CHAPTER - 1

Introduction

1.01 Rural Cooperative Banking and Credit Institutions play an important role in meeting the growing credit needs of rural India. The volume of credit flowing through these institutions has increased. The performance of these institutions, however (apparent in the share of total institutional credit and the indicators of their financial health), has been less than satisfactory and is deteriorating rapidly. Of late, a number of Committees have gone into the reasons for this situation and suggested remedial measures, but there has been little progress in implementing their recommendations.

1.02 The Government of India, which is committed to reviving and revitalising the rural cooperative credit structure (CCS) and attributes high priority and urgency to it, felt it necessary to commission a fresh review. The Union Government constituted a Task Force (vide Government of India notification dated 05 August 2004 reproduced in Annexure I) to formulate a practical and implementable plan of action to rejuvenate the rural cooperative credit structure. The Task Force comprises the following members and permanent invitees:

Chairman

Prof. A. Vaidyanathan, Emeritus Professor, Madras Institute of Development Studies, Chennai.

Members

Shri M Rama Reddy, President, Sahavikasa Cooperative Development Foundation, Hyderabad

Prof. M. S. Sriram, Indian Institute of Management, Ahmedabad

Shri A. K. Singh, Additional Secretary, Ministry of Agriculture, Department of Agriculture and Cooperation (nominated by the Union ministry of Agriculture, Government of India)

Shri H.S. Chahar, Secretary, Cooperation, (now Principal Secretary) Government of Orissa (nominated by the State Government of Orissa)

Shri L. M. Chaube, Managing Director, U.P. State Cooperative Bank (nominated by the State Government of Uttar Pradesh)

Shri U. C. Sarangi, Commissioner for Cooperation and Registrar of Cooperative Societies, Government of Maharashtra (nominated by the State Government of Maharashtra)

Member Secretary

Shri. Y. S. P. Thorat, Managing Director, NABARD

Permanent Invitees

Shri A. V. Sardesai, Executive Director, RBI, Mumbai.

Shri K. D. Zacharias, Legal Advisor, RBI, Mumbai.

The Terms of reference of the Task Force

1. To recommend an implementable action plan for reviving the Rural Cooperative Banking Institutions, taking into consideration, inter alia, main recommendations made by various committees in this regard.
2. To suggest an appropriate regulatory framework and the amendments which may be necessary for the purpose in the relevant laws.

3. To make an assessment of the financial assistance that the Cooperative Banking Institutions will require for revival, the mode of such assistance, its sharing pattern and phasing.

4. To suggest any other measures required for improving the efficiency and viability of Rural Cooperative Credit Institutions.

1.03 The Task Force was required to submit its report by 31 October 2004. However, on account of some delay in getting the names of the State Government nominees, the Task Force could hold its first meeting only on September 06, 2004. The deadline of 31st October, 2004 for completion of its work being clearly unrealistic, the Task Force sought and obtained concurrence of the Government of India to extend the deadline up to the end of December 2004.

1.04 The Task Force held eight meetings between September and December 2004 at Mumbai, Chennai, Kolkata, New Delhi, Bhopal, Kolhapur and Hyderabad. (The dates and venues of the meetings are given in Annexure II.

1.05 At its very first meeting, the Task Force considered the submissions of representatives of the long term credit institutions, that restructuring these institutions should also be considered. The Task Force appreciated the validity of their concerns. It recognises that the revival of the long term cooperative credit structure is no less important than that of its short term counterpart. The nature, magnitude and complexity of the issues relating to such institutions are, however, quite different from those of institutions of the short-term structure.

1.06 Moreover, since the time available to the Task Force was limited, it was unanimously decided to focus first on designing an action plan for the short-term structure, covering all tiers (including the primary agricultural credit societies) in the first phase and, if time permits, to take up the issues pertaining to the long term structure. As things turned out, however, this has not been possible. The Task Force, therefore, recommends that the Union Government consider setting up a Committee to examine the issues pertaining to the long term cooperative credit structure on the lines of the terms of reference assigned to it.

1.07 At its first meeting, the Task Force considered various issues pertaining to its approach and methodology. The Task Force noted that the current status of cooperative credit institutions, their weaknesses and underlying reasons, as well as measures to remedy them, have been widely discussed and analysed both in literature and more specifically in the reports of the previous committees. The reports of the recent committees listed below, were considered in particular.

a. Task Force to study the functioning of Cooperative Credit System and Suggest Measures for its Strengthening (Capoor Committee, 1999)

b. Expert Committee on Rural Credit (Vyas Committee, 2001)

c. Joint Committee on Revitalisation Support to Cooperative Credit Structure (Vikhe Patil Committee, 2001).

1.08 Apart from relying on the findings of the earlier committees, the Task Force also collected substantial statistical data on the coverage and financial aspects of cooperative credit institutions from published and readily available sources. It also analysed these data to highlight differences across and within States in performance indicators and trends therein. The Task Force also sought to collect information on selected aspects of their governance, through the regional and district offices of the National Bank for Agriculture and Rural Development (NABARD).

1.09 The Task Force also had extensive discussions with senior officials of State Cooperation Departments, managers and chief executives of cooperative credit societies, leading cooperators with deep involvement and experience in the cooperative movement, representatives of trade unions of employees of cooperatives, apart from academics and non government organizations (NGOs) well versed on cooperative credit.

1.10 These consultations were held to ascertain their perceptions and views on the current status of cooperatives, including issues relating to governance and management, the role of the State Governments and the extent of their intrusion or otherwise, into the affairs of the cooperatives. The Task Force invited their views on factors that have impeded cooperatives from becoming autonomous and member driven institutions, and the strategy for their revival and revitalization. During the eight meetings held in different parts of the country, the Task Force was able to exchange views with about 150 cooperators, academics officials etc., from as many as 23 States. A number of organisations also sent in written memoranda.

1.11 A sub-group of the Task Force headed by Shri U. C. Sarangi, also visited several states for more detailed interactions. The sub-group had the benefit of discussion with officials, cooperators and cooperative bankers. At the third meeting of the Task Force, it was felt that the revival strategy needed to be premised on a strong legal and regulatory framework. Accordingly, a sub-group was constituted under Shri Rama Reddy to suggest amendments deemed appropriate in the Banking Regulation Act, State Cooperative Societies Acts, and

Mutually Aided Cooperative Societies Act, which would create a legal environment enabling cooperatives to function as autonomous and member driven institutions.

1.12 The inputs from this sub group and a special consultation with officials and non-officials with first hand knowledge of cooperative law, its administration and problems in changing the law, have been invaluable to the Task Force in clarifying its understanding of the issues involved, and in helping to formulate its recommendations.

1.13 The Task Force records its appreciation and thanks to the cooperative credit institutions across the States, the Reserve Bank of India (RBI), NABARD, NAFSCOB, and various State Governments and the numerous individuals and organisations which personally participated in the consultation meetings and those who gave their views in written memoranda. (Names of persons from different States who interacted with the Task Force as well as those who sent written memoranda are given in Annexure III).

1.14 The Task Force also met Dr Y. V. Reddy, Governor, Reserve Bank of India, Smt. Ranjana Kumar, Chairperson, NABARD, and Shri V Leeladhar, Deputy Governor, Reserve Bank of India, to discuss various aspects of the task assigned to it. The Task Force benefited much from these interactions and is grateful to them for giving liberally of their time.

1.15 The Task Force has a special word of commendation for the Secretariat set up for it by NABARD. While each member of the Secretariat has contributed in shaping the conclusions and recommendations of the report, we would especially like to mention the inputs received from Dr Prakash Bakshi, Chief General Manager, Tamil Nadu RO of NABARD, who not only coordinated the operations at the Chennai end, but provided significant support to the thinking process. The Task Force would like to mention the meticulous attention to detail, which Dr. A. S. Patil brought to bear on the logistical and operational aspects as well as in collating and analysing inputs received from various quarters. This facilitated the work of the Task Force.

1.16 S/Shri S. Muralidaran, T. Ravichandran and D. V. Ramana Rao, are commended for their professional expertise and their general good cheer despite the pressure brought to bear on them. Our thanks are due to S/Shri R. V. Ramakrishna, S. Kannan, Anandan, Smt. Mina Anthony, Smt. Vidya and Shri Sriram Iyer, for relieving the Secretariat of all the tiresome details. Apart from the personnel of NABARD, we are also grateful to the Reserve Bank of India for making the services of Dr. Praggya Das, Assistant Adviser of the Bank, available to the Task Force. The Task Force would like to take this opportunity to record its appreciation of her contribution to our work, by collating, organising and analysing the statistical data. The Task Force is also grateful to Smt. Bharti Gupta Ramola and Shri Varun Gupta for their help and advice at various stages of our work. The Task Force also wishes to thank Smt Shashi Rajagopalan and Smt Vasundara for providing valuable inputs on drafting of the model bill.

1.17 In conclusion, all members of the Task Force and the professional staff that helped us are of the unanimous view that this has been one of the most satisfying assignments handled by us. This was so not only because of the challenge inherent in the subject but because of the chemistry that developed between the members which was an amalgam of mutual trust, professional competence and the conviction that the task assigned is in the nature of a public good and therefore public service.

1.18 The draft report of the Task Force, which was placed on the websites of the Government of India, RBI and NABARD elicited responses from a number of state governments, institutions and individuals. The members of the TF are grateful to the respondents.

1.19 The Task Force discussed the suggestions in a specially convened meeting. On a perusal of the comments received, it was observed that they fall into three broad categories :

- those who support the broad framework and approach adopted by the TF; some of them wanting some conditions to be made even more stringent,

- those which make specific suggestions on the recommendations of the Task Force, and

- those who question the approach and rationale of the recommendations of TF.

The TF has taken into account and addressed all of the comments.

1.20 As regards the last case, no convincing arguments have been advanced while questioning the TF approach and recommendations. The TF is therefore unable to accept the same in the absence of any cogent arguments.

1.21 In the case of others, the TF has summarised the comments and suggestions issue-wise and the responses of the Task Force on them are presented in annexure XXIII.

1.22 The Task Force is grateful to the RBI, which has sent its official comments. The RBI comments in full are presented in Annexure XXIV. The Task Force perused the observations of the RBI and the response of the Task Force on issues raised by RBI is presented in the Annexure XXV.

