11	1	2	39
11. Jammu	3	0	1	0	4
12. Kolkata	27	11	1	10	49
13. Lucknow	46	10	9	5	70
14. Mumbai	202	100	64	54	420
15. Nagpur	55	40	39	29	163
16. New Delhi	11	2	1	1	15
17. Patna	5	0	0	0	5
18. Raipur	7	3	1	2	13
19. Thiruvananthapuram	20	27	12	1	60
Total	845	484	219	173	1721

** Provisional data*

It is observed from the above that at the end of March 2009, out of the 1721 UCBs, 845 banks (49.1percent) were classified under Grade-I and 484 banks (28.1 percent) were Grade-II, while financials of 392 UCBs (22.8 percent) were not considered satisfactory and were categorized under Grade III / IV.

2.4.6 **CRAR Distribution**

Basel I norms have been made applicable to UCBs in so far as it relates to credit risk. As per the existing norms, UCBs are required to maintain capital charge for credit risk based on 1988 capital accord and surrogate capital charge on market risk through an additional risk weight of 2.5 percent. The CRAR position of banks is given in Table 12.

Table 12 :	**CRAR Wise Distribution of UCBs as at end March 2009***				
Range of CRAR	**0% and above but < 3 %**	**3% and above but < 6%**	**6 % and above but < 9%**	**>=9%**	**Grand Total**
Scheduled	9	1	1	42	53
Non-Scheduled	136	24	66	1442	1668
Total	145	25	67	1484	1721
(percent share)	8.4	1.5	3.9	86.2	100

*provisional data

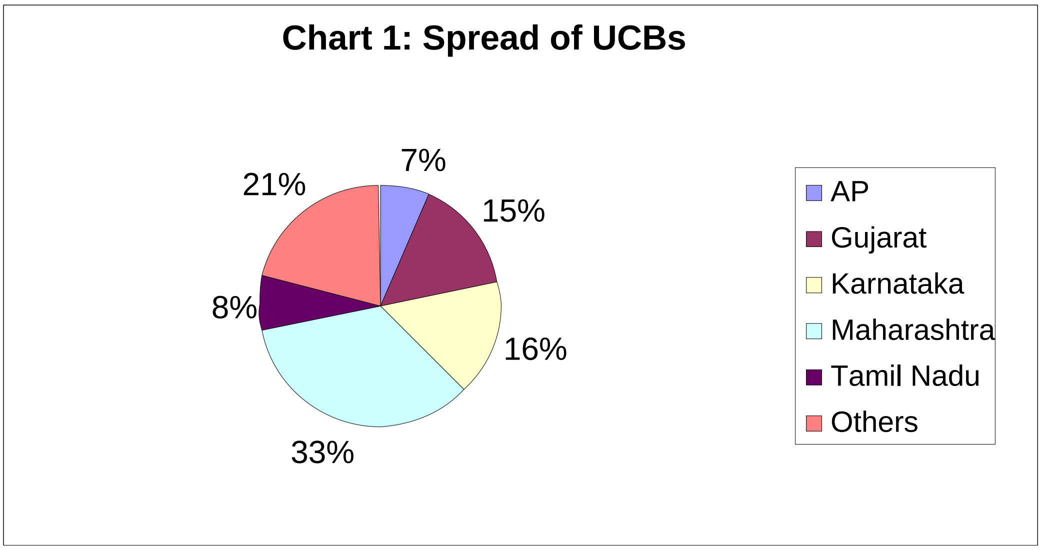
It is observed that out of 1721 UCBs as of March 31, 2009, 237 (13.7 percent) UCBs have CRAR lower than the prescribed CRAR of 9 percent. Out of these banks 145 (8.4 percent) UCBs have CRAR less than 3 percent.

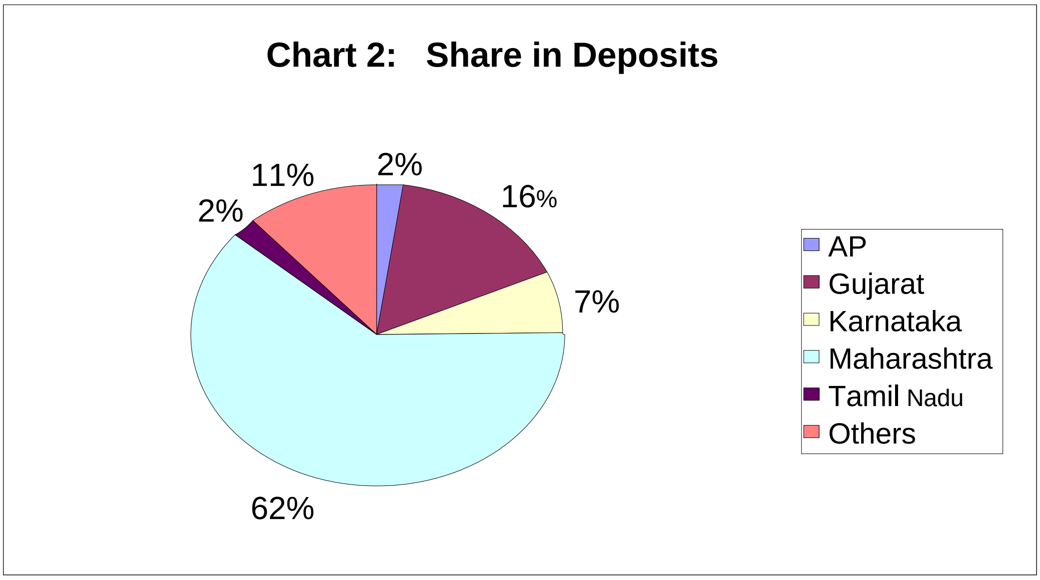
2.5 Diversity in spread

Geographical spread of UCBs is also uneven. UCBs are concentrated in 5 states viz., Maharashtra, Gujarat, Karnataka, Andhra Pradesh and Tamil Nadu, which cumulatively account for 79 percent of the total UCBs and 89 percent of deposits resources. Maharashtra alone accounts for 33.9 of the total UCBs and 61.4 per cent of deposit of the sector (table 13).

Table 13: Regional Spread of Urban Co-operative Banks (as of end March 2009)*			
State	**No of UCBs [Share in Total (percent)**	**Amount of Deposits [Share in Total (percent)**	**No. of Branches/ Extension Counters [Share in Total (percent)]**
1. Andhra Pradesh	6.6	2.3	3.1
2. Gujarat	15.1	16.1	11.5
3. Karnataka	15.9	6.5	10.8
4. Maharashtra	33.9	61.4	55.5
5. Tamil Nadu	7.5	2.3	4.0
6. Others	21.0	11.4	15.1
Total	100	100.0	100.0

** Provisional data*





Chapter 3

Regulatory and Supervisory Framework for UCBs

3.1 Regulatory Policies

3.1.1 UCBs play an important role in meeting the growing credit needs of metropolitan, urban and semi-urban areas of the country. As a significant contributor towards the financial inclusion objectives of the nation, UCBs mobilize savings from the middle and lower income groups and purvey credit to small borrowers, including weaker sections of the society. In order to protect the depositors, UCBs along with other co-operative banks were brought under the regulatory ambit of the Reserve Bank by extending certain of provisions of Banking Regulation Act, 1949 with effect from March 1, 1966. Further, deposit insurance under the provisions of the DICGC Act, 1961 was extended to the cooperative banks by suitable amendment to the State Cooperative Societies Acts empowering the Reserve Bank of India in the matters of supersession of the Board of Management, amalgamation and winding up of cooperative banks.

3.1.2 Duality of Control

Ideally, credit institutions should be under the oversight of a single regulator. However, due to historical reasons and the federal character of our Constitution, cooperation falls under State laws. As per the existing constitutional provisions, the subjects "banking" and "cooperative societies" come under Union and State List respectively and therefore, duality of control over the co-operative banks is inevitable. While the State Cooperative Societies Acts/ Multi State Cooperative Societies Act contained provisions relating to incorporation, registration, membership, management, statutory audit, amalgamation, reconstruction or liquidation, the banking activities such as issue of licence to start new banks/branches, capital and liquidity requirements, matters relating to interest rates, loan policies, investments, etc are governed by the Banking Regulation Act, 1949 (As applicable to cooperative societies). The powers under the State Cooperative Societies Act and Multi State Cooperative Societies Act are vested in the Registrar of Co-operative Societies of the State concerned and Central Registrar of Co-operative Societies respectively and Banking Regulation Act, 1949(AACS) empowers the Reserve Bank to regulate and supervise the banking related matters. The applicability of banking laws to UCBs resulted in ‘duality of control’ between the

Reserve Bank and the Registrar of Cooperative Societies/Central Registrar of Cooperative Societies.

3.1.3. Licensing Policy

In the past, the policy on licensing of UCBs was reviewed from time to time on the basis of the recommendations of three Expert Committees. The Report of the Committee on Urban Cooperative Banks (Madhava Das Committee) 1978, Committee on Licensing of New Urban Cooperative Banks (Marathe Committee), 1992 and Report of the High Power Committee on Urban Cooperative Banks (Madhava Rao Committee), 1999 guided the licensing policy on UCBs. The Madhava Das Committee and Marathe Committee had prescribed certain entry point norms (EPN) in relation to capital and membership for UCBs located in different categories of centres based on population. While the focus of the Madhava Das Committee was viability standards, Marathe Committee emphasized on the 'need' 'potential' and 'adequacy' or otherwise of 'banking cover'. Pursuant to the recommendations of the Marathe Committee, the Reserve Bank liberalized the licensing policy in May 1993 and 823 UCBs were set up between 1993 and 2001. The licensing policy and the EPN thereafter (licensing policy 2002) was broadly on the lines of the recommendations of the Madhava Rao Committee, which focussed on strong start up capital and professional background of the promoters with proven track record. Under the new licensing policy, the Reserve Bank issued another 16 licences till 2004. It was, however, observed that 31 per cent of these newly licensed UCBs became financially weak within a short period. In view of the above and considering that duality of control significantly inhibited the Reserve Bank ability to take action against delinquent banks with the required speed and urgency, licensing of new UCBs and branch Licensing was kept on hold since May 2004. It was decided to consider issuance of fresh licences only after a comprehensive policy on UCBs, including an appropriate legal and regulatory framework for the sector, was put in place and a policy for improving the financial health of the urban co-operative banking sector was formulated. However, subsequent to the signing of Memorandum of Understanding (MoUs) with State Governments as part of the Vision Document for the sector, UCBs in such state and multi state UCBs have been permitted by Reserve Bank from 2007 onwards to open branches, subject to certain conditions.

3.1.4 Prudential Regulations

3.1.4.1 IRAC Norms

Based on the recommendations of the Committee on Financial System (Narasimham Committee) and in line with the norms applicable to commercial banks, income recognition, asset classification and provisioning norms (IRAC) have been introduced to UCBs from 1st April, 1992 onwards. UCBs are required to take income to their profit and loss account only when it is realized and not on accrual basis in case of Non Performing Assets (NPAs). Further, while the assets are required to be classified into standard, sub standard, doubtful and loss depending upon their delinquency period, banks are required to make graded provision depending upon the categorization of assets with incidence of provisioning increasing from the sub standard to loss category. Provision ranging from 0.25 % to 0.40 % is also made on the standard advances as a prudential measure. As per the present instructions, a loan asset is considered NPA if the principal and/or the interest is overdue for more than 90 days. The requirements of the State Co-operative Societies Acts and/or Rules made thereunder or other statutory enactments may however, continue to be followed, if they are more stringent than those prescribed by Reserve Bank.

3.1.4.2 Capital Adequacy

As per the recommendations of the High Power Committee (Madhavrao Committee) 1999, Reserve Bank has introduced CRAR norms (1998 Basel Accord) to urban cooperative banks in a phased manner with effect form 31 March 2002. At present banks are required to maintain capital fund (Tier I and II) to the tune of 9 % of the total risk weighted assets. Further, surrogate capital charge on market risk has been introduced through an additional risk weight of 2.5 %.

3.1.4.3 Investments in Government securities

With effect from April 19, 2001, UCBs are required to achieve certain minimum level of their SLR holdings in the form of government and other approved securities as percentage of their Net Demand and Time Liabilities (NDTL). The present position in this regard is as indicated below:

	Table 14: Minimum SLR investment by UCBs.			
Sr. No.	**Category of bank**	**Minimum SLR holding in government and other approved securities as percentage of Net Demand and Time Liabilities**		
1.	Scheduled banks	25%		
2.	Non-Scheduled banks	September 30, 2009	March 31, 2010	March 31, 2011
	Tier I	7.5 %	15 %	25%
	Tier II	15 %	15 %	25%

3.1.4.4 Exposure Norms

Exposure limits [both credit and investment (non SLR)] in relation to bank's capital funds (Tier I and Tier II) has been prescribed for UCBs. The exposure to an individual borrower and to a group of borrowers should not exceed 15 per cent and 40 per cent of capital funds respectively. UCBs have also been prohibited to have any exposure to share/commodity brokers.

3.1.4.5 Professionalisation of management

To ensure professionalism in the Board, the banks are required to have at least two directors with suitable banking experience (at middle / senior management level) or with relevant professional qualification in the fields of law, accountancy or finance. However, these instructions are not mandatory in case of Salary Earners Banks in view of the nature of their membership.

3.1.4.6 Merger and Amalgamation of UCBs

Merger and amalgamation (takeover) of UCBs comes within the domain of the State/Central Government. However, under the provisions of the Cooperative Societies Acts, prior approval of the Reserve Bank of India is required for an order, inter alia, for sanctioning a scheme of amalgamation or reconstruction by the Government. With a view to facilitating consolidation and emergence of strong entities and providing an avenue for non-disruptive exit of weak/non-viable entities in the UCB sector, the Reserve Bank has issued the guidelines for merger/amalgamation of UCBs on February 2, 2005. Reserve Bank conveys no objection to such proposals for mergers/reconstructions after examining the financial aspects under the following circumstances:

(i) When the net worth of the acquired bank is positive and the acquirer bank assures to protect entire deposits of all the depositors of the acquired bank.