A.Vaidyanathan
Chairman

A K Singh Member	U C Sarangi Member	H S Chahar Member
Rama Reddy Member	L M Chaube Member	M S Sriram Member

Y S P Thorat
Member Secretary

CHAPTER - 2

Evolution of the Cooperative Movement

Introduction

2.01 The Indian cooperative movement was initiated by the government. It spread and diversified with the encouragement and support of the government. Its present condition is also to a great extent because of the intrusive involvement of, and interference by the government. This chapter provides a brief review of the various phases of the evolution of cooperatives in general, and of credit cooperatives in particular, over the past century.

The First Phase: 1900-1930

2.02 By the beginning of the 20th Century, officials of the colonial government perceived the Indian farmers' dependence on usurious moneylenders to be a major cause of their indebtedness and poverty. At that time the cooperative movement had become well established in Europe and achieved remarkable success there. Convinced that the cooperative movement offered the best means of liberating Indian farmers from the crushing burden of debt and the tyranny of moneylenders, Indian officials began to take active interest in promoting credit cooperatives in the country. Societies were organised for the first time in the closing years of the 19th Century.

2.03 The passage of the Cooperative Credit Societies Act in 1904, and the enactment of a more comprehensive Cooperative Societies Act in 1912 marked the beginning of a government policy of active encouragement and promotion of cooperatives. This thinking gained wide acceptance and was adopted as a policy by provincial governments and thereafter, "cooperation" became a provincial subject in 1919. The persistence of government interest in cooperatives and the importance attached to them was reflected in the appointment of three different Committees to review their growth and functioning.

2.04 The classic study by Frederic Nicholson, followed by the Edward Law Committee on Cooperative Legislation, confirmed and reiterated the need for the State to actively promote cooperatives. A decade later, the Maclagan Committee (1915) advocated that “there should be one cooperative for every village and every village should be covered by a cooperative”. The Royal Commission on Agriculture in India, which submitted its report in 1928, suggested among other things, that the cooperative movement should continue to focus on expanding rural credit and that the State should patronise cooperatives and protect the sector.

2.05 It was the Royal Commission which made the observation “if cooperation fails, there will fail the best hope of rural India”. By this time, the State was already deeply involved in promoting agricultural credit cooperatives. The number of societies reached impressive proportions and diversified their activities well beyond agricultural credit. Debates centred on whether or not each village should have a cooperative and whether there should be a single purpose or a multi-purpose cooperative at the village level.

The Second Phase: 1930 - 1950

2.06 The major development during this phase was the role played by the Reserve Bank of India (RBI). The Reserve Bank’s concern and involvement in the sphere of rural credit stemmed from its very statute of incorporation. Specific provisions were made in the Reserve Bank of India Act, 1934 both for the establishment of an Agricultural Credit Department (ACD) in the bank and for extending refinance facilities to the cooperative credit system. Emphasis was laid on setting up, strengthening and promoting financially viable provincial cooperative banks, central cooperative banks, marketing societies and primary agricultural credit societies in each province. The RBI, since 1942, also started extending credit facilities to provincial cooperative banks for seasonal agricultural operations and marketing of crops.

2.07 The Government policy during this phase was not as pro-active on promoting cooperatives as before. There seemed to be a policy lull until 1945, when the Agricultural Finance Sub-committee and the Cooperative Planning Committee were set up by the Government of India (GoI). By then, there already were signs of sickness in the Indian rural cooperative movement. A large number of cooperatives were found to be saddled with the problem of frozen assets, because of heavy overdues in repayment. The Sub-committee's recommendation that the frozen assets of the members of such cooperatives be liquidated, by adjusting the claims of the society to the repaying capacity of the members, marked the beginning of State interference in the management of cooperatives and the consequent erosion in the credit discipline of the members. The Cooperative Planning Committee identified the small size of the primary cooperative as the principal cause of failure. It also advocated State protection to the cooperative sector from competition.

The Third Phase: 1950 – 1990

2.08 After Independence, rapid and equitable economic development became the central focus of State policy. Cooperatives in general, and rural financial cooperatives in particular, were once again on centre stage. Taking cognisance of the weakness of the cooperative system, the All India Rural Credit Survey (AIRCS) not only recommended State partnership in terms of equity, but also partnership in terms of governance and management. Other recommendations included linking credit and marketing cooperatives and enlarging their area of operation. The recommendations of the AIRCS stopped just short of the Government running the cooperatives, and paved the way for its direct intrusion in the governance and management of cooperatives.

2.09 State policy came to be premised on the view that the government should ensure adequate supply of cheap institutional credit to rural areas through cooperatives. The thinking then was that if the institutions that were meant to deliver such cheap institutional credit failed, there either had to be reorganisation of existing institutions, or creation of new types of institutions. The Hazari Committee recommended integration of short term and long term structures. The Bawa Committee (1971) recommended setting up Large Multi-purpose Cooperatives in tribal areas. The National Commission on Agriculture (1976) recommended setting up Farmers Service Cooperative Societies with the active collaboration of the nationalised banks.

2.10 NABARD was created on the recommendation of the CRAFICARD (Sivaraman Committee 1981). The State's heightened interest in and concern for the performance of cooperatives in the country was obvious. The focus, however, was on expanding and reorganising the State supported structures, without addressing the tasks of restoring and strengthening autonomy, mutual help and self-governance that are the cornerstones of genuine cooperatives.

2.11 The State gave primacy to cooperatives as the sole means of delivering institutional credit to rural areas and injected large and increasing amounts of funds directly. Upper tier cooperative banks were encouraged to accept public deposits and borrow from other financial institutions. However, the system was soon found to be burdened by growing overdues. In keeping with the national priority of financing the rural sector adequately, the involvement of commercial banks was first suggested as a social control measure. The involvement of commercial banks was thereafter institutionalised through the nationalisation of major commercial banks in 1969. During the post-nationalisation period, there was an unprecedented penetration of commercial banks in the rural sector. This trend, however, was accompanied by rigid policy directives right down to the micro level on cost of credit, purposes, categories of borrowers, geographical areas, etc.

2.12 As the financial involvement of the government in cooperatives increased, its interference in all aspects of the functioning of cooperatives also increased. The consequent interference with the functioning of the co-operative institutions, often compelling them to compromise on the usual norms for credit worthiness, ultimately began to affect the quality of the portfolio of the cooperatives.

2.13 Instead of tackling the root cause of their weaknesses, the State took responsibility for strengthening the institutions, by infusing additional capital and “professional” workforce. Both the State and the workforce then began to behave like “patrons”, rather than as providers of financial services. Whenever any professional organisation is in trouble, it usually finds its own solution by re-negotiating the terms with its financiers and re-visiting its operating strategies. However, in the case of the rural financial institutions, the State has always provided a “solution”, irrespective of the need of the recipient organisation, thereby donning the role of a “patron”.

2.14 In due course, political expediency also led to laxity in ensuring quality of credit and its repayment. The Government of India’s 1989 scheme for writing off loans of farmers, greatly aggravated the already weak credit discipline in the cooperative system and led to the erosion of its financial health. It also set up an unhealthy precedent and spawned a series of schemes by the State Governments, announcing waivers of various magnitudes, ranging from interest write off to partial loan write-offs. The competitive populism adopted by the political class has severely impaired the credibility and health of the cooperative credit structure.

2.15 The State has used co-operatives to channel its development schemes, particularly subsidy-based programmes for the poor. As these institutions have a wide reach in the rural areas and also deal with finances, the choice was natural. The trend, however, also made cooperatives a conduit for distributing political patronage. This and the sheer magnitude of resources and benefits channelled through the societies, makes control of decision-making and management attractive to parties in power, for accommodating their members, to influence decisions through directives, and for individual politicians to be on the management boards of the cooperatives.

2.16 Concerns about these trends and the need to overcome them began to be voiced around this time. The Agriculture Credit Review Committee (Khusro Committee, 1989) for the first time, talked of the importance of encouraging members' thrift and savings for the cooperatives. It also emphasised the need for better business planning at the local level and for strategies to enable cooperatives to be self-sustaining. To this end, the Committee was also in favour of serving non-members, if it made business sense. In a sense, there were larger macro economic changes on the anvil in the economy. The 1990s witnessed more concerted attempts both by the government and by non-official organisations and cooperators, to explore ways to revitalise the cooperatives.

The Fourth Phase: 1990s and onwards

2.17 During the last fifteen years, there has been an increasing realisation of the destructive effects of intrusive State patronage, politicisation, and the consequent impairment of the role of cooperatives in general, and of credit cooperatives in particular, leading to a quest for reviving and revitalising the cooperative movement.

2.18 Several Committees (notably those headed by Chaudhry Brahm Perkash, Jagdish Capoor, Vikhe Patil and V S Vyas) were set up to suggest cooperative sector reforms during this period. The Brahm Perkash Committee emphasised the need to make cooperatives self-reliant, autonomous and fully democratic institutions and proposed a Model Law. Subsequent Committees have all endorsed this recommendation and strongly supported replacing existing laws with the proposed Model Law. They have also recommended revamping and streamlining the regulation and supervision mechanism, introducing prudential norms and bringing cooperative banks fully under the ambit of the Banking Regulation Act, 1949. To facilitate the implementation of these reforms, they proposed that governments provide viable cooperative credit institutions with financial assistance for recapitalisation.

2.19 Progress in implementing these suggestions has been very tardy because of the States' unwillingness to share in costs and their reluctance to dilute their powers and to cede regulatory powers to the Reserve Bank of India (RBI). The passage of the Mutually Aided Cooperative Societies Act by the Andhra Pradesh government in 1995, however, marked a significant step towards reform. Following the example of Andhra Pradesh, eight other States (viz., Bihar, Chhattisgarh, Jammu and Kashmir, Jharkhand, Karnataka, Madhya Pradesh, Orissa and Uttaranchal) have passed similar legislation to govern and regulate mutually aided cooperatives.

2.20 In all cases these new laws provide for cooperatives to be democratic, self-reliant and member-centric, without any State involvement or financial support. They provide for cooperatives registered under the old law to migrate to the new Act. The old Acts were not repealed, nor was there any serious effort to encourage and facilitate the conversion of old cooperatives to come within the purview of the new Act. Most existing cooperatives, therefore, continued to adhere to the old law.

2.21 The new law, however, did lead to the emergence of a “new generation autonomous financial cooperatives”, albeit slowly and unevenly across the country. While the number of cooperatives registered under the new liberal Act is slowly picking up, the conversion from the old law to the new Act has largely been in the arena of commodity cooperatives. The reason for the slow pace at which both credit cooperatives and the primary agricultural credit societies (PACS) are adopting the new law is largely because they are not eligible for refinance under the existing legal and structural arrangements.

2.22 As will be evident from the next chapter, these developments have not made much of an impact on the way cooperatives function. The movement has continued to deteriorate and reached the point that necessitated the appointment of the present Task Force, which has been entrusted with the task of coming up with an implementable action plan for carrying the reforms forward.

CHAPTER - 3

Nature and Extent of Impairment and Remedial Measures

3.01 The first section of this chapter reviews the institutional arrangements for providing rural credit and the role of the Cooperative Credit Structure (CCS). It then examines the various levels of impairment at the financial, governance and managerial fronts. Even though these issues are well known and widely discussed in general terms, the chapter (and related Annexures) seek to present a more detailed quantitative picture of these features and highlight the nature and extent of their variation in different tiers and States. The second section reviews the reform measures suggested by earlier committees and the outline of the approach of the Task Force in formulating its recommendations on the Revival Package (RP). But before doing so, a brief discussion on the weaknesses in the basic data and the need to improve it seems to be in order.

The Information base

3.02 The Task Force has relied mainly on secondary data relating to various aspects of different tiers of the CCS at the State level, supplemented with information compiled through specially commissioned but selective, inquiries through the regional offices of the National Bank for Agriculture And Rural Development (NABARD). These data along with some analysis based on them, are presented in a series of Annexures to this report.

3.03 The secondary data used in this chapter and elsewhere, are from two sources – the NABARD and the National Federation of State Co-operative Banks (NAFSCOB). Ideally, the Task Force would have preferred to rely on data put out by NABARD. It was not able to do so, partly because NABARD's database was mainly focused on the intermediate and apex tiers, and partly because it did not have the break up required by the Task Force.

3.04 While using the data it soon became apparent to the Task Force that the statistical data reporting and compilation relating to the cooperative sector leaves much to be desired. The Task Force found that:

- The data are not up-to-date and validated,
- There are no uniform formats for collecting and presenting data on comparable concepts and categories, and
- There are significant variations in the data obtained from different sources for the same period and parameters

These deficiencies are particularly serious in the case of primary agricultural societies (PACS). The Task Force also found that states have their own varying rules for accounting and disclosure of financial accounts of cooperatives, in most cases there are no separate rules for financial cooperatives and that the rules are in any case not consistently applied so it is very difficult to compare financial cooperatives' financials across time, states and with other financial sector players.

3.05 The Task Force would like to underscore the importance of consistent reporting and disclosure of financial accounts as per generally accepted accounting norms for financial sector players as well as making available sufficiently detailed, comprehensive, up-to-date and authenticated data on the functioning of cooperatives and other agricultural financing institutions to the public domain. This is necessary both for monitoring, operations and policy formulation by the top management of NABARD, as well as for use of policy makers in other financial institutions and government. The Task Force notes that NABARD has taken over the responsibility of bringing out the publication Statistical Statements Pertaining to the Co-operative Movement in India, once done regularly by the Reserve Bank of India (RBI). The NABARD's latest published compilation, however, provides data only up to 1997-1998. A special effort was, therefore, needed to get more up-to-date data for the Task Force. To ensure that financial reporting by financial cooperatives is consistent with generally accepted accounting norms for financial sector players , the Task Force recommends that NABARD work with the Institute of Chartered Accountants of India to develop and publish appropriate accounting standards and that the use of these for financial reporting be made mandatory through appropriate rules under the state cooperative laws.

3.06 To ensure that data on the credit system is collected and used meaningfully, the Task Force recommends that NABARD take immediate steps to devote sufficient resources and personnel to handle the task. The Task Force also recommends that NABARD set up a Department of Statistical Analysis, suitably staffed by appropriately qualified human resources at the very earliest. The effort would be in the nature of a public service by this institution. The NABARD's top management should also institutionalise arrangements for systematic analysis and interpretation of emerging trends in rural credit, as well as analysis relevant for specific issues of policy.

Salient features of the CCS

3.07 The short term Cooperative Credit Structure (CCS) has a federal three-tier structure with PACS being the grass root level institutions, the Central Banks at the District level (DCCBs) and the apex Bank at the State level (SCB). In the North-Eastern States and smaller States, there are no DCCBs and the SCB purveys credit through its affiliated PACS (and so the CCS is a two-tier system). In this section, we focus on the characteristics, in terms of scale, diffusion, structure and performance of the CCS at the national level, and bring out the regional diversities.

3.08 The Task Force has relied primarily on the data base available with NABARD, as far as SCBs and DCCBs are concerned. Data on source-wise deposits and sector-wise loans outstanding are taken from NAFSCOB. The Task Force noted that NABARD does not maintain any data base on PACS. The only source is the NAFSCOB compilation, based on information provided by the State Governments and the CCS. Hence, the Task Force has used the data published by NAFSCOB as far as PACS are concerned. There are, however, considerable doubts about how complete their coverage is, whether the data are up-to-date and whether there is any attempt at validating the data. The data on PACS, therefore, need to be used with caution and then too should be limited to getting a broad picture of their characteristics.

3.09 According to the NAFSCOB compilation, there are 1,12,309 PACS, which works out to roughly one PAC for every six villages in the country. The societies have, therefore, a wider spread and reach in rural India than the commercial banks (CBs) and Regional Rural Banks (RRBs). The CCS, moreover, has more than twice the rural outlets and 50 per cent more clients than commercial banks and RRBs put together. There is, however, a wide variation in the density of cooperative outlets. While the density is high in States like Maharashtra and Kerala, it is very low in the North Eastern region.

3.10 The total membership of the PACS is reported to be around 12 crore. Scheduled Castes and Scheduled Tribes and small farmers each, are reported to account for about 36 per cent to 37 per cent of the PAC membership as per NAFSCOB. Only half the members are borrowers - this proportion being less than average among small and marginal farmers and least among Scheduled Castes. These figures, it must be reiterated, are only indicative.

3.11 Even in terms of basic functions, there is a considerable diversity across States. In some regions there are a few pure thrift and credit societies that generate resources only from members and do not have financial transactions with non-members. In Maharashtra, apart from the regular PACS, there are around 22,000 thrift and credit societies (called *path sansthas*). In States like Kerala, PACS collect deposits from members, as well as non-members, in a significant way.

3.12 According to NAFSCOB estimates, which, as mentioned before, needs to be treated as indicative rather than precise, 62 per cent of the PACS in the country are viable, 30 per cent are potentially viable and eight per cent are either dormant, defunct or under liquidation. Here again, there are considerable variations across States (see Annexure IV)

3.13 There are also differences in the structure of the CCS. Most States, for instance, have different structures for purveying long term (LT) and short term (ST) credit, but Andhra Pradesh has a single unified structure for providing both long term and short term loans. Most States have a three-tier structure, comprising PACS, DCCBs, and SCBs. While in Gujarat, the SCB conducts most of its transactions with lower tier organisations and does not have any branches outside of its Head Office, in Maharashtra the SCB undertakes full-fledged banking activities through multiple branches, that operate like branches of any other commercial bank.

3.14 Apart from the diversity at regional levels, the level of development in terms of accounting practices, supervision and prudential norms vary. The upper tiers, viz., SCB and DCCB, are supervised and follow most of the prudential and accounting norms. These norms, however, are not applied to the primary level cooperatives. It is important to keep this factor in mind, while using the financial data of the PACS. But equally importantly, this must be kept in mind while using financial data for the CCS as a system because a large proportion of the outstanding of the higher tiers is tied up in the successive lower tiers.

3.15 All this highlights the considerable diversity in the density, scale and structure of the CCS, as well as the nature and severity of their problems across the country. This diversity must be recognised in implementing the recommendations of the Task Force. The recommendations too must allow for sufficient flexibility, to adapt to varying levels and patterns of the system and its problems in different regions.

Role of Cooperatives in Providing Agricultural Credit

3.16 The main players in the field of agricultural credit in the formal sector include the commercial banks, the regional rural banks (RRBs), and the rural cooperatives. The rural credit cooperatives in the country are in an impaired state. Several factors have led to the impairment of the Cooperative Credit Structure, but it would be advisable to understand the magnitude of the problem first. The cooperatives once dominated the rural credit market in the institutional segment (with a share of around 65 per cent, going by the All India Debt and Investment Survey 1991), but now have a significantly smaller role.

3.17 Data for the past decade indicates a fall in the share of cooperatives in the rural credit market, from around 62 per cent in 1992-93 to about 34 per cent in 2002-2003 inspite of an increase of just under 10% per annum in the absolute disbursement on a compounded annual basis. The shares of different institutional sectors in providing credit to the rural areas are shown in the table below.

Flow of ground level credit to agriculture (both ST and LT) through various agencies and their relative shares

Rs. crore

Agency	1992-93	1997-98	2000-01	2001-02	2002-03
Coop Banks	9,378	13975	20,718	23,524	23,636
Percentage share	62%	44%	39%	38%	34%
Regional Rural Banks	831	2040	4,219	4,854	6,070
Percentage share	5%	6%	8%	8%	9%
Commercial Banks	4,960	15831	27,807	33,587	39,774
Percentage share	33%	50%	53%	54%	57%

Source: NABARD

Two trends emerge from the overall flow of credit to agriculture from the commercial banking sector. The number of rural branches of commercial banks has gone down marginally as part of the branch rationalisation programme. The second trend is that even though the commercial banks almost meet their targets for lending to the priority sector, they have moved more towards larger customers. The average size of direct loans to agriculture in the portfolio of the commercial banks was Rs. 13,500 in 1997, and is Rs 31,585[1] now. The average size of loans of the PACS, in comparison, is currently only Rs 6,640[2] per borrower, according to the data tabulated overleaf.