(ii) When the net worth of acquired bank is negative and the acquirer bank on its own assures to protect deposits of all the depositors of the acquired bank.

(iii) When the net worth of the acquired bank is negative and the acquirer bank assures to protect the deposits of all the depositors of the acquired bank with financial support from the State Government extended upfront as part of the process of merger.

In all cases of merger/ amalgamation the financial parameters of the acquirer bank post merger should conform to the prescribed minimum prudential and regulatory requirement for urban co-operative banks. The realizable value of assets has to be assessed through a process of due diligence.

Further, guidelines were also issued on January 30, 2009 on DICGC supported mergers in legacy cases pertaining to UCBs having negative net worth as on March 31, 2007.

Since the issuance of guidelines in February 2005, the Reserve Bank has received. Proposals involving 99 target banks. Reserve Bank has issued 82 NOCs, out of which 66 mergers have been effected (as of March 31, 2009) after issuance of necessary notification by the concerned State Govts/ CRCS.

3.2 Vision Document

3.2.1 The spectacular growth of UCBs in the late nineties and up to 2003, which had resulted in increasing their penetration, ironically, also led to certain weaknesses in the sector that adversely affected public perception and thereby, their competitiveness. The decline in public confidence in the UCB sector, deepened in the aftermath of the crisis in Gujarat and Andhra Pradesh and concomitantly, the position of UCBs generally deteriorated. As on June 30, 2004, 732 out of 1919

(38.14%) UCBs were categorized in Grade III or IV signifying weakness and sickness. Recognizing the systemic risks, duality of control that impedes supervisory efforts and keeping in view the needs of its clientele, Reserve Bank reviewed the entire gamut of legislative, regulatory and supervisory framework for these banks, and in March 2005, brought out a draft 'Vision Document for UCBs'. The vision document, which was drawn with the main objective of maintaining the viability and competitiveness of the UCBs, discussed the characteristics of the sector, analyzed the problems afflicting the banks and proposed strategies for dealing with problems affecting the sector

3.2.2 **MoU with Governments & Constitution of TAFCUBs**

'Vision Document' provides for MoUs between the Reserve Bank and the other regulators viz., the State Governments and Central Registrar of Co-operative Societies (CRCS). The MoU is a working arrangement between the Reserve Bank and the State Government/CRCS to ensure that the difficulties arising from duality of control over UCBs are suitably addressed and resolved. In terms of the MoU, the Bank undertakes to constitute a State Level Task Force for Urban Co-operative Banks (TAFCUB) with representatives from RBI, State Government and the sector for identification and drawing up of a time bound action plan for the revival of potentially viable UCBs and providing non-disruptive exit route for non-viable UCBs. The MoUs also seek to encourage and facilitate human resources development and IT initiatives in UCBs. Under the MoU, the State Government undertakes to introduce long form audit report for statutory audit and modify audit rating models so as to align the same with the gradation system adopted by the Reserve Bank for all UCBs. The MoU also provides for statutory audit by Chartered Accountants (CAs) for UCBs with deposits over Rs.25 crore and special audit by CAs. As on date, 26 State Governments viz., Governments of Andhra Pradesh, Assam, Chattisgarh, Delhi, Goa, Gujarat Haryana, Himachal Pradesh, Jharkhand, Karnataka, Kerala, Madhya Pradesh, Maharashtra, Manipur, Meghalaya, Mizoram, Orissa, Puducherry, Punjab, Rajasthan, Sikkim, Tamil Nadu, Tripura, West Bengal, Uttaranchal and Uttar Pradesh have entered into Memorandum of Understanding with the Reserve Bank for supervisory and regulatory co-ordination. A similar agreement was also entered into with Central Registrar of Co-operative Societies, Government of India, in respect of UCBs registered under the Multi State Co-operative Societies Act. MOU arrangements so far encompass 1712 UCBs out of 1721 UCBs (as of March 2009) thereby covering 99 per cent of the total number of urban cooperative banks and 99 per cent of the total deposits of the sector. Efforts are on to enter into MoUs for regulatory coordination with the remaining states as well. With the signing of MOUs, state level Task Force for Urban Co-operative Banks (TAFCUBs), having representatives from RBI, State Government and UCB sector have been constituted in each state. Similar Task Force has also been constituted in respect of multi state UCBs. The impact of the consultative process is reflected in the improving health of banks in States where TAFCUBs have been functioning. While the total number of Grade I and II banks has increased during the three year period, the number of Grade III and IV banks has correspondingly declined as seen below:

Table 15: Gradation of banks since entering into MoUs with State Governments.

Year	No. of UCBs	No. of Banks in Grade (I + II)	No. of Banks in Grade (III+IV)	Grade I + II as a Percentage to the total	Grade III + IV as a percentage to total
2005	1872	1147	725	61	39
2006	1853	1176	677	63	37
2007	1813	1250	563	69	31
2008	1770	1274	496	72	28
2009	1721	1329	392	77	23

Further, after the signing of MoU, there has been improvement in asset quality and growth in public deposits (in spite of reduction in number of UCBs)

The regulatory comfort brought about by MoUs with State Governments has enabled the Reserve Bank to extend additional business opportunities to UCBs including organic growth through new branches. In July 2008, UCBs in MoU States and Multi State UCBs have been permitted to set up off site ATMs and branches based on their Annual Business Plans and subject to certain prudential parameters.

3.2.3 Differentiated Regulatory Regime

The period prior to the Vision Document, UCBs were regulated on the premise that ‘one size fits all’. Taking into account the heterogeneity in the sector and with the enunciation of the 'Vision Document', a differentiated regulatory regime has been adopted by Reserve Bank as against to the earlier regime of 'one size fits all'. For the purpose, banks are classified under two Tiers (Tier I and II). The differentiated regulatory norms prescribed for the two Tiers are given in the Annex 2. While both Tier I and Tier II are subjected to same CRAR discipline (credit and market risk) and prudential requirements on exposure norms, Tier II banks are required to adopt 90-day norm for loan impairment as against 180- days loan impairment norms for Tier I banks, stricter provisioning requirements on standard advances, enhanced risk weight on commercial real estate advances and disclosures in their balance sheets.. Further, larger Tier II scheduled UCBs meeting certain eligibility criteria have been permitted to open currency chest and full fledged Authorized Dealer Category I License.

3.3. Supervisory Regime for UCBs

3.3.1 Urban Co-operative banks (UCBs) whose financials, method of operations and compliances with the rules and regulations are not satisfactory and which poses threat to continued financial viability are to be identified for appropriate supervisory interventions. The extant supervisory framework for UCBs can be classified under the broad head (i) On Site Supervision and (ii) Off Site Supervision.

3.3.2 On Site Inspection

The on site inspection is undertaken under Section 35 of the Banking Regulation Act, 1949 (AACS) as a follow up of the objectives and the conditions stipulated while licensing the bank under Section 22 of the Act, ibid. The on site inspection is required to make a realistic assessment of the realizable value of assets as also the total outside liabilities. The excess of realizable value of assets over the total outside liabilities thus worked out would represent the net worth of the bank or the real exchangeable value of the paid-up capital and reserves. The inspecting officers are also required to work out the CRAR, after excluding the unprovided for provisions for NPAs, diminution in the value of assets etc.

3.3.3 Graded Supervisory Approach

Further, on the basis of the inspection findings, all banks (scheduled and non scheduled) are classified into four grades to enable the Reserve Bank to initiate prompt corrective action. In order to take the appropriate supervisory steps based on banks' financial conditions, banks are classified into four grades, viz., Grade I, II, III and IV on the basis of capital adequacy, level of NPAs, profitability and compliance with reserve requirements. The periodicity of on-site inspections of UCBs is also depended on the gradation of banks and is as under:

- Scheduled UCBs: once in a year.
- Grade III / IV non-scheduled UCBs: once in a year.
- Other banks: once in 2 years.

While Grade I and II are considered as financially strong banks under Grade III and IV are considered weak and sick banks requiring supervisory intervention by the regulator. A framework of graded supervisory actions / responses to be initiated in respect of UCBs that are classified as Grade III / Grade IV have therefore been prescribed that can vary in severity depending on the degree of impairment of the bank's financial position. After finalization of the inspection report on individual banks, the Regional Offices of Reserve Bank may initiate action as per the framework of graded supervisory actions. The measures taken by the RBI as far as the banks in Grades III and IV are concerned can be grouped broadly in to three categories, as under:

(a) Those aimed at strengthening the financial position of the banks, and
(b) Those aimed at limiting the growth of assets and liabilities.
(c) Those aimed at preventing preferential payments of deposits.

The measures for strengthening the financial position of the banks include formulation of an action plan for recovery of NPAs, strengthening of capital base through larger accretion of reserves, limiting dividend pay outs, etc. The banks are advised to recover the loans and advances extended to their directors or their relatives / firms, reduce the rate of interest on deposits, reduce the reliance on high cost deposits by widening the depositor base, reduce exposure to sensitive sectors, bring the mismatches in assets and liabilities within prudential limits, etc. The boards of directors of the banks are advised to formulate an action plan for the purpose of bringing a rapid turn around of the banks. In the case of banks that are finding it difficult to meet the claims of depositors on account of temporary liquidity problems, they are directed to limit the growth of assets and liabilities or incur any expenditure. These measures help the bank prevent any run on the bank.

3.3.4 **Supervisory rating system**

RBI has also evolved a supervisory rating system to assess the aggregate strength and soundness of UCBs. Rating models have been developed based on CAMELS factors viz., (i) Capital Adequacy (ii) Asset Quality (iii) Management (iv) Earnings (v) Liquidity and (vi) Systems & Control.

3.3.5 **Off Site Surveillance (OSS) system**

As part of off-site supervision, software was developed to facilitate the preparation and submission of all returns by UCBs to RBI, electronically. The OSS statements of UCBs are designed to monitor regulatory compliance and obtain information from them on areas of prudential concern. Such areas include aspects relating to Assets and Liabilities, Earnings, Asset Quality, Sector / Segment wise Analysis of Advances, Concentration of Exposures, Connected or related lending and Capital Adequacy. Initially, the software was implemented in all UCBs with deposits above Rs.100 crore. It was subsequently extended to all banks with deposits above Rs.50 crore. As all these banks were able to successfully adopt the software, it is now also being implemented in smaller UCBs i.e. those with deposits less than Rs.50 crore.

Chapter 4

International Experiences on Umbrella Organizations for Credit Unions (Co-operative Banks)

4.1 This chapter is about co-operative banking experience in other parts of the world where the co-operative movement has been strong and cooperative banks are flourishing. The Group perused available literature on the subject. It elicited through a questionnaire the views of some of the international co-operative regulators on Umbrella Organization in their respective countries (Annex 3 and 4). Among them, the American, Australian, Austrian, Canadian, Dutch, Finnish, French and Italian models were looked at closely. Some members of the Group had an opportunity of visiting Australia, a few European countries and the USA where they interacted with officials of the Umbrella Organizations and regulators. Based on these studies and interactions, the various overseas models have been summarized in this chapter.

4.2 European Models

4.2.1 The cooperative banking sector in Europe was created in response to the economic challenges and deprivation faced by significant number of the population in the 19th and early 20th centuries. Most continental European cooperative banks were established on the basis of the ideas of Hermann Schulze (1808–83) and Friedrich Wilhelm Raiffeisen(1818–88). UK and Irish credit unions only appeared during the second half of the 20th century and were based on the model of the US credit unions, which themselves were inspired by Canadian adaptations of the German cooperative banking concept. (Wim Fonteyne, IMF Working paper, 2007).

(I) Austria; Raiffeisen Bank Group

(i)Raiffeisen Bank (RZB) is an international co-operative bank based and founded in Austria in 1927. It is currently one of the largest banks in the country. It provides the full range of commercial and investment banking services in Austria and ranks among the leading banks in Central and Eastern Europe.

(ii) Group Structure: The Raiffeisen Banking Group has a 3-tier structure. The first tier is formed by around 570 independent and locally active Raiffeisen banks (credit co-operatives) and their more than 1,600 branches. The second tier consists of eight central provincial banks called Raiffesenlandesbanks owned by the Raiffeisen banks of the respective federal provinces. The second tier is either organised in the form of co-operatives or joint stock banks. Raiffeisen Zentralbank Österreich AG (RZB) is organised as a joint-stock company, 88% of which is owned by regional Raiffeisenlandesbanks.

(iii) The local banks with a business profile similar to savings banks concentrate on retail customers and small businesses. Since 1960s, there was a wave of mergers between tiny regional cooperatives to form banks which were of a sufficient size for modern banking. Regional Raiffesenlandesbanks function as bankers for the regional savings and credit cooperatives. They provide services that cannot be carried out by local banks. RZB was founded after the First World War and acts as the central institution of the sector, the liquidity center for the Raiffesenlandesbanks and also operates as a commercial bank. RZB is a leading corporate and investment bank in Austria. RZB owns 70% of Raiffeisen International. RZB is the central institute of the RZB group and the founder of Raiffeisen International. RZB has specialized subsidiaries for leasing, insurance, building and loan association, investment banking, investment funds, private banking, private equity management

(iv) **Mutual Assistance Features**: Individual Raiffeisen banks, the Raiffeisen regional banks, and the RZB provide mutual assistance to protect the interests of creditors and ensure the continued existence of the troubled institution. Any financial assistance provided is accompanied by conditions such as changing management to remedy the underlying cause of the financial problem. The Group also has cross Guarantee System (Haftungsverbund). Voluntary membership commits participating savings banks to be jointly and severally liable for all deposits and liabilities of member banks, up to a limit established by a formula. Member banks are required to provide support for other member banks facing financial distress, which could include provision of liquidity, granting of loans, provision of guarantees, capital injections as well as intervention in business policy and changes in management. A unique feature of the arrangement is that the provisions are implemented by a company that is empowered to establish and monitor risk management policies and systems for member banks, and to intervene and make executive management decisions in a troubled savings bank.