Average loan size of Public Sector Banks vis-à-vis PACS (as on March 2003

Amount in Rupees

Particulars	No. of Accounts	Loan Amount Outstanding	Average loan size
Public Sector Banks (PSBs)	164 lakh	51,799 crore	31,585
PACS	639 lakh	42,411 crore	6,637

Source: PSBs - Report of Trend and Progress of Banking, RBI
PACS- NAFSCOB. Total no. of borrowers assumed to be total no. of accounts

[1] Trend and Progress of Banking in India, RBI Mumbai.
[2] NAFSCOB

3.18 Thus, in a country predominated by small or marginal land holdings, the reach of the cooperative system is much deeper than the other institutional arrangements in the rural areas.

3.19 Notwithstanding the falling share of cooperatives in the overall share of institutional credit practically in all States, it was found that in States like Gujarat, Maharashtra, Haryana, Madhya Pradesh, Chhattisgarh, Orissa and Rajasthan, the share of cooperatives in institutional credit is currently 50 per cent or more. In States like Bihar, Jharkhand, Himachal Pradesh and Assam, their share is negligible (Details are presented in Annexure V. Analysis of ground level credit flow on an All India basis is presented in Annexures V A to V C)

3.20 The traditional banking system, the systems and procedures of which are actually designed for the urban industrial and business financing, has limitations in reaching out to the last mile. The exposures of the banks for this segment have risen, but, the rates for defaults in repayment have also gone up. Most often, this happened because banks have not applied appropriate methods for banking with the poor, by keeping in touch with the customers and applying social collaterals. Banks have traditionally worked on documentation related appraisals, rather than on trust and production related appraisals. The client group, however, needs much more support than what the banks currently provide. By implication, we need to necessarily look to the cooperative sector for delivering credit to small and marginal farmers, and those who have little or no productive assets. It is, therefore, imperative that the cooperative sector, particularly at the primary level, be revived on a priority basis.

Nature, Extent and Causes of Impairment of the CCS

Impairment of Governance

3.21 World over, cooperative credit structures have been based on the concept of mutuality, with thrift and credit functions going hand in hand. But, in India, the structure has largely been focused on credit. The primary level cooperatives, therefore, have traditionally been agencies for credit dispensation. Because of this characteristic at the base level, the upper tiers were created to ensure that the lower tiers get refinance. The structure is, therefore, driven by borrowers at all levels, which creates a serious conflict of interest. A solution is to aggressively advocate conversion of pure credit to thrift cum credit cooperatives. Such societies would not only increase the financial stakes of the members in the system, but also factor in natural incentives for better governance.

3.22 The impairment in governance is deep and is represented by the composition of the boards of directors of the cooperatives and the reporting systems. Because of the structural ordering, the lower tiers are managed by the higher tiers in varying degrees of detail in different States. In almost all States, the function of conducting elections for the cooperative structure is vested with the State Government. Similarly, the function of auditing is also vested with a State-run audit system. By implication, the cooperatives lose their right to self-governance and have to look up to the State constantly for several of the functions that naturally fall in the domain of the general body and the Board of Directors. Some pointers on the governance systems are highlighted below:

- No elections have been held in the CCS units across all tiers for long (10 years or more) in three States
- Boards of nine out of 30 SCBs and 134 out of 368 DCCBs have been superseded
- Most State Governments combine the roles of Dominant Shareholder, Manager, Regulator and concurrent Supervisor and Auditor
- The Department headed by the Registrar of Societies (RCS) can and does, influence administrative matters. The interference is

in the form of supersession of Boards (please see Annexure VI for details on grounds for supersession of Boards), appointment of administrators and assuming powers to approve staffing patterns, recruitment, emoluments, asset purchase pattern etc.

- The Department also interferes in financial matters in various forms, like direction on interest rates, interference in loan decisions, announcement of waivers, and direct or indirect pressure on non- recovery of loans (State wise details of such interference is given in Annexure VII)
- The impairment of the governance structure is also because of politicisation of these institutions, reflected in the fact that directors on Boards of Cooperative Banks are involved in active politics either at the State, District, and Taluka level (Annexure VI). Data on political background of Directors on Boards of SCBs are indicated in Annexure VI A.
- Audit is pending in at least 15 per cent of the PACS for more than a year. This is a optimistic estimate. Audits are more regular in the upper tiers. Apart from delays, the quality of audit needs to be examined carefully. As the State machinery is involved in conducting audits, those actually conducting audits may not be professionally trained to audit financial cooperatives. It is therefore, doubtful that they are able to understand and comment on the reporting of the actual financial position of PACS.
- Audit at the higher tiers are done in a relatively efficient manner, the income recognition and provisioning norms are more standardized and therefore, the accounting data from the higher tiers could be assumed to be relatively more reliable. Nevertheless, the audit classification of some banks in some States seems to suggest that the audited results do not depict a true and fair position of the banks concerned.

3.23 While there are issues of internal governance that are a cause of concern, we also have to remember that even the external regulation and supervision for the structure are not as stringent as it is for the commercial banking structure. In particular the following aspects are to be considered:

- Primary agricultural societies (PACS) are excluded from the scope of the BR Act,1949
- The minimum capital requirement is only Rs 1 lakh for banks
- The cash reserve ratio (CRR) requirements are lower than that for commercial banks
- The Capital at Risk Weighted Asset Ratio (CRAR) norms have not been prescribed even for SCBs and DCCBs
- All CCS units are, however, subject to submission of regular returns on their financial status and operations, the compliance of which is weak
- The cooperative banks are open to periodic inspection by NABARD. The compliance with the supervision findings and regulations is, however, weak.

3.24 The central regulatory authority (the RBI) is naturally concerned at its inability to ensure that financial institutions comply with even the relatively diluted prudential norms applicable to them and to enforce punitive measures against banks that are in poor and deteriorating financial health. The RBI's plight may be attributed to three primary reasons, of which dual control of cooperative banks by the RBI and the State Governments, is one. The ambiguities on the precise jurisdiction of powers between the two, and the reluctance of the State Governments to enforce disciplinary sanctions by the RBI, are others. Attempts to change the law (through the Banking Regulation Amendment bill) have failed.

3.25 The States (and in some cases the Union Government) have not helped the regulatory authority. On the contrary, their actions (e.g., waiver of loans in 1989 by the Union Government, periodic waivers of interest and principal by the State Governments, delay in payments by the State Governments on promises made, their formal or informal instructions to delay or dilute loan recovery, and their unwillingness to facilitate recoveries under the Revenue Recovery Act) have contributed to an atmosphere, that encourages defaults in payment and worse.

Impairment in Management

3.26 The impairment in the management of the rural cooperatives is a direct result of the impairment in governance. The various forms of interference of State Governments include deputation of officials to top positions in many banks, setting up common cadres for senior positions in cooperatives across tiers, determination of staffing pattern, and interference in the operational decisions of the cooperatives. The Task Force has sought to collect information on areas in which the state governments are involved in the operational aspects of cooperative banks. The details that the Task Force has been able to collect from the Regional Offices of NABARD in the matter are indicated in Annexures VI and VII.

3.27 The impairment in management is also owing to the following additional factors:

- Managers of PACS in several States are drawn from a common staff pool who do not feel accountable to the PACS. Remuneration often is without reference to business level or results.
- A generally ageing staff profile characterised by inadequate professional qualifications and low levels of training. (Annexure VI).

- Delineation of Governance and management functions are unclear and the boards take up issues at operational level, thereby losing sight of the long term strategic issues
- Poor housekeeping, weak internal controls and systems.

3.28 The cumulative result is that members, who are mostly borrowers, have little or no sense of stake in the cooperatives, or any accountability in ensuring prudent management of funds. On the contrary, government policies (loan and interest waivers, delaying recoveries, the fact that loans carry State guarantees) encourage them to presume that they can with impunity, delay or even fail to meet their repayment obligations. Boards of management and their functionaries are not held accountable for laxity in granting and monitoring loans, poor quality of loan portfolios, high default rates and non performing assets (NPAs) and their adverse effects on the financial health and viability of the societies.

Financial Performance

Profitability

3.29 Data on the proportion of societies in different tiers that reported making profits during 2000-2001 and 2002-2003, the numbers that reported zero or negative net worth and the magnitude of reported accumulated losses are shown in the following table :

Financial Results of the CCS

Financial Results of the CCS

Tier		2000-01	2001-02	2002-03
No of SCBs		29	30	30
	No. in Profits	24	24	25
	No. in Losses	5	6	5
	No. that have eroded net worth	6	9	8
	Total Accumulated losses (Rs. Crore)	492	567	281

No of DCCBS		367	368	367
	No. in Profits	247	243	237
	No. in Losses	120	125	130
	No. that have eroded net worth	139	139	144
	Total Accumulated losses (Rs. Crore)	3,177	3,770	4,401
PACS [3] (Total number approximately one lakh)	No. in Profits	46,807	45,292	58,683
	No. in Losses	41,991	43,511	53,626
	Total Accumulated losses (Rs. Crore)	2,112	NA	4,595

Source: For SCB and DCCB: NABARD, For PACS: NAFSCOB

State-wise details of PACS reporting profit for the years 2001-2002 and 2002-2003 are given in Annexure VIII

3.30 Based on available data, while the large majority of SCBs were reporting profits during this period, more than 35 per cent of DCCBs and more than half the PACS were reporting losses. About one in five SCBs and almost 38 per cent of the DCCBs have eroded their net worth. Accumulated losses of DCCBs amounted to around Rs 3,200 crore in 2000-2001 and increased to Rs 4,400 crore two years later. Accumulated losses of PACS exceed that of DCCBs.

3.31 Considering that the upper tier cooperatives largely depend on the primaries for their business, it can be said that the structure stands on very weak foundations. It is also evident from the above that data, that current profits or losses could be misleading, especially since some of the institutions that are making current profits could have heavy accumulated losses and that all of them may not have made the required provisions against their NPAs. Statistics on cooperative banks that do not comply with Section 11 of the Banking Regulation Act is also given and we find that some of these institutions may have current profits, but accumulated losses.

[3] Since norms of income recognition and prudential norms are not applied to PACS, the data presented for PACS may not present an absolutely true and fair picture of the state of affairs.

3.32 In 2002-2003, for instance, eight out of the 30 SCBs and 144 out of 367 DCCBs are not compliant with Section 11 of the Banking Regulation Act, which means that they have completely eroded their net worth. The amount of deposits eroded (over and above the net worth erosion) at the DCCB and the SCB level in loss making banks is also significant. The erosion of deposits was at Rs 3,100 crore at the level of DCCBs and Rs 142 crore at the level of SCBs. The data relating to the erosion of deposits in PACS is, however, not available.

3.33 The performance of these institutions vary across States and across regions. While the number of loss making DCCBs far outnumber the profit making ones in the eastern region, the performance in the northern region seems to be much better. In southern and western India, the number of profit and loss making DCCBs even out. Detailed Region wise profitability analysis of DCCBs is given in Annexure IX

Recovery rates and NPAs

3.34 The reason for the losses can be traced mainly to the overall business levels and poor recovery position of each of the tiers. As is evident, the recovery percentages for the system as a whole have been low continuously, making the system unsustainable without external injection of resources.

Recovery and NPA Percentages of the co-operative system

Tier		2000-01	2001-02	2002-03
SCBs	Recovery %	82	82	79
	NPA %	13	13	18
DCCBs	Recovery %	67	66	61
	NPA %	28	22	20
PACS	Recovery %	65	67	62
	NPA	No NPA Norms have been specified for PACS		

Source: SCB and DCCBs-NABARD, PACS -NAFSCOB

3.35 While the recovery and NPA positions indicate the extent of reported impairment in the upper tiers, the figures at the primary level have to be viewed with caution, as there are no standard practices in respect of financial reporting. The picture presented in the table above, therefore, may seem more optimistic than the reality. Recovery is a hard number, provisioning is to account for likely losses on account of an assessment of impairment.

3.36 There is considerable variation in performance within each tier and also across States (Annexures XI, XII, XIII).

3.37 Low recovery of loans obviously affects the profitability of the institutions. Poor loan recovery has resulted in a peculiar phenomenon, often referred to as “imbalances”. Imbalances are the differences between the amounts showing as outstanding from a borrower in the books of a higher tier entity (a DCCB) and the amounts shown as being repayable in the books of the borrowing entity (say the PACS). The imbalance occurs when the PACS receives interest and repayment from a sub-set of its customers and pays in the amount towards its borrowing from the DCCB.

3.38 When the amount is paid to the DCCB, the total amount is applied first by the DCCB to the total interest due. The residual amount then is applied to the principal. Imbalances also occur when the PACS collects the loans and uses the cash to fund its overheads over and above the actual interest spread available to it. These two factors and in some situations actual defalcation result in a curious situation, where the principal amount due to the PACS at the ground level is smaller than the principal amount to be paid by the PACS to the DCCB. While this syndrome has been described in some circles as an accounting issue, it is important to recognise the larger cause, which is actually poor loan recovery or high overheads or frauds.

3.39 Considering that there has been widespread discussion on imbalances within the cooperative credit system, one would expect the recovery position of the higher tier to be lower than that of the lower tiers if the portfolios of both the tiers were perfectly aligned. However, the data given in the above table indicates the contrary. The superior performance of the upper tiers of the system may be because of diversification in their business, and better performance of the non-agricultural portfolio due to non-recognition of losses on portfolio guaranteed by the State Government or due to repayments out of growing deposits. This diversification of portfolio is also reflected in the exposure to agriculture and other sectors as given in the table below. While diversifying the portfolio has its own advantages in risk management, it also has the potential danger of the institutions suffering a strategic drift. These indications prompt the Task Force to focus the efforts of the rehabilitation package on the primary level, where the exposure to agriculture is the maximum.

Break up of loan outstandings as on 31 March 2003[4]

(Rs. Crore)

Tier	Agriculture loans	Non-Agri. loans	Other Loans	Total	Agri as a % of total
SCBs	12,488	16,366	6,198	35,052	36
DCCBs	30,951	21,931	9,516	62,398	49
PACS	23,153	7,668	11,591	42,412	55

Costs and Margins

3.40 The data on costs and margins of the SCBs and DCCBs during the period 2000-2001 to 2002-2003 is given below.

[4] Break up of purpose-wise loans outstanding taken from NAFSCOB.

Costs and Margins of SCBs and DCCBs

Figures in percentages

Particulars	SCBs (all India)			DCCBs (all India)		
	2000-01	2001-02	2002-03	2000-01	2001-02	2002-03
Yield on Assets	9.38	8.88	8.67	10.13	9.86	9.16
Cost of funds	6.88	7.19	6.26	7.09	6.97	6.32
Financial Margin	2.50	1.69	2.41	3.04	2.89	2.84
Transaction costs	1.36	1.38	1.46	2.04	1.92	1.72
Risk Costs	1.25	1.90	1.42	1.89	1.65	1.73
Net Margin	0.09	(0.52)	0.04	0.15	0.27	(0.01)

Source: NABARD

3.41 The cost of funds refers to the average cost from all sources, deposits, borrowings and refinance from NABARD. Deposits account for a relatively small proportion of the PACS' funds, most of which is from refinance through the higher tier institutions. The DCCBs depend largely on public deposits and have for long been offering higher interest rates than other institutions, as a means of attracting deposits. This is done partly with the encouragement and approval of the State Governments. The "captive deposits" syndrome, which requires the lower tier to compulsorily place a part of its deposits with the higher tier, puts pressure on the system as a whole, to fix a higher rate of interest.

3.42 While the financial margins of the system seem reasonable, the system gets impaired partly because of high transaction costs and high risk cost. High transaction costs are because of lack of standardized business model irrespective of business volume, overstaffing in some cases and not linking salaries with business levels in others. High risk costs are because of low recovery levels. To compound the problem, cooperatives do not have adequate risk mitigation systems and procedures. Implementing Asset Liability Management (ALM), managing interest rates on deposits and loans, appropriate credit appraisal and monitoring are done more as an exception than as normal practice.

3.43 Inspite of interest rates having been ‘deregulated’, lending rates are subject to limits set by the State Government. Lack of scope for cross subsidisation compounds the problem. At the higher tiers, there has been over-exposure to certain sectors of agriculture, which increases the covariance risks. Sugar, cotton and tea, for instance, are sectors where the primaries have an exposure at the farm level and the DCCBs and SCBs have an exposure at the processing unit level.

3.44 The loan portfolios of the system as a whole are thus, prone to greater risk and, therefore, required provisions for risk costs are also relatively high. Because of these factors, the net margin is extremely low and in many cases negative. Costs and Margins available to DCCBs in select States are presented in Annexure X. Annexures XI to XIII provide some idea of the range of variations in gross and net margins among DCCBs across States.

3.45 Lending rates of PACS are also subject to state set ceilings and are set well below the market rate, despite higher risks. Transaction costs are also high (again owing to business model issues, overstaffing and salaries unrelated to the magnitude of business). There is considerable doubt whether PACS have to (as per state set rules) or do, follow well-defined norms for risk provisioning. It is impossible to judge the extent of actual provisioning from available accounts. A perusal of accounts for PACS in a few selected districts, and in the opinion of officials with first hand knowledge of ground reality, suggests that they generally do not make any provision at all, or do not make adequate provisions for risks.

3.46 Other relevant data on business parameters / infrastructure at the level of PACS and DCCBs are indicated in Annexures XIV to XIX.

Concerns arising out of Financial Impairment

3.47 Rural credit institutions mobilise a large amount of deposits, nearly Rs 1,30,000 crore in gross terms, of which Rs 73,512 crore (56 per cent) are from the public. A large proportion of the deposits are collected from individual depositors. The break up of the source wise deposits is given below:

Source wise deposit outstanding as on 31st March 2003.

(Rs. crore)

Tier	Cooperatives	Individuals	Local Bodies	Others	Total
SCBs	29,402	6,995	1,246	1,469	39,112
Percentage	75	18	3	4	100
DCCBs	27,086	40,710	3,020	1,578	72,394
Percentage	38	56	4	2	100
PACS		19,120			19,120

Source: NAFSCOB

3.48 As seen above, 38 per cent of the deposits of DCCBs are from cooperatives, including PACS. As statutory liquidity ratio (SLR) requirements of urban cooperative banks and other banking institutions in the area can be placed in the DCCB (and in turn DCCBs place their SLR deposits in SCBs), the deposits under the head "cooperatives " may have a significant component of SLR related deposits. This adds to the overall risks to the cooperative banking sector, taking it much beyond the exposure of individual deposits in the district and state level banks. Erosion of deposits in the higher tiers, therefore, could have a "domino" effect on the banking system in the area.

3.49 To protect the interests of depositors, DCCBs and SCBs are subject to controls under the Banking Regulation Act. They are required to observe prescribed prudential norms and their individual depositors also have insurance cover up to Rs 1 lakh by the Deposit Insurance and Credit Guarantee Corporation of India (DICGC). It is evident, however, that the insurance coverage provided is limited, as institutional deposits with the upper tiers do not get covered by the DICGC, thus placing the individual depositors of the lower tier institutions at risk, as several banks have had significant erosion of deposits. This certainly is an area of concern.

3.50 It is also important to note that deposits at the level of PACS are not covered by the DICGC. This is a matter of serious concern. While deposits of individuals at the level of the PACS is not uniformly high, some states like Kerala, Tamil Nadu and Orissa together account for around 70 per cent of the outstanding deposits of PACS in the country. Some states (like Kerala and Tamil Nadu) have introduced their own insurance mechanisms to give limited protection to PACS depositors. These schemes have, however, remained notional as depositors in neither State have received actual protection.

Remedial Measures and Approach to Reform

3.51 Obviously, unless the causes of the serious and growing impairment in several dimensions are tackled, cooperatives cannot be expected to arrest their declining role in providing agricultural credit, let alone play a significant role in achieving the targeted rapid expansion of credit to the farm sector. As noted earlier, several committees and concerned cooperators have suggested measures to revive and revitalise the CCS, so that cooperatives become an effective medium for meeting the savings and credit needs of small and marginal farmers, rural artisans and other under-privileged sections of rural society.

3.52 Reviving and revitalising the CCS is essential, both on functional and ideological grounds. In functional terms, cooperatives already have a wider and deeper reach in the countryside than other financial institutions. Experience has shown that the latter serve mostly the better -off segments of borrowers, that have a sufficiently large asset base. They are reluctant to cater to the small and marginal farmers and other underprivileged sections, on grounds that lending to them is far too costly and risky to be profitable.