(II) Finland: OP-Pohjola Group

(i) Group structure: In 2005, OP Bank Group and Pohjola Group Plc, the second largest non-life insurer, joined to form the leading financial group in Finland in 2005, viz. OP-Pohjola Group. The Group comprises 229 independent member cooperative banks (these are independent, local deposit banks that are engaged in retail banking) and the Group's statutory central institution, OP-Pohjola Group Central Cooperative. The central co-operative is the OP Bank Group's development and service centre, and its strategic owner institution. The Central Cooperative is owned by the member co-operative banks. As a central institution, it controls the Group. Pohjola Bank plc (formerly OKO Bank plc) is the largest subsidiary of the Central Cooperative. Pohjola Bank plc is a commercial bank, which also acts as the Group's central bank. It is observed that there is joint responsibility for all OP-Pohjola Group member banks' liabilities and commitments.

(ii) **OP-Pohjola Group Central Cooperative** : Being the development and service centre for the OP-Pohjola Group, it prepares the OP-Pohjola Group's joint operational guidelines, promotes co-operation within the Group, safeguards the Group's interests, supervises member cooperative banks' risk management, capital adequacy and liquidity and provides member cooperative banks with centralised services The Core service areas include product and service development, service provision, ICT services, Group steering and strategic owner institution. Central Cooperative's subsidiaries support and complement operations of the member cooperative banks. The major subsidiaries include Pohjola Bank plc , Helsinki OP Bank plc, OP Life Assurance Company Ltd, OP Fund Management Company Ltd, OP Mortgage Bank, OP-Kotipankki Oyj. The Group Central Cooperative own 29.9% of shares and have 56.8% of votes of Pohjola Bank plc (April 30, 2007).

The Group Central Co-operative is obliged to give member banks instructions concerning liquidity, solvency, risk management and joint accounting principles in consolidated financial statements. It has also the responsibility to supervise member bank's operations.

(iii) **Pohjola Bank plc** acts as an independent commercial bank and financial institution for the member cooperative banks. It also has the responsibility for the international affairs of the Group. The Bank is the central financing institution of the cooperative banks and as a commercial bank it engages in the business operations set forth in the Credit Institutions Act. The special purpose of the Bank is to promote and support, as a central financing institution, the activities of the cooperative banks and other institutions belonging to the Cooperative Banks Group. The bank can offer investment services as well as custodial and asset management services. The bank is responsible for the debts and commitments of the central institution and its member banks and other Cooperative Credit Institutions. The central institution and its other member banks are in turn responsible in the same way for this bank's debts and commitments.

Pohjola Bank plc has issued two categories of shares; Series A and K. Series A are intended for the public and are listed on the Helsinki Exchanges. Each Series A share entitles its holder to one vote at the general meeting of shareholders. Series K shares can only be owned by a Finnish cooperative bank and the central institution, Group Central Cooperative. Each Series K share gives its holder five votes. The Series K share can be converted into Series A share upon a demand of the shareholder or, in respect of nominee-registered shares, subject to certain conditions and the Articles of Association. The majority of Supervisory Board members are elected from among the members of the Supervisory Board of the OKO Bank Group Central Cooperative. One of their duties is to appoint the Chairman of the Executive Board and the President.

(iv) **Co-operative Control:** Pohjola Bank plc, through its issuance of two categories of shares, presents a hybrid model that blends the benefits of a listed entity and those of a cooperative. While the Series A shares enable raising capital on stock exchange, the Series K share ensures cooperative control over the institution.

(III) France: Credit Agricole Group

(i) **Structure:** Originally, the Credit Agricole Group was the banker of the French agricultural sector and farming communities. However, it has evolved and broadened its activities to service all sectors of the economy and all types of clients. The organization has a three-tier structure. There are more than 2,500 local banks grouped into 39 Regional Banks, which in turn hold a majority of the capital of Credit Agricole S.A., the central bank of the Group. The Federation Nationale du Credit Agricole (FNCA) is the representative body of the Group. The Federation also offers support and services to the Regional Banks, such as occupational training and human resources management. Credit Agricole S.A. is the largest bank of France having a unified, yet decentralized, organization.

(ii) **Ownership Structure**: The local banks, which are cooperative societies, own most of the capital of Regional Banks, and form the base of the Group. As key players in France's local communities, the local banks' directors play an important role in France's local economies, enabling Credit Agricole to tailor its product and service offering to suit customer requirements. The Regional Banks are co-operative entities and undertake all banking activities. Some of the Regional Banks have obtained funds from capital markets by issuing non-voting shares (certificats cooperatifs d'investissement). Regional Banks, via SAS Rue La Boetie (SPV), hold a majority stake (55% of shares) in Credit Agricole S.A. Credit Agricole S.A. in turn, holds 25% of the share capital of each Regional Bank.

(iii) **Role of Credit Agricole S.A**: As a result of Credit Agricole's desire to embrace the market while strengthening its mutual identity, Credit Agricole S.A. was floated on the stock market in December 2001. Credit Agricole S.A. is a universal bank, present across the entire spectrum of banking and insurance activities. Credit Agricole S.A. represents all Group business lines and entities, and has three main roles within the Group, i.e. lead institution, central banker and the entity responsible for ensuring consistent development. It manages the treasury operations of Credit Agricole and raises and lends funds on the international capital markets. It also provides many of the international services offered by the Group as well as a number of technical and financial services through its specialized subsidiaries. Credit Agricole S.A. designs the products marketed by the Regional Banks and is responsible for its subsidiaries and for international growth.

(iv) Credit Agricole S.A. owns 25% of the Regional Banks' capital and all Group interests in foreign banks and operating subsidiaries specializing in particular business lines. In view of Credit Agricole S.A.'s stake in the Regional Banks, 25% of the Regional Banks' results are accounted for in the results of Credit Agricole S.A. using the equity method. Credit Agricole S.A. coordinates the implementation of commercial strategy, in particular by defining broad marketing and communications policy. As the Group's lead body, it also is in charge of managing centralized savings and advances for the Regional Banks apart from audit and risk management.

(IV) Italy: The Italian cooperative banking sector-

(i) The co-operative banking sector consists of two types of banks. There are the rural Banche di Credito Cooperativo (BCC), which have Iccrea as their supporting institution and central bank. Secondly, there is the Banca Popolare which operates relatively independent of each other. These Popolari are generally larger than the individual BCC banks. The individual populari differ a lot from each other. Some are very modern and financially healthy institutions, while others still sell only a limited range of products and have weak financials. Banche Popolari are often medium sized cooperative banks although there are examples of banks of this kind which are among the largest in the country.

(ii) The structure of these banks usually follows a single-brand architecture in which the bank has several branches across the country operating under a single brand. Besides that, there is no common organizational feature that makes them different from other banks. It is important to point out that Banche popolari are not subject to the operating limits that apply to BCC. Hence, they are in all aspects similar to joint stock companies having the whole spectrum of activities at their disposal. The only different rule regarding Banche Popolari is that they are legally obliged to allocate at least 10% annual profit to legal reserves.

(iii) Shareholders' stake in the company may not exceed 0.5% of the total nominal value of the company (with the only exceptions of investment funds whose ownership limits depend on the funds' discipline. As in other cooperatives the principle of "one head one vote" is applicable. The latter characteristic safeguards these banks from possible take-over with all the possible advantages and disadvantages that we may imagine (management targets less biased toward the shorter term, management change harder to accomplish).

(iv)There is no special stock exchange for cooperatives and no specific listing criteria applicable to them.

(v) Besides what previously said there is no other difference with other listed banks. These banks have the same capital raising avenues at their disposal as other banks

(V) **Netherlands: Rabobank Group**

(i) **Group Structure:** Rabobank Group is the largest financial services provider in Netherlands and has an extensive network worldwide. Rabobank Group is a cooperative banking organization comprising Rabobank Netherland (central co-operative of local banks), Rabobank Netherlands' local member credit institutions (local banks) and numerous other subsidiaries like Rabobank International. Both Rabobank Netherlands and all the local Rabobanks have the format of a co-operative. In principle, all customers of the local banks can become members of local banks, with membership bringing certain rights. However, in Rabobank Nederlands, only local Rabobanks that have a co-operative structure and whose Articles of Association have been approved in advance by Rabobank Nederlands can become members. It is, therefore, a closed co-operative. The cooperative structure and local involvement have been the cornerstones of the Group for over a century. In the case of local banks, members exercise influence on the cooperative through the general meetings. In the case of Rabobank Nederlands, members are from local banks who are its shareholders and exercise influence. Interestingly, while Rabobank Netherlands is a subsidiary of the local Rabobanks, it is in fact at the head of an inverted pyramid. It is important to recognize that the Rabobank Nederlands' relationship with the member banks is that it of a 'daughter' with many parents. At the same time it is itself the 'parent' of many subsidiaries, including Rabobank International.

(ii) **Supervisory/regulatory structure**: The local banks serve their customers with the support of Rabobank Netherlands and not vice versa. The latter provides managerial, operational and advisory services, which include credit approvals, cost sharing and other centralized functions such as IT, human resource management, liquidity, capital and risk management, etc. Further, in accordance with the Credit System Supervision Act, 1992, it is responsible for supervising the financial health and professionalism of the local Rabobanks. It also acts as treasurer to the Group and a holding company of a large number of subsidiaries.

(iii) **Deregulated supervision**: In the Netherlands, licensing of banks and subsequent supervision is carried out by Dutch Central Bank (DNB). The local Rabobanks have their own banking licenses, but at a local level they do not need to comply with all the licensing conditions specified in law. The law gives DNB power to set aside certain elements of the licensing application, and certain terms and conditions attached to the licensing power if the bank in question is affiliated to a central credit institution. Considering that the local Rabobanks are members of Rabobank Nederlands, supervision of the solvency, the liquidity and the administrative organization of the member banks have been assigned to Rabobank Nederlands instead of DNB. Rabobank Group is treated as a consolidated entity for regulatory and supervisory purposes.

(iv) **Shareholding:** Local Rabobanks do not have any shareholders and as such, do not pay dividends. Hence, they retain all profits. Local banks, which are members of Rabobank Nederlands, hold shares of the latter. Rabobank Netherlands had issued trust-preferred securities and membership certificates for raising Tier I capital. It is understood that some form of concessions are given to such securities holders in interest payments, customer service etc.

(v) **Mutual Support System**: In accordance with the Credit System Supervision Act, 1992, an internal Cross-Guarantee System is in place whereby certain entities within the Rabobank Group are liable for the other participants' financial obligations in case of a shortfall of funds. Participating entities within the Rabobank Group include Rabobank Netherlands and the local Rabobanks. This cross guarantee system, in a way, provides, to any bank within the structure, access to the resources of the entire

Group, facilitating support in times of need. In effect they all have joint and several liabilities for each other's commitment. In order to be part of the system, banks have to comply with certain rules. The compliance with these rules is monitored and supervised from a central level.

4.2.2 **Major Features of the European Model**

(i) **Presence of apex entity that acts as central bank**: It is observed from the above that one of the major features of the European co-operative banking model is the organization of the co-operative banks into cohesive federated network models. The Federated Cooperative Bank Model as prevalent in countries such as Netherlands (Rabobank Group), France (Credit Agricole Group), Finland (Op-Pohjola Group) etc, broadly revolves around a strong apex level entity, which can also enjoy supervisory powers. All the local cooperative banks are generally members of the apex entity. Each member exercises its voting rights under the 'one member one vote' principle. The apex entity supports and advises the individual member banks in areas such as customer services, ALM, IT, Mutual Funds, product development etc.

(ii) **Access to Capital markets**: Further, the financial co-operatives at the base level are able to indirectly tap the capital markets through the apex central body which in turn raises capital via subsidiary route. Rabobank Nederland in the Rabobank Group, Pohjola bank plc in the OP-Pohjola Bank Group and RZB in the Raiffeisen Bank Group are few such examples. However, co-operative character is retained at the ground level. Pohjola Bank plc, through its issuance of two categories of shares, presents a hybrid model that blends the benefits of a listed entity and those of a cooperative. While the Series A shares enable raising capital on stock exchange, the Series K share ensures cooperative control over the institution. Further, in case of Banche Popolari, which are generally medium sized cooperative banks in Italy the shares of the bank are traded like any other company's shares.

(iii) **Mutual Support System:** A significant characteristic of the European cooperative network of banks is the existence of a mutual support system. It is observed that in the case of Rabobank Group (Netherland), Raiffeisen Bank Group

(Austria) and OP-Pohjola Bank Group (Finland) legally binding cross guarantees are in place whereby, if any bank within the group faces financial difficulty, the other members of the Group would support it; in effect they all have joint and several liabilities for each other's commitments. While in Rabobank Group the compliance with these rules is monitored and supervised from a central level. However, in the case of Raiffeisen Bank Group (Austria) the mutual support arrangement are implemented by a company that is empowered to establish and monitor risk management policies and systems for member banks, and to intervene and make executive management decisions in a troubled savings bank. Any bank within these structures therefore has access to the resources of the entire group, facilitating timely support. As such, the group could essentially be regulated as a single entity.

(iv) **Self Regulation:** It is also seen that in some cases, especially in Rabobank Group, the apex body is vested with supervisory powers and obligations over the cooperative banks, which indirectly provides self regulation. However the Group, as a whole, is being regulated by the regulatory authority. OP-Pohjola Group Central Cooperative also has the responsibility of supervising member banks' operations.

(v) **Presence of Supervisory and Executive Board:** It is observed that in many of the European Co-operative Models, the Board of the banks has been bifurcated into Supervisory and Executive Board. While Supervisory Board is responsible for laying down the broad contours of strategy, the Executive Board is vested with the mandate to execute day to day operations within the limits set up by the Supervisory Board. In case of Op-Pohjola Banking Group, the Central Co-operative's Supervisory Board approves Op-Pohjola Groups strategy, main risk management principles, business objectives, capital plan etc. The Executive Board is responsible for organizing the monitoring of the same in member banks.

4.3 Credit Union's Umbrella Organization in Australia

4.3.1 The Credit Union's 'Umbrella Organization' in Australia comprises of the Credit Union Services Corporation Australia Limited (CUSCAL) and Indue Limited and they have been the two industry bodies since the credit union industry was bought under Prudential Supervision in 1992 under the Financial Institution Scheme. The majority of Australia's credit unions (110 out of 135) are members of CUSCAL. The Umbrella organizations have a corporate structure. Credit unions have shares in these industry bodies which provide a range of services to the credit unions, including access to payments system, access to wholesale monies, credit cards securitization vehicles etc

4.3.2 **Credit Union Services Corporation Australia Limited (CUSCAL)**

Pursuant to the Financial Institution Scheme (FI) Scheme of 1992, all the leagues have combined to form a national industry body, CUSCAL. Cuscal is owned by around 110 credit unions who are also its shareholders. Shareholdings are broadly linked with the balance sheet size of each affiliated credit union. CUSCAL provides a range of transactional and wholesale banking products& services to support the operations of credit unions and other financial institutions e.g. finance companies. The transactional banking (settlement and payment related activities) include chequing, debit and credit cards, ATM and EFTPOS facilities etc. Liquidity and capital management (on and off balance sheet activities) include investments and cash -e.g. deposit accounts, NCDs, brokerage services, derivatives facilities, lending (e.g. overdrafts, standby facilities, term loans) and securitization. CUSCAL's revenue and profit are essentially derived from a range of fee income (transactional banking activities), margins & fees from securitization, and net interest margins from its liquidity and lending activities

4.3.3 **Credit Union Financial Support System (CUFSS)**

CUFSS, a registered company limited by guarantee, runs an industry funded and owned liquidity support scheme certified by APRA under the Banking Act 1959. Essentially a self-regulatory system CUFSS is an additional protection for depositors in addition to the regulation of the Banking Act and prudential supervision of the Australian Prudential Regulation Authority (APRA). CUFSS' objectives are to (i) protect the interests of Credit Union depositors, and (ii) to promote financial sector stability, particularly in relation to Credit Unions. Each individual CUFSS Member's commitment to the system is through the Industry Support Contract (ISC) which sets out their obligations, rights and responsibilities. Each credit union provides a "commitment" of up to 3.2% of its total assets to the scheme. As required and as decided by CUFSS, it will provide emergency financial support to its credit unions. CUSCAL is a CUFSS shareholder in its own right and banker for CUFSS. It gets to appoint one of the CUFSS directors. The majority of Credit Union money pledged is lodged with Cuscal. In the event of CUFSS approving financial accommodation Cuscal is normally used as a conduit to collect the individual Credit union contributions and pay to the assisted credit union.

4.3.4 CUFSS functions are: (i) to administer the emergency liquidity support system (ii) monitor members' liquidity, capital & profitability (iii) advise members about liquidity and risk management (iv) assist the orderly exit of members by way of merger (v) determine and arrange emergency financial support if required (vi) liaise closely with regulators**.**

4.3.5 **INDUE**

(i) Indue is owned by the shareholding credit unions. The primary line of business is to provide clients access to the Payments Clearing System via Westpac's ESA account. The payment products includes Visa debit cards, Visa credit cards, direct entry, chequing, BPay, EFTPOS, and prepaid cards. Indue Ltd also facilitates ATM network labelled for credit union clients or "Indue Money" brand. Indue services the network for a fee and collects transaction charges. This is managed through wholly owned subsidiary (Indue Aggregation Service Pty Ltd). Indue Ltd is also a facilitator for securitization through its subsidiary and charges fee and portion of excess margin. It has also a retail IT banking platform through which software services for banking application are provided.

(ii) Twenty credit union are clients for transactional services out of which 19 are also its shareholders. Ownership is linked to asset size with a cap of 15% for any one shareholder. Historical emphasis was on providing low cost services to these owner / clients, however of late it has been increasingly moving toward more of a commercial, profit-focused enterprise. CUSCAL with over 100 credit union customers; 150 financial service brands, $4.2B in assets (15 times the size of Indue) is the main competitor.

4.4. Credit Union Centrals in Canada

4.4.1 Credit Union Central of Canada (Canadian Central) is the national trade association and central finance facility of all member credit unions and caisses populaires. Caisses Populaires are primarily found in the province of Quebec in Canada, and are essentially the francophone equivalent of a credit union. There are eight provincial credit union centrals and one federation of caisses populaires who comprise the shareholder group of Canadian Central and who appoint 10 Directors to the Board.

4.4.2 **Function of Credit Union Centrals**: The principal role of the provincial centrals is to monitor and maintain system liquidity at the provincial level right till the grass roots. The liquidity pool is shared and designed to maintain system stability by covering normal cyclical requirements. Along with provincial deposit insurance and other financial facilities, the outcome of all centrals working together is the assurance that credit unions are among the soundest of all Canadian financial institutions. Additional services include providing direct access to the Canadian payments system, facilitating fund transfer between credit unions, regular financial updates, and asset/liability management. Canadian Central was first established to provide liquidity for the Canadian system and this remains core to their purpose today. Later on, Canadian Central assumed increased development responsibilities to help credit unions achieve competitive advantages in services improvements, training and knowledge sharing. Canadian Central provides its owners, (the provincial Centrals and other partners) and Canada's credit unions with a forum in which to work together and an instrument to help build and implement national services.

4.4.3 **Central 1 Credit Union (Provincial Central Credit Union)**

Central 1 is a credit union, which is a type of co-operative. It is incorporated under the Credit Union Incorporation Act of British Columbia, and is regulated by both the provincial government and the federal government. Central 1 Credit Union is the central financial facility and trade association for the British Columbia (B.C) and Ontario credit union systems in Canada It's an "**umbrella organization,"** representing retail financial institutions that serve 2.8 million members and hold more than $60 billion in assets. Central 1's role is to serve as central financial facility, liquidity manager, payments processor and trade association for the provincial credit union systems of B.C. and Ontario. It provides leadership, advocacy, technology and a range of support services in fulfillment of these key functions. As the official voice of B.C. and Ontario credit unions, it represent their interests through ties to Credit Union Central of Canada, other provincial centrals, federal and provincial regulatory agencies and various affiliated organizations providing insurance, technology, education and wealth management services.

4.5. **Corporate Credit Unions in the United States.**

4.5.1 A corporate credit union is a credit union for credit unions – a not-for-profit financial cooperative that serves retail credit unions within its field of membership. Corporate credit unions are totally owned and directed by their member credit unions. The nation's 27 corporate credit unions exist solely for the benefit of their member credit unions and do not offer any products or services directly to consumers. By utilizing corporate credit unions, the credit union industry achieves collective cost-savings, synergies and competitive advantages. Ninety nine percent of the U.S. credit unions use their corporate credit unions for one or more services, and these credit unions serve over 90 million Americans.

4.5.2 Corporate credit unions (or corporates) started by being a source of low-cost liquidity for credit unions, usually saving them significant sums of money when they needed to borrow. Also, corporate credit unions eliminated credit union reliance on banks and other vendors through products and services designed to meet the needs and safety standards of credit unions. Over the years, credit unions have demanded financial services from their cooperatively owned corporates that kept pace with emerging technology, flexible service capabilities and income opportunities available in the marketplace. This has enabled credit unions to remain competitive and continue to flourish.

4.5.3 Services Provided by Corporate Credit Unions:

- Investment services
- Credit and liquidity management services
- Payment services (check/image processing, ACH, coin and currency, wire transfers, bill payment, remote deposit capture services, cash management services)

- Settlement services
- Balance sheet management services
- Business services
- International services
- Brokerage services
- Card services
- Educational/training services

4.5.4 Corporate credit unions can be either state or federally chartered. The National Credit Union Administration (NCUA) Rules and Regulations apply to all federally chartered and state-chartered corporate. To protect the National Credit Union Share Insurance Fund (NCUSIF), federal and state examiners jointly examine state-chartered corporate. In addition, the NCUA has an office devoted to examining corporate credit unions.

4.5.5 The U.S. Central

(i) The largest corporate credit union in the United States is U.S. Central Credit Union. Unlike consumer driven credit unions (referred to as "natural person" credit unions in the industry), US Central provides its services only to other corporate credit unions, in effect acting as the "corporate credit union's credit union". The organization was founded in 1974. U.S. Central is the wholesale financial center for the nation's corporate credit unions. U.S. Central is owned and directed by its member corporate credit unions, in the tradition of the cooperative credit union spirit. As the "credit union for corporate credit unions," U.S. Central exists solely to assist them in serving 8,400 credit unions across the country. Currently, U.S. Central's assets total approximately $49.1 billion. U.S. Central provides members with extensive investment, liquidity, and cash-management products and services; risk-management and analytic capabilities; settlement, funds transfer and payment services; and safekeeping and custody services.

(ii) U.S. Central is regulated by the National Credit Union Administration (NCUA) and insured by the National Credit Union Share Insurance Fund (NCUSIF), and deposits, except for Membership Capital Shares (MCS), are insured up to $250,000 per depositor. NCUA regulations state that MCS are subordinated capital and, hence, are exempt from NCUSIF coverage.

4.6 International Umbrella Models- Two Broad Approaches

4.6.1 From the above models on Umbrella Organization, it may be observed that there are two broad distinct approaches for creation of an Umbrella Organization. In European countries, the Umbrella Organization is generally in the form of a strong apex level entity (usually in the form of the central bank). The co-operative networks, arranged under two/three tier framework, revolve around the central apex body. All the local cooperative banks are generally members of the apex entity. Each member exercises its voting rights under the ‘one member one vote’ principle. The apex entity supports and advises the individual member banks in areas such as customer services, ALM, IT, Mutual Funds, product development etc. A significant and distinct character of European network model is the existence of a mutual support system viz., legally binding cross guarantees, which are monitored by the central bank like in Rabobank Nederland or through outside body. The Umbrella Organization viz., Rabo Bank Nederland and Op-Pohjola Group Central Co-operative also enjoy supervisory powers and responsibility. Further, Rabobank Group is considered as one for regulatory and supervisory purpose by the Dutch regulator.

4.6.2 In the case of Australia, USA and, Canada, the Umbrella Organization is not part of any group, but is a distinct entity where the credit unions are its members. In US there is an ‘Umbrella’ of Umbrella Organizations. The Umbrella Organization in US provides extensive investment, liquidity, and cash-management products and services; risk-management and analytic capabilities; settlement, funds transfer and payment services; and safekeeping and custody services. However, in Australia the emphasis has been on transactional (payment like clearing) services and emergency liquidity support. CUFSS a registered company limited by guarantee, is an industry funded and owned liquidity support scheme certified by Australian regulatory body. In Canada, the Umbrella Organization serves as central financial facility, liquidity manager, payments processor and trade association also.

4.6.3 There are other countries (e.g. UK, Brazil, Ireland) where there are no such Umbrella Organizations. One of the reasons could be that credit unions are still in developing stage vis-à-vis their European counterparts. However, they have trade associations as in India lobbying with the regulators.

4.7 Having considered the umbrella systems for credit unions across a spectrum of countries, we learn that these organizations are serving the sector well and have not only resulted in greater efficiency of operations of their members at the grassroots, but have also contributed significantly in augmenting financial stability and safeguarding depositors interests. This has given comfort to the regulators. Notably, in Australia all credit unions adhere to the Basle II norms and their average CRAR is 16 percent. The Umbrella Organization (CUSCAL) itself is very strong with a high credit rating and even more tightly regulated than the credit unions themselves. The umbrellas have evolved over time as a part of a network due to the initiatives of the sector in these countries. Cutting across all the umbrellas, we observe that they all provide banking services to their members and are actually banks. Besides they also act as gateways for the payment systems, issuers of credit/debit cards, ATM network providers and also providers of other services such as fund management, emergency liquidity support. Some of these organizations also provide a route to accessing capital through their subsidiaries. Without doubt, it can be said that the UCB sector in India does need to have the benefit of an Umbrella Organization of its own, which would naturally have its flavor and uniqueness considering the peculiarities of the legal framework that applies to them as also the present infirmities in the sector.

Chapter 5

Designing the Umbrella Organization for UCBs in India

5.1 Need for Umbrella Organization

5.1.1 Urban Cooperative Banks in India cater to the financial needs of the middle and lower middle class people in metropolitan, urban and semi-urban centres. They operate on a standalone basis, unlike rural cooperatives in India, which have a three tier structure. These banks are large in number, though of varied asset size, ranging from small to medium. Although they compete with commercial banks, their share in total deposits is barely 4 percent. There is a significant part of the UCB sector that lacks professionalism and is unable to keep pace with rapid advancements in IT, modern banking systems and financial products. The sector also has significant number of banks which are weak and need financial support. There have been occasions when, due to contagion effect, banks have encountered liquidity problems. Being in the nature of cooperative societies, the UCBs' ability to augment their capital is also restricted, thereby hindering their growth.