3.53 Cooperatives, of the mutual thrift and credit type, are the only form of organisation by which economically disadvantaged individuals and groups could, through voluntary collective action, overcome their disadvantageous position in an unequal market and promote their well being. Organisations, in which members know each other first hand, are closely linked through kinship and other social relations, and have a strong mutual stake in proper use of the common credit pool, credit would be put to good use. Costs of administration and risks of default in repayment could be reduced. No less relevant is the moral appeal of cooperatives as a counter and an alternative to individual or corporate enterprise, for mobilising and using economic resources for owners' profit.

3.54 Recognising the important role that the cooperative network can play in delivering credit to sections of the rural population, which cannot, or are unlikely, to be reached through commercial and rural banks, all the earlier-mentioned committees are unanimous on the steps needed to realise their potential. They emphasise the need to (a) restore democratic management in the societies by holding free and fair elections regularly, (b) reduce the scope for government interference in their management to a minimum; (c) rationalise staff and improve their professional ability; and (d) create a climate conducive to prudent management of resources and efficient management and recovery of dues. Some suggest de-layering of the cooperative structure, increasing the service area of primary cooperatives to make them viable, and even making DCCBs and PACS branches of the SCBs.

3.55 Practically all reviews have recommended strongly against waivers of interest and loan repayment by governments, restraining or impeding recovery processes and such other measures, that create strong disincentives to borrowers to settle their dues fully and promptly. They have also been unanimous in recommending abolition of “dual” control in matters of financial regulation of cooperative banks and vesting the needed authority and responsibility fully and wholly with the central regulatory authority, the RBI, under the Banking Regulation Act.

3.56 Both the Capoor and the Vikhe Patil Committees recommended special financial assistance to help viable and potentially viable DCCBs and SCBs to wipe out accumulated losses, strengthen their capital base, consolidate their outstanding debt from past borrowings and convert them into medium term loans at lower rates of interest. They have further recommended that the cost of financial restructuring (running into thousands of crores of Rupees) should be shared by the Union and the State governments, provided credible steps are taken to enable and encourage cooperatives to function efficiently.

3.57 Having perused the reports of earlier committees, the Task Force agrees with their central approach and thrust that the cooperative credit structure (CCS) needs:

- Special financial assistance to wipe out accumulated losses and strengthen its capital base
- Institutional restructuring to make for democratic, member driven, autonomous and self-reliant institutions

- Radical changes in the legal framework to empower the RBI to take action directly in matters and to the extent deemed appropriate for prudent financial management of banks, and
- Qualitative improvement in personnel in all tiers and at all levels through capacity building and other interventions, leading to an increase in overall efficiency.

3.58 Our recommendations on the specific measures in each of these spheres are detailed in subsequent chapters. They should be viewed as an inter-related, integrated package, to be calibrated by time and institutional responsibility. The package needs to be implemented in a way that it may have a synergetic impact in improving the health and vitality of the cooperative credit structures. Any propensity to pick and choose its recommendations cannot but destroy the “warp and woof” of the fabric, that constitutes its core. Unless the conditionalities prescribed go hand in hand with the resource support, the ailments characterising the cooperatives will not be addressed, and the money invested will go down the drain. If the assignment given to the Task Force is not to be repeated by another committee in the future, it is necessary that the package prescribed by it be accepted in full. Such an approach will have the best chance of being accepted by the stakeholders as the basis for reform and revival.

CHAPTER - 4

General Approach and Financial Restructuring

Guiding Principles

4.01 The Task Force is of the view that financial restructuring of the cooperative credit structure (CCS) must follow some basic principles, enumerated below.

- Re-engineering, including financial re-engineering, must cover all the tiers of the cooperative credit structure. In the opinion of the Task Force, a superstructure can only be as strong as the base. Recapitalisation and restructuring the intermediate and upper tiers of the cooperative credit structure, without addressing the infirmities at the primary level, would defeat the objectives of reviving and revitalizing the CCS. Primary agricultural cooperative societies (PACS) are the foundation of the short-term cooperative credit structure and much of the weakness of the upper tiers is because of their poor financial health and deficiencies in the way they are organized and managed.

- The Revival Package (RP), therefore, must include assistance for restoring the PACS to acceptable levels of financial health. It must put in position an environment and specific measures that could enable the PACS to evolve into democratic, self-governing and financially well managed institutions.

- It has been brought to the notice of the Task Force that such an exercise could be difficult because the number of credit cooperatives at the base level is very large. To overcome this difficulty, the Task Force has suggested some simple criteria for identifying eligible institutions, sharing patterns, etc.

- Recapitalisation must cover the aggregate erosion of capital in all the tiers of the CCS. It was pointed out to the Task Force that financial constraints pose a case for partial recapitalisation, limited to losses arising out of agricultural lending alone. The Task Force is not in agreement with this line of reasoning, as it believes that partial recapitalisation, like under-financing projects, have the potential to place the entire resource support at risk.

- The Task Force is not advocating an open-ended recapitalisation of all credit cooperatives, however. It is conscious that the resource support in the way of recapitalisation, is ultimately a charge on public funds and therefore, must be recommended with utmost caution. Keeping this in view, the Task Force recommends that recapitalisation be limited to institutions that conform to the standards of eligibility prescribed by it (and enumerated later in this chapter). At the same time, it also recommends the future setup of the remaining non-viable, dormant and defunct credit cooperatives or banks, by way of mergers, amalgamations or closure. The Task Force suggests transitional arrangements to ensure flow of credit in the areas of operation of such societies.

- Adhering to the principle that a behavioural shift cannot occur without a strong incentive, the Revival Package combines a generous and comprehensive capitalisation package, with a stringent set of conditionalities for legal and institutional reforms. The Task Force thus, allows options to State governments and the CCS to accommodate ground level diversities in implementing the Revival Package in a phased, but time-bound manner.

4.02 The major issues taken into consideration in working out the details of financial reconstruction include:

a) criteria for determining eligible purposes and institutions,
b) the quantum of assistance required,
c) the sharing pattern,
d) conditionalities and
(e) timeframe.

Eligible Purposes

4.03 The Task Force is of the opinion that resource support for financial restructuring must enable eligible institutions to clear accumulated losses, maintain minimum capital and retire equity contributions by State Governments. The resource support should also cover the costs of technical assistance to upgrade human resources and management systems, as well as the costs of implementing the package.

Accumulated Losses

4.04 The accumulated losses of various units of the CCS arise from several sources, enlisted below:

- Non-repayment of loans given to members for agricultural and non-agricultural businesses and the resulting 'imbalances'
- Non-repayment of loans given to members for other purposes and the resulting 'imbalances'
- Losses on account of non-credit businesses of CCS units (like the Public Distribution System (PDS), and procuring and supplying agricultural inputs)
- Non-repayment of direct loans under State Government guarantees and where the State has failed to honour the guarantee after the loans have been defaulted

- Non-repayment of other direct loans without any guarantee from a State Government or any other, and
- Failure of State Governments to release funds to cover waivers of loans and interest, interest subsidies and other subsidies announced by them periodically

4.05 Accumulated losses as shown in the balance sheets of the CCS units do not reflect or take into account amounts not received from State Governments as invoked guarantees or other dues. "Dues receivables from the State Government" are shown without making any further provisions.

4.06 The Task Force recommends that such losses be provided for within the financial package for the CCS. The Task Force considered and rejected the possibility that the assistance be restricted to losses arising out of agricultural loans only, as it would tantamount to partial recapitalisation. For the same reason, the Task Force does not agree with the suggestion that accumulated losses arising out of non-financial businesses need not be covered by the package.

4.07 The Task Force recognises that along with well documented reasons, like poor appraisal, ineffective follow-up, etc., losses can also be traced to disproportionately high management and administrative overheads. The losses of the CCS units can also be traced to high cost of funds, arising from the captive deposit syndrome, entailing untenable interest rates on deposits and loans, defalcations, etc. The solution to these problems lies in restructuring governance and in measures to improve the efficiency of managements.

4.08 The measures needed to improve the governance and efficiency of the CCS are detailed elsewhere in this report, with the recommendation that the cost involved be borne out of the financial package. The Task Force would like to emphasise that its recommendation that the accumulated losses of the CCS units be covered by the Financial Package does not tantamount to writing off their defaulted loans. The taskforce would expect the CCS units to take every possible step in future, including recourse to legal action, to recover their loans subsequently. It also expects the State machinery to assist the process to the extent necessary. The Task Force also recommends that wherever defalcations have come to light, stringent action be taken against those involved.

4.09 While discussing the modalities for determining the extent of accumulated losses, the Task Force took note of the fact that the quality of housekeeping at the primary level has serious shortcomings. The Task Force also observed that in a number of States, no standardised norms and procedures exist at the primary level for making provisions for losses. This being the case, estimates of institution-wise accumulated losses on the basis of the extant, and in many cases outdated, financial statements put out by the primary level institutions could lead to serious distortions in the assessment of the accumulated losses at that level. The accumulated losses of the CCS units, therefore, must be estimated afresh and in a transparent manner.

4.10 The fresh appraisal of losses will require estimating accumulated losses in keeping with uniform NPA (non performing assets) norms, and to have the accounts of all societies in all states audited for the latest year on that basis. The Task Force took into account the argument that this process would be time-consuming at the level of PACS (primary agricultural cooperative societies), if done through the existing institutional structures. Recognising the merit of this argument and the need to expedite the process, it is recommended that the task be entrusted to specially designated auditors, under a fee-based arrangement. The Task Force feels that the true and fair picture of the institution-wise accumulated losses at all levels will then emerge.

Capital to Risk weighted Asset Ratio (CRAR)

4.11 The Task Force notes that under the existing arrangement, cooperative credit institutions including cooperative banks are outside the CRAR framework, on the ground that there is an in-built accretion to capital every time a loan is availed of by a member. The Task Force feels that in view of the huge rates of default characterising the CCS, there is a need to bring all tiers of the CCS under the CRAR framework. The Task Force notes that under the present regulatory framework, commercial banks are required to maintain a minimum CRAR at 9%.