5.1.2 The organizational structure of UCBs, their small size and limited area of operation add to their vulnerability. Further, in the wake of advances in information and communication technology, payment and settlement systems and services, they need to widen their range of services to run on professional lines and match the services provided by commercial banks.

5.1.3 Internationally, cooperative banks, popularly called Credit Unions, operate in networks and have an entity which provides a wide range of services to them, such as, fund management services, lines of credit, asset management, payment and settlement system gateway, ATM networks, credit card, investment, securitisation, capital raising and other financial services. These entities act as Umbrella Organizations and the networks provide cooperative solidarity. International experience has shown that the presence of such an Umbrella Organization has contributed towards the member Credit Unions being stable, sound and efficient entities.

5.1.4 The Working Group had a close look at the Umbrella Organizations of credit unions in certain countries, such as, Australia, Belgium, Canada, Finland, France, Germany, Netherlands, Poland and USA. These have been discussed in the preceding chapter of this report. In particular, it was noteworthy that the presence of such organizations has induced a climate of self-regulation and good corporate governance in the sector. This has resulted in greater comfort for regulatory authorities in these countries. The Working Group is convinced that an Umbrella Organization that provides a variety of professional services to UCBs helps them in augmenting their capital and provides emergency liquidity support would be immensely helpful for the sector. This, indeed, was also the unanimous view of all the representative bodies of UCBs across various states as also cross-section of UCBs which were consulted by the Working Group.

5.2 Umbrella Organization at the National Level

5.2.1 The Working Group carefully went into the important issue of whether in India we should have an Umbrella Organization at the national level or whether each state should have its own Umbrella Organization. While countries such as Canada and USA have provincial Umbrella Organizations, Australia and European countries have preferred to consolidate and have national level organizations.

5.2.2 UCBs in India are not evenly spread across the country. They have predominant presence in five states, viz. Andhra Pradesh, Gujarat, Karnataka, Maharashtra and Tamil Nadu accounting for about 89 percent of the total business of the sector. Further, UCBs in Maharashtra alone had about 64 percent of the total business. In contrast, their presence was minimal in many states. Considering the regional spread and market share of UCBs, the Working Group is of the opinion that having multiple umbrella organizations for UCBs in India or state-wise umbrellas may be neither feasible nor desirable. Therefore, the Working Group is of the view that there should be one Umbrella Organization at the national level for the entire UCB sector.

5.3 Functions of the Umbrella Organization

5.3.1 The Umbrella Organization should act as a central credit institution for UCBs, like similar organizations abroad for Credit Unions. It should provide a wide range of services such as providing loans and advances, refinance, payment and settlement services, IT services, ATM network services, investment banking, fund management, management consultancy, capacity building services and even capital support. The UCB sector was found to be particularly keen that the organization provides payment and settlement services and liquidity assistance. This may possibly be emanating from the concern arising in the context of implementation of the new eligibility norms for MICR clearing, RTGS, SGL/CSGL accounts and making them out of reach for a large number of UCBs and lack of avenues for temporary liquidity assistance (even against SLR securities) in case of need and urgency; more so in case of run like situations. Similarly, many small UCBs are looking forward to a centralized agency for buying, selling and managing Government securities on their behalf in view of their lack of skill and expertise in the areas. The Working Group recommends that the Umbrella Organization should provide a whole range of services to member UCBs, as described above.

5.4 Form of organization of the Umbrella Organization

5.4.1 The form of organization of the proposed Umbrella Organization was a subject matter of intense discussion within the Working Group. While cooperative sentiments favored an apex cooperative structure, considering the limitations and legal barriers that prevent UCBs from enhancing capital there was consensus on a company form of organization. The company form is generic; and within the company form, there could be a wide variety of organizations, each one having its own characteristics and advantageous. From the detailed discussions that took place, emerged a clear preference for a single national level institution over state specific institutions. The Working Group reviewed the current legislative and regulatory framework for various forms of organizations keeping in view the proposed functions detailed above. The permissible and non-permissible activities for different form of organizations are summarized as under:

Table 16: Summary of permissible and non-permissible activities for different form of organizations

Sl. No.	Form of organization	Permitted Activities	Activities not permitted
1	Multi State Cooperative Bank	Most activities	i) Acceptance of UCBs as members ii) Raising of capital from the market
2	NBFC(Deposit Taking) Loan/Investment companies	Most activities	i)Acceptance of demand deposits ii) Limit on acceptance of Term Deposits iii)Current Account with RBI iii)SGL Account with RBI v) Clearing and settlement: Membership of Clearing House, RTGS, NDS, etc. vi)Limit on borrowings
3	NBFC(ND) Loan/Investment	Most activities	i)Acceptance of public deposits ii)Current Account with RBI iii)SGL Account with RBI iv) Clearing and settlement: Membership of Clearing House, RTGS, NDS, etc. v) Limit on borrowings
4	Section 25 company	Most activities	i)As at Sl. No. 2 and 3 ii)Distribution of dividend and hence may not be acceptable to the shareholders/UCBs
5	Banking company	All the activities listed at paragraph three above	No perceivable restrictions

5.4.2 During the discussions, some members of the Working Group and officials from the UCBs and their Federations expressed a view that the proposed Umbrella Organization should be an apex cooperative bank registered under the Multi State Cooperative Societies Act, 2002 and all the UCBs should become members of the apex bank and contribute to its share capital. Further, the proposed Multi State Cooperative bank can take up all activities permissible under the provisions of the Banking Regulation Act, 1949(AACS) and also act as central credit institution for member banks (UCBs). The Working Group deliberated on the issues involved at length. The Working Group, while acknowledging some of the successful cooperative banking models in European counties, is of the opinion that a cooperative form of Umbrella Organization would face the same legal constraints as a UCB. As the apex bank would not be able to raise capital funds from the market, it would have to depend upon UCBs. Further, the existing laws in India do not permit setting up of an apex UCB at the national level. Hence, the Working Group did not find the cooperative format of organization feasible for the proposed Umbrella Organization.

5.4.3 There was also a view that the proposed Umbrella Organization could be set up as a company under Section 25 of the Indian Companies Act, 1956. The share capital of the company may be closely held by UCBs. The argument for a non-profit organization was in consonance with the cooperative principle of reserving of profits and creation of a commonwealth of resources for the benefit of its shareholders, viz. UCBs. It is observed that the Central Government permits formation of such companies for promotion of commerce, art, science, religion, charity, etc. However, the activities proposed to be undertaken by UO for UCBs may not fit into the objects for formation of a Section 25 company. Further, a Section 25 company structure may not encourage UCBs for equity participation as such a company would not be able to distribute dividend.

5.4.4 The Working Group observed that in quite a few countries, e.g. Australia, Canada, USA, etc. the Umbrella Organization is a banking company owned by the cooperative credit unions, and functions as their banker. Its banking operations are, however, confined to the members only. A banking company can perform all the functions of an Umbrella Organision. As a banking company predominantly held by UCBs, it would fall in the regulatory and supervisory domain of the Reserve Bank and SEBI (if, a listed public company). It can have access to capital markets by diluting the shareholdings of UCBs. The organization would be professionally managed as the structure of governance is laid down by the Banking Regulation Act, 1949. Further, it would have to comply with corporate governance principles and policies. Though a banking company structure appears to be suitable for Umbrella Organization, the Working Group felt that there would be severe hindrances in its formation as banking company may compete with UCBs for its business. Very often, it has been argued that the cooperative funds should remain within the cooperative sector. An Umbrella Organization in the form of a banking company may siphon off the funds collected by UCBs for deployment outside the cooperative sector. Further, as per the existing licensing policy, the minimum entry point capital for a banking company is prescribed at Rs.300 crore and it would be difficult to mobilize such a huge amount of start up capital from UCBs as participation would be voluntary. The members from the UCB federations were, however, optimistic about raising the requisite capital funds from the sector for formation of a banking company. They were also of the view that Umbrella Organization as a banking company may be the first choice, since it is the most suitable form of organization.

5.4.5 The Working Group observed that non-banking financial companies (NBFC) could perform most of the functions of Umbrella Organization, as described in paragraph 5.3. The minimum startup capital for such companies has been stipulated at Rs.2 crore, for the present, as per the Reserve Bank's policy for issue of certification for registration. The Working Group is of the view that even though contribution to share capital of the Umbrella Organization would be voluntary, the initial startup capital could easily be garnered from UCBs. It would be better to build the edifice, brick by brick, with low startup capital and augment the capital funds over the years, rather than to commit huge capital funds from the cooperative sector, which itself is facing difficulties in raising capital. Further, at present, the Reserve Bank has been vested with adequate power to regulate and supervise NBFCs. The current RBI regulations, however, do not permit NBFC to undertake certain activities and place restrictions on certain others; more importantly, the Payment and Settlement services. Considering that access to Payment and Settlement gateways and dealing platforms for securities through Umbrella Organization are the most sought after services, the Working Group was of the view that it would be within the powers of the Reserve Bank to grant regulatory permissions/ forbearances wherever necessary, depending upon the type of functions. NBFCs may be broadly divided into deposit taking and non-deposit taking. The term "deposit", however, does not include amount of money received from banks and financial institutions and further, the term "public deposit" excludes certain categories of deposits. The NBFCs that are authorized to accept/hold public deposits need to have minimum net owned Funds and they are required to maintain certain specified percentage (15%) of the public deposits in liquid assets in the form of approved securities and unencumbered term deposits with scheduled commercial banks. These NBFCs should achieve minimum investment grade credit rating for accepting public deposits. The regulations for the deposit taking NBFCs are tighter than that of non-deposit taking. On the contrary, a non-deposit taking NBFC enjoys more freedom in undertaking its business, more particularly deployment of its funds. Keeping in view the extant regulations applicable and the relative merits of deposit taking and non-deposit taking NBFCs, the Working Group is of the opinion that to start with, a non-deposit taking NBFC may be the most suitable form of organization and recommends that Umbrella Organization may be initially set up as a non-deposit taking NBFC. The Umbrella Organization in the form of a non-deposit taking NBFC would, however, access money from UCBs and others, which are not treated as public deposits. The conversion of the Umbrella Organization to a banking company could be considered in due course in the light of experience gained.

5.5 Authorized capital, subscribed/ paid up capital

5.5.1 The extant RBI regulations stipulate that a company incorporated under the Companies Act, 1956 should have minimum net owned funds of Rs.2 crore to be eligible for Certificate of Registration from the Reserve Bank for commencement of business of non banking financial institution. However, keeping in mind the proposed business profile and number of promoters (UCBs), the Working Group is of the opinion that Umbrella Organization should have its authorized and paid up capital much above the prescribed minimum. The Working Group is of the view that the authorized and paid up/subscribed capital of the Umbrella Organization may be pegged at Rs.200 crore and Rs.100 crore respectively. With net owned funds of Rs.100 crore, it would be able to sustain about Rs.800 crore of assets at 15% CRAR. Considering the proposed functions of Umbrella Organization, the Working Group considers net owned funds of Rs.100 crore as adequate and recommends that the Umbrella Organization should have an authorized capital of Rs.200 crore and subscribed capital of Rs.100 crore. Incidentally, for access to payment and settlement system (RTGS), the members should have a minimum net worth of Rs.50 crore. Further, to begin with, the entire share capital may be contributed by UCBs. The shareholdings may be divested subsequently; and a majority stake (up to 51%) may be held by UCBs.

5.5.2 The Working Group deliberated at length on the modus operandi of raising share capital for the Umbrella Organization. It was felt that share capital of the Umbrella Organization should be closely held by the UCBs and subscription should be voluntary. However, some members strongly felt that contribution to the share capital of the Umbrella Organization should be made compulsory for UCBs and the Reserve Bank could consider issuing direction to UCBs in this regard. The Group discussed on the pros and cons of the proposal and was of the view that though equity participation by all UCBs should be encouraged; there could be constraints to make it compulsory for UCBs. The Group was of the view that both the options should be kept open. The National and State Federations should educate UCBs about the benefits of having an Umbrella Organization and also play a big role for its set up and raising of capital.

5.5.3 There were 1,721 UCBs with an asset size of Rs.1,96,395 crore as on March 31, 2009. If they initially contribute Re.0.10 (i.e. 10 paise) per every 100 rupee of assets, Rs.196 crore could be raised as capital. However, since the share holding would be voluntary for UCBs, their participation is expected at 50-60% in terms of assets, though it could be much more in terms of actual number. For example, a bank having an asset size of Rs.10 crore may have to contribute Rs. 1.00 lakh as shares; and the largest UCB having an asset size of Rs.17,521 crore, may have to contribute Rs.17.52 crore. The proposed amount of Rs. 100 crore may be called up / subscribed in two or more installments, if necessary, depending upon the need and response. Further, to begin with, a onetime and uniform entrance fee of Rs. One lakh per member could also be collected and kept in the Reserve Fund. That would provide about Rs.10 crore. The Working Group felt that some kind of fiscal incentives by the Government to UCBs for their contribution would help the Umbrella Organization in mobilizing the share capital.

5.6 Sources of Working Capital

5.6.1 To begin with, the capital funds would normally go to finance fixed assets of Umbrella Organization and the balance amount could be used for financing activities. Umbrella Organization would also need some source of working capital. Being a non-deposit taking NBFC, it would have access to the following sources for its working capital:

i) Borrowings from banks/financial institutions
ii) Deposits: term deposits from UCBs
iii) Debt instruments: bonds/debentures
iv) Refinance: against financial assets (loans and advances) including securities
v) Other miscellaneous sources

5.6.2 The Umbrella Organization would need to have access to deposits from UCBs, which could be a major source of working capital for carrying out its business. A significant number of UCBs have low credit deposit ratios and they park their surplus funds with DCCB/SCB and commercial banks. Umbrella Organization, being the central credit institution for UCBs, may be able to tap these deposits for its financing and investment activities.

5.7 CRR and SLR

5.7.1 During the discussions with the representatives from UCBs and their federations, an argument was put forth that the Umbrella Organization, being the central credit institution for UCBs, their deposits should be reckoned for the purpose of CRR and SLR. One can see some merit in this argument in the sense that such an option would provide Umbrella Organization an assured source of working funds.

5.7.2 Scheduled UCBs are required to maintain CRR only in current accounts with the Reserve Bank. Non-scheduled UCBs are, however, permitted to maintain CRR as current account balances with higher financing agencies (DCCB/SCB) and with public sector banks, besides their own cash balances. According to the provisions of Banking Regulation Act, 1949 (As applicable to Cooperative Societies), deposits of UCBs with higher financing agencies (DCCB/SCB) are eligible for SLR. The Act ibid also provides that loans and advances availed by UCBs from DCCB/SCB are not to be included under liabilities for the purpose of CRR/SLR. However, as a matter of prudence and measure of monetary policy, non-scheduled UCBs have been advised to shift their entire SLR portfolio to Government and other approved securities by

March 31, 2011 and scheduled UCBs are, at present, required to maintain SLR only in Government and other approved securities.

5.7.3 The Working Group feels that it would be attractive for UCBs to place deposits with Umbrella Organization if these deposits are treated as CRR/SLR. The Umbrella Organization would definitely need such deposits to meet its working capital requirements. The Working Group, therefore, recommends that the Reserve Bank may consider exempting UCBs placing term deposits with the Umbrella Organization from maintenance of SLR in the form of Government and other approved securities up to 15% of their NDTL. The Working Group also feels that this would serve as an incentive for UCBs to take up membership of the Umbrella Organization. The Working Group feels that the Reserve Bank which has been instrumental in promoting several developmental and financial institutions should consider the recommendation positively and favorably as the Umbrella Organization is being conceptualized to provide the much needed stability to the UCB sector that would also contribute to financial stability.

5.8 Business Profile and Sources of Income

5.8.1 Profitability of the UO's operations is very crucial and, therefore, in most countries, the central credit institutions have a significant asset portfolio outside the captive business. Further, its ability to raise capital and debt in the market would also depend upon the strength of its balance sheet. The Working Group, therefore, recommends that UO should delicately balance its commitment towards UCB sector and the need to keep its asset portfolio strong and healthy.

5.8.2 As the Umbrella Organization would function as a central credit institution, it would orient its business to provide various services as listed at paragraph 5.3 to the member UCBs (loans and advances, refinance, payment and settlement services, IT services, ATM network services, investment banking, fund management and capital support). This would fetch it revenue in the form of interest, commission, exchange, etc. It is felt that the income derived from services extended to the UCB sector may not be sufficient to sustain the Umbrella Organization. The large and strong UCBs may not avail some of the services. However, small and medium sized UCBs are expected to avail most services for their clients and for themselves, as they may not be eligible for carrying out such activities on their own. The Umbrella Organization's asset portfolio would predominantly comprise loans and advances, which would involve more than the normal risk as many of the UCBs are small entities and have local operations. The Umbrella Organization could also lend to non-UCBs. It would also need to have a healthy investment portfolio.

5.9 Management

5.9.1 It goes without saying that an Umbrella Organization, such as the one under design should be run on thoroughly professional lines and observe the best practices insofar as corporate governance is concerned. The Working Group recommends that the Memorandum and Articles of Association of the company (Umbrella Organization) should specifically provide for appointment of independent directors. In order to achieve this objective, the fit and proper criteria for the Board of Directors and Executive Board/CEO may be prescribed either in the Memorandum and Articles of Association, or by the regulators.

5.9.2. The Working Group is the opinion that the CEO should be a professional of repute, with deep knowledge and understanding of the UCB sector, combined with business acumen of a finance company to inspire confidence in the Umbrella Organization. The Working Group leaves it to the Reserve Bank for putting in place a suitable system, standards and stringent fit and proper criteria to ensure that the position of CEO is held by a competent person. The Working Group is also of the considered view that the Reserve Bank should nominate on the Board a suitable officer, at least during the initial formative years of the Umbrella Organization, Subsequently, the Reserve Bank may have an Observer on the Board. This would not only lend the Umbrella Organization greater credibility, but its nominee's guidance would also be useful in adherence to best corporate governance practices, regulations and formulation of appropriate business strategies and products.

5.10 Regulation and Supervision

5.10.1 The Umbrella Organization, being an NBFC, would be governed by the provisions of Indian Companies Act, 1956 and the Reserve Bank of India Act, 1934. It would function under the supervision of the Reserve Bank.

5.11 Emergency Liquidity and Solvency Support

5.11.1 Occasionally, UCBs confronted by financial distress, caused by temporary liquidity problems, need emergency liquidity support systems to come to their rescue. Similarly, UCBs classified in Grade III and IV with meager or entirely eroded net worth needs solvency support for their revival. Representatives from the UCB sector, during the meeting with the Working Group emphasized the need for addressing these pressing issues.

5.11.2 The Working Group, while appreciating the need for evolving a mechanism to address the aforesaid twin issues, is of the view that it should not be the mandate of the Umbrella Organization to provide such emergency liquidity and solvency support to UCBs as it may be difficult for it to meet the quantum of financial assistance that may be required in this regard. Further, solvency support is subject to high risk and low or nil return and envisages a fairly long period of pay back. Neither the sector, nor the Umbrella Organization, being a non-deposit taking NBFC, would be in a position to fund the recapitalization needs of problem UCBs. However, arrangements need to be put in place to address and resolve these problems.

Emergency Liquidity Support

5.11.3 The Working Group believes that due to lack of homogeneity, uneven geographical spread of UCBs, cultural differences, affinity to state federations and state laws on cooperation, the bonding of UCBs at the State level is strong. Empirical evidence also demonstrates that the contagion effects are localized and solidarity amongst the cooperatives at the State level is far greater than at the national level. The emergency liquidity supports need to be provided to UCBs in financial distress and, in most cases, such facility would be without collateral and for a short term. The uncollateralized emergency liquidity support would carry more than the normal counter party credit risk. Therefore, a thorough understanding of the local polity, the management and operations of the distressed UCB, its problems and prospects would be necessary. The Working Group is of the view that a State level institution would not only have better appreciation of the financial needs of the distressed UCB, but also pull resources for supporting the UCB concerned. Therefore, the Working Group recommends State-specific Emergency Fund Facility Schemes.

5.11.4 The Working Group is of the opinion that emergency liquidity support to UCBs could be provided through “Emergency Fund Facility Scheme” under a tripartite Industry Support Agreement (ISA). Under the Agreement, all the UCBs registered under a particular State Cooperative Societies Act should contribute a certain sum (say 0.05 % of their assets) to the Emergency Fund as deposits at a specified rate of interest (say at the prevailing interest rate for deposits for six months), which would be available to the participating UCBs as a soft loan (liquidity support) carrying interest, say at 8% [cost of funds (6%) +2% markup] for a period of not more than six months/one year. The quantum liquidity support at a soft rate (First Tranche) may be capped at 50 % of net worth of the UCB concerned. Further, under the ISA, a participating UCB should also commit to provide a line of credit to the Emergency Fund when called upon to do so (say additional 0.05% of its assets) at a specified rate of interest (say, the prevailing interest rate for one year deposit). The amount that could be raised through the line of credit may be used for providing liquidity support under Second and Third Tranches to UCBs, at rates higher than the loan under First Tranche say at 10%[cost (8%)+ 2%mark up} and 12%[cost(10%)+2% mark up) respectively. The Second and Third Tranches may also be to the extent of 75% and 100% of the net worth of the UCB concerned, respectively.

5.12 Revival Fund

The presence of a large number of weak and sick UCBs (about 399; 23% of the total), which need solvency support, call for an urgent need for creation of a Revival Fund. If UCBs with negative net worth were to be brought to positive net worth, an enormous sum of about Rs.2, 500 crore may be required. While RBI may pursue a menu of options, including mergers, with or without DICGC support, and financial restructuring for turn around of these banks, possibly, an amount of Rs.2000 crore may still be necessary. However, such a fund could only be raised out of contribution from the net profits of UCBs. The total net profit of the sector being about Rs.1,000 crore, mobilization of this magnitude of resources from the sector may not be feasible. The Working Group has observed that though the Central/State Governments have been supporting the revival of the rural cooperatives, such support was not extended to UCBs. Therefore, in the absence of capital contribution from the Central/State Governments, the Revival Fund for solvency support to UCBs would not be feasible. The Working Group also believed that the providing solvency support to UCBs from contributions from the profits may be resisted by the sector and the contribution would be too little to rescue sick UCBs. Therefore, it would be more appropriate to provide both short and medium term finance from the Emergency Fund. UCBs not complying with the prescribed CRAR may be supported from the Emergency Fund by way of subscription to Tier II instruments issued by these banks.

5.13 Emergency Fund Facility Trusts

5.13.1 In view of the State specific approach to Emergency Fund Facility, the Working Group also recommends setting up of a separate Trust, viz., Emergency Fund Facility Trust at the State level. The representatives from State Government, participating UCBs and State Federation may be in the Board of Trustees to administer the trust funds. As an institutional set-up in the form of TAFCUB is already in place in MOU States and TAFCUB has good understanding about the UCBs in the State and access to information on UCBs, the Working Group believes that the collaboration of the TAFCUB with the Board of Trustees for administration of the trust funds may be necessary. Financial assistance to distressed UCBs from the trust funds may be made on the recommendations of TAFCUB. The modalities and terms and conditions for such support may be worked out by the Board of Trustees in consultation with TAFCUB.

5.13.2 In states where the presence of UCBs is small and it is not viable to set up such a facility, UCBs could affiliate themselves with another state that offers such a facility. The Working Group, while recommending State specific trust funds, is aware of UCBs registered under the Multi State Cooperative Societies Act having presence in more than one States. Such banks may seek affiliation to the trust funds of the

State, where their registered Head Office is located or they may elect to have their separate trust funds.

5.14 The Task of Setting up of the Umbrella Organization & Trust Funds

While the Working Group has enunciated the broad contours of the proposed Umbrella Organization, it will need to be set up in a professional manner with the guidance and support of the Reserve Bank, State/Central Government, representative bodies of the UCBs. The large UCBs will have a major stake in the Umbrella Organization and are expected to be the important drivers. The Working Group recommends that the task of setting up of the Umbrella Organization be entrusted to a Steering Committee presided by a suitable official of the Reserve Bank. The aforesaid Steering Committee will have as its members the Central Registrar of Cooperative Societies (CRCS), Registrar of Cooperative Societies, Maharashtra (the state with maximum number of UCBs), representative each of the NAFCUB and four major UCBs. Similarly, TAFCUBs may be entrusted with the responsibility of working as the Steering Committee for setting up of trust funds. It is expected that the task of setting up of the Umbrella Organization and trust funds would be accomplished within one year.

Chapter 6
Summary of Recommendations

6.1 There are a large number of Primary (Urban) Cooperative Banks (UCBs) in the country forming a heterogeneous group in terms of size and spread. Many of these banks are very small in size and reach. They compete with larger participants in the same banking space. Over the years, a number of UCBs have become weak and non-viable, thus posing systemic risk to the UCB sector. They lack avenues for raising capital funds since they can neither go in for public issue of shares, nor can they issue shares to members at a premium. There is a significant part of the UCB sector that lacks professionalism and is unable to keep pace with rapid advancements in IT, modern banking systems and financial products. The sector also has significant number of banks which are weak and need financial support. There have been occasions when due to contagion effect banks have encountered liquidity problems.

6.2 The organizational structure of UCBs, their small size and limited area of operation add to their vulnerability. Further, in the wake of advances in information and communication technology, payment and settlement systems and services, they need to widen their range of services to run on professional lines and match the services provided by commercial banks

6.3 At the same time, there are a number of UCBs in the sector that are financially strong and viable. Some sort of cooperative bonding and mutual support system could make the sector strong and vibrant.

6.4 Internationally, cooperative banks, popularly called Credit Unions, operate in networks and have an entity which provides a wide range of services to them such as, fund management services, lines of credit, asset management, payment and settlement system gateway, ATM networks, credit card, investment, securitisation, capital raising and other financial services. These entities act as Umbrella Organizations and the networks provide cooperative solidarity. International experience has shown that the presence of such an Umbrella Organization has contributed towards the member Credit Unions being stable, sound and efficient entities. This has also provided regulatory comfort to the regulators. The Working

Group had a close look at the Umbrella Organizations of credit unions in certain countries, such as, Australia, Belgium, Canada, Finland, France, Germany, Netherlands, Poland and USA.

6.5 The Working Group is convinced that there is a strong case for a similar Umbrella Organization for Urban Cooperative Banks in India, as also for a an emergency liquidity support facility for banks confronting liquidity problems. Reserve Bank of India has been instrumental in promoting several institutions and mechanisms in the interest of financial stability. This is yet another area where the central bank can play an important role in strengthening the urban cooperative banking sector as a part of banking sector reforms. Accordingly, the Working Group has made recommendations for constituting an Umbrella Organization for UCBs in India as also for an Emergency Funds Facility.