4.12 The Task Force recognises that credit cooperatives (including cooperative banks) operate in defined geographical areas, with credit portfolios concentrated in a single sector, subject to the risk of higher concentration. It feels that there is a case for factoring in the pressure exerted by the higher covariance risk inherent in such an arrangement. The Task Force, therefore, recommends that all CCS units, viz., PACS (primary agricultural cooperative societies), DCCBs (Central Cooperative Banks at the District Level), and SCBs (apex Cooperative Banks at the State Level), be initially supported with external resources, wherever needed, to achieve a minimum CRAR of 7%.

4.13 The CRAR may increase further through internal accretions within three years from the date of capitalization to 9%, and further to 12% in the next two years. The Task Force further recommends, with a view to protecting the resources being made available to the CCS, that under the Revival Package, a review be carried out by the RBI (the Reserve Bank of India) to determine whether a case exists for a higher level of CRAR.

Retirement of Government Share Capital

4.14 Looking back in history, the Task Force cannot but agree with Lord Tennyson that "the old order changeth yielding place to the new, lest one good custom should corrupt the world". State partnership was introduced by the All India Rural Credit Survey (1954) to enhance the borrowing powers of cooperatives by increasing their capital base. This initiative has, over time, been the single most important cause for bureaucratisation of the system and for the intrusive and pervasive control by the State Governments over all aspects of cooperative functioning.

4.15 The Task Force is of the view that the time is now opportune to reverse the course of history. Initially, loans were made available to State Governments to contribute to the share capital of cooperatives. The time has now come for cooperative credit institutions to return the equity received by them from the State Governments over time. To facilitate this process, which incidentally, constitutes an important cornerstone of its recommendations, the Task Force recommends that soft loan support be provided to institutions that do not have the wherewithal to return State Government equity. The Task Force believes that this will pave the way for cooperatives to return to their original mandate of member-driven and member centric institutions.

Technical Assistance

4.16 Elsewhere in this report, the various forms of impairment endemic to the CCS have been indicated. The need to design specific financial proformae for working out accumulated losses and to be able to confirm these losses through specially commissioned audits, has also been highlighted. The Task Force is of the view that special audits will enable true and fair assessment of the financial assistance to be provided to the CCS, but would not be able to ensure that the CCS remain on the same trajectory on a continuing basis.

4.17 Various other measures are required to inject method in the CCS accounting system, like developing and implementing a software-based common accounting system, dovetailed into an appropriate MIS (management information system), to facilitate proper and timely decisions at all levels. The system would also require appropriate hardware support. During its discussions, the Task Force was of the unanimous view that provision for hardware needs to be consistent with the requirements of cooperatives at rural centres. Members felt that providing sophisticated equipment at centres where requirements could be met with simpler hardware options, would be a waste of money.

4.18 The Task Force also discussed at length, the issue of training and capacity building in cooperatives. It was felt that the training available in the system had largely ignored credit cooperatives at the ground level. Most of the training has traditionally focused on officers in the intermediate and senior executive levels of the cooperatives. The desirable training strategy would meet the needs for training and skills development of a balanced mix of staff, elected representatives and members.

4.19 The existing training programmes are, moreover, archaic and outdated, focused more on issues like the history of cooperation and legal enactments, than on matters pertaining to business and operations. This trend too needs to be set right. The extant training facilities are provided through various channels, including institutions sponsored by the State Governments, CCS (which are substantially supported by NABARD), College of Agricultural Banking, Bankers' Institute of Rural Development, National Institute of Bank Management, etc.

4.20 Taking into account, the number and range of cooperative credit institutions in the country, there is space for all these institutions to play a meaningful role. Having said this, the Task Force would like to clearly state that in the light of the resource support now being recommended by it, the nature and scope of cooperative training cannot be left to the whims and fancies of individual institutions. There is a need to standardize the training programmes and curricula, so that the programmes can be replicated and implemented across the country.

4.21 To operationalise these recommendations, the Task Force suggests that a joint group be set up under the chairmanship of NABARD, comprising representatives of the RBI, select government sponsored institutions and those promoted by the cooperative structure, with a mandate to finalise the training strategy by the end of June 2005.

Eligible Institutions

4.22 Having determined the purposes qualifying for resource support, the Task Force now discusses the methodology for identifying institutions eligible for it. It was argued that all units of the cooperative credit structure (CCS) must be capitalised. The Task Force is unable to accept this line of reasoning, because even preliminary data clearly indicate the existence of cooperatives at different levels, whose performance is so poor that no amount of capitalisation can address their basic infirmities.

4.23 The Task Force is inexorably led to the conclusion that capitalisation must first be conditional to a rigorous classification of the CCS into institutions which deserve capital support and those that do not. Having said this, the Task Force would like to draw attention to the fact that the CCS in India constitutes a very large network of outlets, spread across the length and breadth of the country.

4.24 The criteria for classifying ground level institutions in the past were business size, availability of paid Secretary, own premises, etc. While these criteria do indicate certain information about the institutions concerned, they are not suitable for assessing financial viability, which is at the heart of the present exercise . The Task Force is of the view that in principle, the eligibility of institutions should be determined on the basis of criteria which are uncomplicated and empirically verifiable. The criteria for identifying institutions that deserve resource support should also be able to be dovetailed with a simple methodology, for obtaining data necessary for deciding on their eligibility and for working out the desirable quantum of resource support.

4.25 During the discussions, it was pointed out that the criteria for all institutions should be the same, for the purpose of uniformity. The Task Force is, however, of the view that institutions at the ground level, viz., PACS (primary agricultural cooperative societies) are mainly conducting their business through borrowed funds. As a result, a criterion which combines interest margins vis a vis operating costs and the level of recovery would be more relevant in their case. At the same time, net worth and erosion are more applicable to upper tier institutions, which conduct business wholly or partly through public deposits.

4.26 It needs to be mentioned here, that eligibility of the DCCBs (and the SCBs too) for the Revival Package, would be determined after factoring in the impact of capitalisation of all the PACS affiliated to them[5]. The chart below indicates the criteria suggested by the Task Force for classifying institutions in the CCS eligible for resource support :

Institutions	Criteria
PACS	1) Gross Interest Margin >= 50% of operating expenses[6] and 2) Recovery >= 50% of demand
DCCBs	Positive net worth and those with negative net worth with deposit erosion of less than 25%
SCBs	Positive net worth and those with negative net worth with deposit erosion of less than 25%

Quantum of Assistance

4.27 The Task Force recommends that the actual amount of assistance be based on audited balance sheets as at the end of March 2004. Suitable arrangements should, therefore, be made for a special audit, especially of PACS. The assessment in the following paragraphs is, however, based on data available as on March 2003 and, therefore, is only indicative at this stage.

4.28 In working out the requirements of resource support for cooperatives, the Task Force has followed the bottom up approach. It has first reviewed the extent of impairment at the level of the primary societies and estimated the resources required for cleansing it. The strategy is based on the logic that once the losses at the primary level are met, there would be a resultant downward impact on the accumulated losses at the level of the DCCB. The same reasoning would apply to capitalisation of DCCBs and SCBs.

Losses at the level of PACS

[5] Thus, in case some of the PACS affiliated to a particular DCCB do not get covered under the package, as they are ineligible, the dues of such PACS would have to be factored in the capitalisation of that DCCB. The same logic would follow for capitalisation of SCBs.
[6] Operating expenses for the purpose of this exercise would include all administrative and management expenses and would not include provisions required to be made.

4.29 The accumulated losses of PACS as at the end of March 2003, aggregated to Rs 4,595 crore[7]. The classification of these losses into those attributable to agricultural loans, non-agricultural loans, other loans, and non-credit business, is not available in the existing database.

4.30 A rough estimate, however, is possible at the macro level. The losses have been classified by first arriving at the break-up between credit and non-credit losses, on the basis of the proportion of loans outstanding to working capital. The losses attributable to loans for agricultural business, non-agricultural business and loans for other purposes (like jewel loans etc.) have then been estimated on the basis of the proportion of purpose-wise loans outstanding[8]. However, to get such an exercise done at the level of each society would involve enormous time and effort, delaying the entire re-capitalisation process, without any significant value addition. The Task Force, therefore, suggests that accumulated losses at the level of PACS be divided into those arising out of credit business and non-credit business.

The estimated magnitudes of the accumulated losses of the PACs on this basis are tabulated below.

(Rs. Crore)

Total Accumulated Losses	4,595
Losses on account of credit business	3,170
Losses attributed to non-credit business (e.g., PDS etc.)	1,425

Losses at the level of DCCBs

[7] Based on data specifically obtained from DCCBs through regional offices of NABARD. Estimates relate to position as at the end of 2002-03.

[8] As per the above criteria, credit & non-credit related losses at the PACS level aggregate Rs.3,170 crore and Rs. 1,425 crore respectively. The credit losses can further be bifurcated into losses due to agri loans (Rs.1,744 cr.), non-agri loans (Rs. 571 cr.) and other loans (Rs.856 cr.) on the basis of proportion of these types of loans to total loans outstanding.

4.31 The accumulated losses of DCCBs aggregate Rs 4,401 crore as on March 2003[9]. As mentioned earlier, cleansing the balance sheets of PACS would automatically reduce the accumulated losses of the DCCBs. The Task Force has, consequently estimated the losses of the DCCBs, by setting off the credit losses of the PACS on account of their loans for agriculture and non-agricultural business operations (estimated at Rs. 2,314[10] crore), against the accumulated losses of DCCBs. The balance of losses at the DCCB level represents :

- residual losses on account of loans to PACS for other purposes,
- DCCB's lendings to societies other than PACS
- Direct lending by DCCBs to individuals and units for agriculture or non- agriculture purposes

4.32 A precise estimate, however, can only be made after the Balance Sheets are trued based on prescribed NPA norms, through special audit by supervising officials of the NABARD.

Losses at the level of SCBs

4.33 The accumulated losses of SCBs (apex cooperative banks at the state level) aggregate Rs 281 crore. A precise estimate, here too, can only be made after the Balance Sheets are trued based on prescribed NPA norms, through special audit by supervising officials of NABARD.

Invoked Guarantees

[9] Data by NABARD

[10] For the purposes of these aggregate estimates, it is presumed that most of the loans for 'other purposes' are made by PACS out of their own resources. However, if a DCCB has provided credit limits to PACS for such purposes, the same would have to be factored in its losses.