6.6 The broad contours of the proposed Umbrella Organization and the Emergency Fund Facility Scheme are summarized hereunder:

(A) Umbrella Organization (UO)

1) There shall be a professionally managed national level UO which shall provide to the UCBs a range of services on the same lines as is done by UOs for credit unions in several countries. These services are:
    (i) Offering credit facilities
    (ii) Providing liquidity to meet short term mismatches
    (iii) Fund management services
    (iv) Investment banking services
    (v) Payment and settlement services/gateway
    (vi) IT Services
    (vii) ATM Network and services
    (viii) Management consultancy
    (ix) Capacity building services

(Para 5.2.1, 5.2.2, & 5.3.1)

2) Membership of the UO shall be voluntary. The regulators may consider issuing appropriate instructions to UCBs for subscribing to the share capital of the UO. (Para 5.5.2)

3) UO will be a non-deposit taking Non Banking Financial Company to start with. The conversion of the UO to a banking company may be considered in due course in the light of experience gained. (Para 5.4.5)

4) Its authorized capital will be Rs. 200 crore and startup paid-up capital Rs.100 crore. The paid-up capital could be called up in two or more installments depending on the need and response. (Para 5.5.1)

5) The capital will be contributed by the UCBs voluntarily @ 10 paise per Rs.100/- of assets or such rate as may be necessary. (Para 5.5.3)

6) The Governments may consider providing suitable fiscal incentives to UCBs for contributing to the share capital of the UO. (Para 5.5.3)

7) There shall be a onetime uniform membership fee of Rs. One lakh per member UCB which shall reside in a Reserve Fund. (Para 5.5.3)

8) Being a non-deposit taking NBFC, it would have access to the following sources for its working capital:
   (i) Borrowings from banks/financial institutions
   (ii) Deposits: term deposits from UCBs
   (iii) Debt instruments: bonds/debentures
   (iv) Refinance: against financial assets (loans and advances) including securities
   (v) Other miscellaneous sources

   (Para 5.6.1)

9) Considering that the proposed UO would be a national level organization intended to strengthen the UCB sector and consequently promote financial stability, the Reserve Bank of India, which has played a pioneering role in promoting several financial and developmental institutions in the country may consider grant of certain reliefs and regulatory dispensations, which would help in making the UO sustainable, such as:

   (i) Deposits kept by the UCBs with the UO qualifying as CRR/SLR
   (ii) Permitting the UO membership of the Payment & Settlement systems
   (iii) Any other support that may be required in future, such as setting up of ATM networks, etc.

   (Para 5.4.5 & 5.7.3)

10) The UO will be a professionally managed organization having adequate number of independent directors. The CEO will be a person of repute, possessing wide experience and acumen in finance and banking. In the formative years, the Reserve Bank of India may closely guide and oversee the affairs of the UO through a nominee director. Subsequently, they may consider placing an observer on the Board. (Para 5.9.2)

11) The Reserve Bank of India may consider constituting a Steering Committee under the chairmanship of a senior official to work out the modalities for setting up of the UO. The Committee will have as its members the Central Registrar of Cooperative Societies (CRCS), Registrar of Cooperative Societies, Maharashtra (the state with maximum number of UCBs), representative each of the NAFCUB and four major UCBs. (Para 5.14)

(B) Emergency Fund Facility Scheme

1) In each state, emergency liquidity support to UCBs in distress on account of sudden pressures on liquidity could be provided through "Emergency Fund Facility Scheme" under a tripartite Industry Support Agreement (ISA). Under the Agreement, all the UCBs registered under a particular State Cooperative Societies Act should contribute a certain sum (say 0.05 % of their assets) to the Emergency Fund as deposits at a specified rate of interest (say at the prevailing interest rate for deposits for six months), which would be available to the participating UCBs as a soft loan (liquidity support) carrying interest, say at 8% [cost of funds (6%) +2% markup] for a period of not more than six months/one year. The quantum of liquidity support at a soft rate (First Tranche) may be capped at 50% of net worth of the UCB concerned. (Para 5.11.4)

2) Under the ISA, a participating UCB should also commit to provide a line of credit to the Emergency Fund when called upon to do so (say additional 0.05% of its assets) at a specified rate of interest (say, the prevailing interest rate for one year deposit). The amount that could be raised through the line of credit may be used for providing liquidity support under Second and Third Tranches to UCBs, at rates higher than the loan under First Tranche say at 10%[cost (8%)+ 2%mark up} and 12%[cost(10%)+2% mark up) respectively.

The Second and Third Tranches may also be to the extent of 75% and 100% of the net worth of the UCB concerned, respectively. (Para 5.11.4)

3) In states where the presence of UCBs is small and it is not viable to set up such a facility, UCBs could affiliate themselves with another state that offers such a facility. (Para 5.13.2)

4) In the concerned states an UCB Emergency Fund Facility Trust should be established. The Board of Trustees will comprise representatives of State Government, participating UCBs and State Federation. (Para 5.11.3)

5) Financial assistance to distressed UCBs from the trust funds may be made on the recommendations of TAFCUB. The modalities and terms and conditions for such support may be worked out by the Board of Trustees in consultation with TAFCUB. (Para 5.13.1)

6) UCBs registered under the Multi State Cooperative Societies Act having presence in more than one States may seek affiliation to the trust fund of the State where their registered Head Office is located, or they may choose to have their separate trust fund. (Para 5.13.2)

7) TAFCUBs may be entrusted with the responsibility of working as the Steering Committee for setting up of trust fund. (Para 5.14)

(C) Revival Fund

1) A large number of weak and sick UCBs (about 399; 23% of the total) need solvency support.

2) If UCBs with negative net worth were to be brought to positive net worth, an enormous sum of about Rs.2, 500 crore may be required. While RBI may pursue a menu of options, including mergers, with or without DICGC support, and financial restructuring for turn around of these banks, possibly, an amount of Rs.2000 crore may still be necessary. However, such a fund could only be

raised out of contribution from the net profits of UCBs. The total net profit of the sector being about Rs.1,000 crore, mobilization of this magnitude of resources from the sector may not be feasible. Further, contribution from the profits to the Revival Fund would be resisted by UCBs. The Working Group also felt that the State and Central Government may not come forward to contribute to the Revival Fund for UCBs. Therefore, creation of separate Revival Fund for UCBs is not recommended. (Para 5.12)

3) UCBs not complying with CRAR may be supported from the Emergency Funds. (Para 5.12)

V.S. Das
Chairman

Dr S.K. Goel Member	J.P. Gupta Member	S.D. Indoria Member
P. Vijaya Bhaskar Member	A.K. Khound Member	K.D. Zacharias Member
H.K. Patil Member	Anandrao Adsul Member	Jyotindra Mehta Member

S.S. Barik
Member Secretary

Mumbai 400 001
October 15, 2009

Annex 1

The list of organizations / participants invited for interaction with the Working Group Members.

1. Participants from the UCBs:

i. Shri S.K Banerji
MD, Saraswat Co-operative Bank Ltd, Mumbai

ii. Dr. M. L. Abhyankar
Chairman, COSMOS Co-op Bank ltd, Mumbai.

iii. Shri Shrinivas D.Joshi
CEO, Shamrao Vithal Co-operative Bank Ltd, Mumbai

iv. Shri Kalpak Doshi
Vice Chairman, Vijay Commercial Co-operative Bank Ltd, Rajkot

v. Shri S.B Adsul.
Vice Chairman, Mahanagar Co-op Bank Ltd, Mumbai.

vi. Shri Pawan Kapoor
CEO, Hindustan Co-op Bank Ltd.

2. Participants from UCBs Federation/Association/TAFCUB:

i. Shri M. Shantaram
Karnataka Urban Banks Federation.

ii. Shri R.S.Jaju, CEO and MD
The A.P. Mahesh Co-op urban bank Ltd

iii. Shri H.K. Srinivasa,CEO
Sir M. Vishweshwaraiah Co-operative Bank Ltd

iv. Smt. Gayathri Devi Sri Harsha,CEO
Mahila Co- Operative bank Ltd.

v. Shri R.Jayaram, Director
Tamil Nadu State Federation of Urban Co-operative Banks, Chennai

vi. Shri D.Chandran, General Manager
Sivakasi Co-operative Urban Bank Ltd., Sivakasi.

vii. Shri. T. Sivadasan, General Manager,
Tirur Urban Co-operative Bank Ltd.

viii. Shri. K. Jayavarma, General Secretary
The Kerala Urban Co-operative Banks Federation

ix. Shri N.C Paul,
Chairman, West Bengal Federation.

x. Shri L.K Saikia,
President Assam Federation.

xi. Shri Tanveer Ahmed
Secretary, Bihar Federation

xii. Shri. A.K Ibochouba Singh
CEO FMUCBCS

xiii. Shri O.P Sharma
Member TAFCUB, Punjab

xiv. Shri K.K Sharma
Member TAFCUB, Punjab

xv. Shri P.C Kashyap
Member TAFCUB, HP

xvi. Smt. Arti Bisaria
Member TAFCUB, MP

xvii. Shri Niranjan Surana
Member TAFCUB, Rajasthan

xviii. Shri R.B Shandilya
Member TAFCUB, UP

xix. Shri Mudit Verma
Member TAFCUB, UP

3. Suggestions received from UCBs / Organizations

i. Cooperative Bank of Rajkot Limited
Rajkot

ii. The All India Cooperative Bank Employees Federations,
Chennai

iii. Nagarik Sahakari Bank Limited,
Gwalior.

Annex 2

Deviations in extant Prudential Norms as applicable to Tier I and Tier II banks

	Tier I bank	Tier II bank
Definition	(i) Banks having deposits below Rs.100 crore, operating in a single district. ii) Banks with deposits below Rs.100 crore operating in more than one district provided the branches are in contiguous districts and deposits and advances of branches in one district separately constitute at least 95% of the total deposits and advances respectively of the bank. iii) Banks with deposits below Rs.100 crore, whose branches were originally in a single district but subsequently, became multi-district due to reorganization of the district. The deposits and advances as referred to in the definition may be reckoned as on 31st March of the immediate preceding financial year.	Bank which is not a Tier I bank.
NPA norm	180 days loan delinquency norm for loan accounts (including gold loans and small loan up to Rs 1 lakh). This relaxation was valid up to March 31, 2009.	90 days loan delinquency norm for loan accounts including gold loans and small loans up to Rs. 1 lakh.
Asset Classification norm.	With effect from March 31, 2005, an asset is required to be classified as doubtful, if it has remained NPA for more than 12 months. However, for Tier I banks, the 12-month period for classification of a substandard asset in doubtful category is effective from April 1, 2009	With effect from March 31, 2005, an asset is required to be classified as doubtful, if it has remained NPA for more than 12 months.
Provisioning Norm.	(i) Standard Assets: 0.25 % for all type of standard advances.	(i) Standard Asset: 0.40 per cent. For agricultural and SME sectors it is 0.25 per cent. For personal loans, loans and advances qualifying as capital market exposures and commercial real estate loans, loans and advances to systemically important NBFCs-ND provisioning requirement is 2.0 %. Salary Earners' banks in Tier II may provide for standard assets in respect of

	Tier I bank	Tier II bank
	(i) Sub standard- 10% (ii) Doubtful (up to one year):100% of unsecured portion plus 20% of secured portion (iii) Doubtful (one to three years): 100% of unsecured portion plus 30% of secured portion (iv) Doubtful for more than 3 years D-III) : 100% of unsecured portion plus 50% of secured portion (v) Loss: 100%. W.e.f April 1, 2010- the provisioning norms for secured portion of the doubtful assets more than three years (D –III) are as under: (i) outstanding stock of D-III assets as on March 31, 2010 -50 per cent -60 per cent with effect from March 31, 2011 -75 per cent with effect from March 31, 2012 -100 per cent with effect from March 31, 2013 (ii) Advances classified as 'doubtful for more than three years' on or after April 1, 2010- 100 %.	personal loans at the rate of 0.4 percent i) Sub standard- 10% (ii) Doubtful (up to one year):100% of unsecured portion plus 20% of secured portion (iii) Doubtful (one to three years) : 100% of unsecured portion plus 30% of secured portion (iv) Doubtful for more than 3 years (D-III) : 100% of unsecured portion plus 50% of secured portion (v) Loss: 100%. W.e.f April 1, 2007- the provisioning norms for the secured portion of the doubtful assets more than three years (D –III) are as under (i) outstanding stock of D -III as on March 31, 2007 -50 per cent -60 per cent with effect from March 31, 2008 -75 per cent with effect from March 31, 2009 -100 per cent with effect from March 31, 2010 (ii) advances classified as 'doubtful for more than three years' on or after April 1, 2007- 100 %

Annex 3

Copy of E-mail Send to the International Regulators:

Dear Sir/Madam,

The Reserve Bank of India (Central bank of India) has constituted a Committee to look into various successful international co-operative banking groups/networks and make recommendations to facilitate emergence of organizations that can provide to the co-operative banks capital and liquidity support in times of need, professional and technological support, etc. In India, most of the co-operative banks are small in size and reach. They compete with larger participants in the same banking space. Over the years, some of cooperative banks in India have become weak. They lack avenues for raising capital since they cannot make public issue of shares nor can they issue shares to members at a premium. At the same time, there are a few co-operative that are bigger in size and financially strong. Looking at various successful federated models internationally, especially in Europe and USA, a need is felt for such an umbrella organization.

2. In this backdrop, a brief questionnaire is attached for your comments. We shall be grateful to receive your views on the subject.

4 Yours sincerely,

--sd---
(A.K Khound)
Chief General Manager-in-Charge

Questionnaire

1. Is there an umbrella or central or agency type organization for credit unions in your country/province?
2. Is such an organization at the national level or provincial level?
3. What is the form of such organization? In other words, is it a trust or company or cooperative owned by member credit unions?
4. Do the credit unions in your jurisdiction allow members to write cheques? If so do the CUs have direct access to clearing and settlement arrangements?
5. Is the central organization for CUs a bank?
6. Are others e.g. Government or other non-members allowed to invest in such centrals/agencies?
7. What are the services that such organizations provide? Rank in order of priority 1 to 5 for each service /support
   - For supporting credit unions by way of capital?
   - For providing temporary liquidity – collateralized or otherwise
   - For managing investments
   - For providing access to payments and settlement systems
   - IT procurement and maintenance
   - Training
   - Any other –please indicate
8. If the form of organization is other than a cooperative, can you state the reasons why an alternative form of organization was though to be more appropriate?
9. Is the central /umbrella organization under the same regulator/supervisor as the CUs?
10. What are the principles for governance followed by the regulator? Does the appointment of CEO require approval of the regulator? Are 'fit and proper' criteria prescribed for directors/managers? If so how are these enforced? Is there a nomination committee to assess whether 'fit and proper' criteria are fulfilled by prospective candidates before election to position of director?
11. Are minimum competence principles prescribed?

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Annex 4

Comments Received from International Regulators on Umbrella Organization:

Sl.No.	Questions	Response.
1	Is there an umbrella or central or agency type organization for credit unions in your country/province?	**1. [Fawcett, Nigel, Senior Consultant on Mutual's Savings and Investment Team, HM Treasury, UK]** Credit unions (CUs) are represented by several 'trade bodies', the largest of which is the Association of British Credit Unions (ABCUL). It represents around 80% of the Great Britain CUs (Northern Ireland is not covered as it has its own legislation and regulation, although this might change in the mid-term.). There are 4 or 5 other bodies that, broadly, represent the views of the smallest CUs on a local basis. ABCUL's function is one of lobbying Government and providing training and support to CUs. **2. [Jennifer Inglis, Registry of Credit Unions, Dublin, Ireland]** Yes - Irish League of Credit Unions (ILCU) **3. [Brandon Khoo, Australian prudential Regulatory Authority, Ex.GM]** Yes, there are two in Australia. CUSCAL and Indue. Information on these are available on www.cuscal.com.au and www.indue.com.au 4. [**Amaro Luiz de Oliveira Gomes, Head of Department, Financial System Regulation Department, Banco Central Do Brasil]-** There are 37 second-level credit unions (centrais) and 3 third-level credit unions (confederations) 5. [**Anthony Prost, CFA, Director, Supervision of financial institutions, Quebec, Canada]-**Yes, Umbrella.
2	Is such an organization at the national level or provincial level?	1. **[Fawcett Nigel, Senior Consultant on Mutual's Savings and Investment Team , HM Treasury, UK]** ABCUL is a national body covering GB(Great Britain) **2. [Jennifer Inglis , Registry of Credit Unions, Dublin, Ireland]-** National Level **3. [Brandon Khoo, Australian prudential Regulatory Authority, Ex.GM]** The national level - there is no supervision of credit unions at a provincial

Sl.No.	Questions	Response.
		(or what we call "state" level in Australia) level. Jurisdiction for CUs moved from the state level to the federal level in 1992. 4. [**Amaro Luiz de Oliveira Gomes, Head of Department, Financial System Regulation Department, Banco Central Do Brasil]-** The second-level credit unions congregates credit unions of the same member-state and the third-level ones are at the national level. 5. [**Anthony Prost, CFA, Director, Supervision of financial institutions, Quebec, Canada]-** Provincial.
3	What is the form of such organization? In other words, is it a trust or company or cooperative owned by member credit unions?	**1. [Fawcett, Nigel, Senior Consultant on Mutuals Savings and Investment Team , HM Treasury, UK]** ABCUL is incorporated as an industrial and provident society (IPS) (in effect a cooperative) under the Industrial and Provident Societies Act 1965. It is made up of the member CUs, each of whom has one vote. Trade organization **2. [Jennifer Inglis ,Registry of Credit Unions, Dublin, Ireland]-** Trade organization **3. [Brandon Khoo, Australian prudential Regulatory Authority, Ex.GM]** They are companies - formed under the Corporations law in Australia. Credit unions are shareholders in these companies 4. [**Amaro Luiz de Oliveira Gomes, Head of Department, Financial System Regulation Department, Banco Central Do Brasil]-** They are all cooperatives. 5. [**Anthony Prost, CFA, Director, Supervision of financial institutions, Quebec, Canada]-**Co-operatives owned by co-operative members.
4	Do the credit unions in your jurisdiction allow members to write cheques? If so do the CUs have direct access to clearing and settlement	**[Fawcett Nigel, Senior Consultant on Mutual's Savings and Investment Team , HM Treasury, UK]** Credit union members cannot write cheques although those that join the new banking platform will have access to debit cards. Some CUs issue credit cards under an affiliation arrangement with the Coop bank

Sl.No.	Questions	Response.
	arrangements?	**2. [Jennifer Inglis ,Registry of Credit Unions, Dublin, Ireland]-no** **3. [Brandon Khoo, Australian prudential Regulatory Authority, Ex.GM]** Yes - credit unions access the payments system through the two industry bodies which in turn operate through major banks. 4. [**Amaro Luiz de Oliveira Gomes, Head of Department, Financial System Regulation Department, Banco Central Do Brasil]-** Most of them do. They have indirect access to clearing and settlement arrangements via commercial banks. 5. [**Anthony Prost, CFA , Director, Supervision of financial institutions, Quebec, Canada]-**Yes/yes
5	Is the central organization for CU is a bank?	1. **[Fawcett Nigel, Senior Consultant on Mutual's Savings and Investment Team, HM Treasury, UK]** No; as currently constituted industrial and provident societies are prohibited form undertaking banking business. (The Coop Bank is, in fact, a company set up as a wholly owned subsidiary of the Coop Group, which is an IPS.) **2. [Jennifer Inglis,Registry of Credit Unions, Dublin, Ireland]-No** **3. [Brandon Khoo, Australian prudential Regulatory Authority, Ex.GM]** No, but there would be no prohibition on them if they wanted to seek a banking license 4. [**Amaro Luiz de Oliveira Gomes, Head of Department, Financial System Regulation Department, Banco Central Do Brasil]-** No, but 2 out of the 3 confederations have banks. 5. [**Anthony Prost, CFA, Director, Supervision of financial institutions, Quebec, Canada]-**No.
6	Are others e.g. Government or other non-members allowed to invest in such centrals/agencies?	1. [**Fawcett Nigel, Senior Consultant on Mutuals Savings and Investment Team, HM Treasury, UK]** Credit unions may issue subordinated debt, but few if any take this path. There is investment by way of loans and grants into the sector, rather than with the purpose of creating a return for the investor. The Treasury is looking to amend the legislation to permit

Sl.No.	Questions	Response.
		corporate members of CUs. Such members would invest by way of deferred rather than ordinary shares. Both membership and lending to corporate members would be restricted to a percentage of the membership and assets **2. [Jennifer Inglis, Registry of Credit Unions, Dublin, Ireland] -No** **3. [Brandon Khoo, Australian prudential Regulatory Authority, Ex.GM]** Yes - open market. There is no prohibition on which entities may invest in these companies. 4. [**Amaro Luiz de Oliveira Gomes, Head of Department, Financial System Regulation Department, Banco Central Do Brasil]-** No. They are not even allowed to take deposits from non-members. 5. [**Anthony Prost, CFA , Director, Supervision of financial institutions, Quebec, Canada]-** No
7	What are the services that such organizations provide? Rank in order of priority 1 to 5 for each service /support *For supporting credit unions by way of capital? *For providing temporary liquidity – collateralized or otherwise *For managing investments *For providing access to payments and settlement systems *IT procurement	1. **[Fawcett Nigel, Senior Consultant on Mutual's Savings and Investment Team, HM Treasury, UK]** Organizational investment in CUs is geared towards improving financial inclusion and capability, both significant Government programmes. The nature of the investment is to provide funding for loans to the less financially secure. This broadly covers points one and two below. The other issues raised are covered, but generally peripherally. **2. [Jennifer Inglis,Registry of Credit Unions, Dublin, Ireland]-** Has not given any comment **3. [Brandon Khoo, Australian prudential Regulatory Authority, Ex.GM]** I don't think I can rank it in level of priority. At the end of the day, it is a service entity established by the credit unions. In effect, it is a pooling of resources to service the needs of the credit union. To a degree, they do all of the above to varying degrees. The importance of each varies from credit union to credit union. 4. [**Amaro Luiz de Oliveira Gomes, Head of Department, Financial System Regulation Department, Banco Central Do Brasil]-** • For providing temporary liquidity –

Sl.No.	Questions	Response.
	and maintenance *Training *Any other –please indicate	collateralized or otherwise - 4 • For managing investments - 1 • For providing access to payments and settlement systems • IT procurement and maintenance - 3 • Training - 5 • Any other – Auxiliary supervision - 2 Obs: I included services provided both by central and by confederations 5. [**Anthony Prost, CFA , Director, Supervision of financial institutions, Quebec, Canada]-** ▪ For supporting credit unions by way of capital? -5 ▪ For providing temporary liquidity – collateralized or otherwise -5 ▪ For managing investments -5 ▪ For providing access to payments and settlement systems-5 ▪ IT procurement and maintenance -5 ▪ Training -4 ▪ Any other –please indicate-Audit and Inspection of banks-5
8	If the form of organization is other than a cooperative, can you state the reasons why an alternative form of organization was though to be more appropriate?	1. **[Fawcett Nigel, Senior Consultant on Mutual's Savings and Investment Team , HM Treasury, UK]** Not applicable **2. [Jennifer Inglis, Registry of Credit Unions, Dublin, Ireland]-** Has not given any comment **3. [Brandon Khoo, Australian prudential Regulatory Authority, Ex.GM]** The legal form of the entities are corporations but they operate in a cooperative manner for the most part. I should point out that the legal form of credit unions in Australia are also corporations under the Corporations Law. 4. [**Amaro Luiz de Oliveira Gomes, Head of Department, Financial System Regulation Department, Banco Central Do Brasil]** Not applicable 5. [**Anthony Prost, CFA , Director, Supervision of financial institutions, Quebec, Canada]-** Not applicable
9	Is the central /umbrella organization under the same regulator	1. **[Fawcett Nigel, Senior Consultant on Mutual's Savings and Investment Team, HM Treasury, UK]** ABCUL does not at present carry out financial services directly and so is not regulated. If it were to

Sl.No.	Questions	Response.
	/supervisor as the CUs?	offer financial services to CUs only, this would count a corporate business and is unlikely to be regulated. Only if it were to provide services directly to individuals would it be regulated. **2. [Jennifer Inglis, Registry of Credit Unions, Dublin, Ireland]-** No, they are unregulated. **3. [Brandon Khoo, Australian prudential Regulatory Authority, Ex.GM]** Yes - the Australian Prudential Regulation Authority. These organizations need to be closely supervised due to their importance to the credit union industry and they can be quite sophisticated. For example, CUSCAL has model recognition for interest rate risk in the trading book purposes 4. [**Amaro Luiz de Oliveira Gomes, Head of Department, Financial System Regulation Department, Banco Central Do Brasil]-** The centrals are supervised by the Central Bank just like the first level Cus but the confederations are not supervised 5. [**Anthony Prost, CFA , Director, Supervision of financial institutions, Quebec, Canada]-** Yes
10	What are the principles for governance followed by the regulator? Does the appointment of CEO require approval of the regulator? Are 'fit and proper' criteria prescribed for directors/managers ? If so how are these enforced? Is there a nomination committee to assess whether 'fit and proper' criteria are fulfilled by prospective candidates before election to position	1. [**Fawcett Nigel, Senior Consultant on Mutual's Savings and Investment Team, HM Treasury, UK]** At present there are very few requirements, but in the review of the IPS legislation, it has been recognised that good corporate governance is of great importance to the coop sector and the Treasury is looking at ways to stimulate this on a statutory basis, without being excessively intrusive. 2. **[Jennifer Inglis, Registry of Credit Unions, Dublin, Ireland]-** Not applicable **3. [Brandon Khoo, Australian prudential Regulatory Authority, Ex.GM]** Please refer to the APRA website for our requirements on governance, fit and proper, APRA's powers etc. refer to www.apra.gov.au 4. [**Amaro Luiz de Oliveira Gomes, Head of Department, Financial System Regulation Department, Banco Central Do Brasil]-** CEOs and other positions have to be approved by the Central Bank, according to fit and proper criteria. There's no

Sl.No.	Questions	Response.
	of director?	such nomination committee to examine curricula of candidates. 5. [**Anthony Prost, CFA , Director, Supervision of financial institutions, Quebec, Canada]-** (i) What are the principles for governance followed by the regulator?- Principle based approach (Governance, compliance, risk management) (ii) Does the appointment of CEO require approval of the regulator?-no (iii) Are 'fit and proper' criteria prescribed for directors/managers?-no (iv) If so how are these enforced?-not applicable (v) Is there a nomination committee to assess whether 'fit and proper' criteria are fulfilled by prospective candidates before election to position of director?-no
11	Are minimum competence principles prescribed?	1. [**Fawcett Nigel, Senior Consultant on Mutual's Savings and Investment Team, HM Treasury, UK]** Not for unregulated business - for selling & delivering financial services they, generally, are. 2. **[Jennifer Inglis, Registry of Credit Unions, Dublin, Ireland]]**-No. **3. [Brandon Khoo, Australian prudential Regulatory Authority, Ex.GM]** Please refer to the APRA website for our requirements on governance, fit and proper. Again, refer to www.apra.gov.au 4. [**Amaro Luiz de Oliveira Gomes, Head of Department, Financial System Regulation Department, Banco Central Do Brasil]-** There are not strictly speaking competence principles, but the candidates shall not: have been condemned for certain criminal offences; have been declared (by the respective regulators) unable to take positions in financial institutions, insurance companies or public companies; or have taken part in companies which have gone bankrupt. 5. [**Anthony Prost, CFA , Director, Supervision of financial institutions, Quebec, Canada]-** No