4.34 The Task Force was given to understand that as of end March 2004, State Governments had extended guarantees to the extent of Rs 4,495 crore in favour of DCCBs and SCBs, for loans issued by them to various agencies and units. These guarantees comprise those aggregating Rs 3,181 crore in favour of SCBs, and Rs 1,314 crore in favour of DCCBs. The Task Force noted with concern that guarantees aggregating Rs 827 crore and Rs 337 crore had been invoked by SCBs and DCCBs respectively, because of defaults by the borrowing agencies. These amounts had not, however, been paid by the respective State Governments to the concerned banks.

4.35 The Task Force would like to impress on the State Governments that not paying funds to the SCBs and DCCBs would seriously impact their financial viability. It, therefore, urges State Governments to pay these monies to the respective banks immediately, with accumulated interest. However, State Government representatives, who interfaced with the Task Force pointed out that in most cases, the financial position of State Governments did not enable them to meet these commitments immediately.

4.36 So that the financial position of the State Governments does not put the recapitalisation process at risk, the Task Force recommends resource support for them. It recommends that soft loans be made available to the concerned State Governments on a specific application being made to the implementing agency, as part of the MOU framework designed by the Task Force, to enable them to pay these dues, with accumulated interest to the CCS units concerned, as the first step towards recapitalisation.

Other Receivables from State Governments

4.37 The Task Force notes with concern the propensity of State Governments to announce loan and interest waivers and other subsidy schemes from time to time, which affect the cash flow of the lending agencies and seriously vitiate the repayment climate. The Task Force does not deem it appropriate to review the complexities of the issues involved, but from a purely financial standpoint, it has no hesitation in saying that the sooner these practices are brought to an end, the better it is for the system.

4.38 In the interest of the recapitalisation initiative, the Task Force, albeit reluctantly, recommends that the outstanding amount of Rs 720 crore announced by various State Governments from time to time for such interest waiver and subsidy schemes, be immediately paid by the State Governments, along with the accumulated interest. Here too, however, the Task Force recommends a soft loan support to the State Governments in the light of the state of their finances. Once again, the soft loan will be available on a specific application to the implementing agency within the MOU framework.

4.39 As mentioned earlier in the report, these amounts (invoked but unpaid guarantees + other dues) are generally shown as receivables from the Government and hence, are not reflected in the losses shown in the balance sheets of cooperative banks.

CRAR

4.40 Earlier in the report, the Task Force noted that cooperative credit institutions, including cooperative banks were beyond the CRAR (capital at risk weighted asset ratio) framework. It recommended that all CCS units, including cooperative banks, may initially be supported with external resources. The support would be through a soft loan in the form of a Tier II capital, wherever necessary, to achieve a CRAR of a minimum of 7%, to be taken up by internal accretions to 9% within three years from the date of capitalisation, and further to 12% in the next two years.

4.41 The amount required for taking the CRAR of cooperative institutions to a minimum of 7%, can only be arrived at after the recapitalised balance sheets are available. In the light of the fact that the system has an inherent linking of share capital contribution to loans and that the accumulated losses of the system would have been wiped out at the end of the cleansing process, the amount required is not expected to be large.

Retirement of Government Share Capital

4.42 As at the end of March 2003, the contribution of State Governments to the share capital of CCS institutions aggregated Rs 1,243 crore, as shown below:

Share capital contribution by State Governments

(Rs. crore)

Agency	Amount
PACS	619
DCCBs	521
SCBs	103
TOTAL	1,243

4.43 Elsewhere in the report, the Task Force has recommended that "the time has now come for cooperative credit institutions to return the equity received by them from the State Governments over time. To facilitate this process, which constitutes an important cornerstone of its recommendations, the Task Force recommends that soft loan support be provided to institutions which do not have the wherewithal to return State Government equity".

4.44 The Task Force hopes that the CCS institutions at different levels will understand the justification for and implications of the recommendations made by it, and find the resources for returning State Government equity. However, a sum of Rs 1,243 core has been factored in, as part of the recapitalisation, as soft loan assistance to CCS units, just in case they are unable to do so.

Technical Assistance

4.45 The recommendations of the Task Force for Technical Assistance have been delineated at various places in the report. The major components under this head, including the amounts required, are detailed below:

(Rs. Crore)

Item	Amount
• Pre-capitalisation audit	46.00
o Designing of special balance sheets and training manuals, training of trainers for the special audit	0.50
o Training of auditors for conduct of special audit	0.50
o Special audit costs and vetting by CAs	45.00
• Accounting and Technological support	516.00
o Designing of standard common accounting system and accounting manual, translation into local languages and printing, training of trainers	1.00
o Designing standardised accounting software based audit and information systems and , development of common software etc.	215.00
o Designing of hardware configurations (Personal Computer, dot-matrix printer, modem, networking arrangements, UPS), installation and AMC and funding for supplying the same under a need based arrangement	300.00
• Human Resource Development	108.00
o Designing standardised training manuals, training materials, translation and printing costs	2.00
o Training of Trainers	1.00
o Conduct of Training Programmes for Board members, staff, and members of PACS, DCCBs and SCBs	105.00
• TOTAL	670.00

Implementation Costs

4.46 The process of implementing the recommendations of the Task Force was considered at length. One view was that it could be left to the various stakeholders. Another view was to assign the responsibility of implementing the recommendations to various State Governments. The Task Force rejected both these options, on the ground that there would be a serious conflict of interest if the stakeholders were also to be the implementing agencies. To safeguard the resources being made available, it is necessary to identify an institution at the national level, that enjoys the confidence of stakeholders and has a track record for impartial functioning.

4.47 The National Bank for Agriculture and Rural Development (NABARD) is the natural choice and may be designated to carry out this task, both as pass through and implementing agency. Elsewhere in the report, the Task Force has made recommendations on the responsibilities, which will devolve on NABARD. Suffice it to say at this stage, that in the fitness of things, it would be appropriate to reimburse the institution of all the costs involved in discharging these responsibilities.

4.48 In addition to providing the manpower necessary for conceptualising, guiding, handholding, monitoring and reporting on the initiative, NABARD will also implement the entire technical assistance package in collaboration with suitable partners. The aggregate amount estimated under this head, therefore, has a certain overlap with technical assistance. However, bifurcating the costs on a notional basis, the Task Force estimates a support of Rs 360 crore to NABARD over a five year period.

Overall magnitude of the Financial Package

4.49 On the basis of the data as on 30 March, 2003 and in view of the observations above, the resource support recommended by the Task Force aggregates Rs. 10,839 crore. As mentioned earlier, these estimates are based on data available as on March 2003, and the knowledge that balance sheets, especially of PACS, may not be portraying a true and fair picture of their financial status. The exact amounts would, therefore, be known only after special audits prescribed by the Task Force are over. The aggregate amount may, consequently, be larger than that estimated here. Accordingly, the Task Force recommends a contingency amount of Rs 4000 crore.

Sharing of Liability and Financing

4.50 Having arrived at the aggregate amount involved in the Revival Package, the Task Force turned to the question of sharing the liability. The Task Force is clear in its perception that theoretically recapitalisation is the responsibility of the owners; who in this case are the members of the CCS and the State Governments concerned. The Task Force noted that both the committees prior to it, have recommended the involvement of the Government of India on various grounds, including the fact that a similar exercise had been funded by it for the public sector commercial banks (PSBs) and regional rural banks (RRBs).

4.51 The Task Force would like to clarify that the recapitalisation of PSBs was done by the Union government, in its capacity as the owner. In the case of the RRBs, other stakeholders had also participated in proportion to their equity. Therefore, on the face of it, there does not seem to be any legal ground for the participation of the Union government in the recapitalisation process for cooperatives. However, in view of the fact that historically the Union Government has played a significant role in the development of cooperatives and indeed mentored them over time, a moral responsibility also seems to be involved. Moreover, there is indeed, an urgent need to rapidly expand agricultural credit to boost productivity and production in the agricultural sector. Taking these factors into account, as well as the fact that only a strong CCS can play a major role towards this end, the

Union Government needs to involve itself in the revival of the CCS in national interest.

4.52 During discussions on the sharing pattern, it was submitted that the simplest methodology for doing so, would be to devise a formula based on fixed percentages as suggested by earlier Committees. Issues involved were debated and it was felt that formula based sharing patterns tended to become points of contention between the various stakeholders, jeopardizing the broader objective of reviving the CCS. The Task Force was of the view that the sharing pattern, above all, should be based on a formulation which is empirically verifiable, transparent, and relatively simple to implement. The consensus of the Task Force is that the sharing pattern should be based on the origin of loss, rather than an arbitrary proportion for sharing the liability.

4.53 The two arguments made above lead to the conclusion that in the fitness of things, losses arising out of loans for agricultural purposes at all the levels may be fully borne by the Union Government and an appropriate mechanism on a similar logic may be used for losses from other loans and activities. While this method can fairly easily be implemented at the level of DCCBs and SCBs, it has been mentioned earlier, that determining accumulated losses arising from different types of loans issued by PACS may be very difficult and not really commensurate with the effort involved, as the principal credit business of PACS is agricultural loans.

Sharing Pattern – PACS

4.54 Taking into account the fact that there are almost a lakh PACS at the ground level, undertaking both credit and non-credit businesses, the simplest empirically verifiable sharing formula between the Union government and stakeholders, therefore, would be one, in which the former picks up the bill for losses arising out of all the credit business of PACS. The State Governments will have to bear the losses on account of non-credit businesses (PDS, sale of fertilisers, procurement, etc.), on the ground that such non-credit business is largely driven by them.

Sharing Pattern – DCCBs and SCBs

4.55 As already mentioned, once the losses of retail outlets have been met, the losses at the level of DCCBs from their lendings to PACS at the ground level, would automatically stand reduced. It has already been mentioned that State Governments would be required to pay upfront for their existing liabilities in respect of invoked guarantees and other dues. These liabilities are not reflected in the traditional balance sheets of the cooperative banks, as they are merely shown as receivables from the government. The DCCBs also have losses pertaining to loans given by them to other cooperative societies (like marketing, handloom, consumer societies etc.), with or without government guarantees, and their direct loans to individuals for agricultural and non-agricultural businesses and loans for consumer goods etc.

4.56 As mentioned earlier, the accumulated losses arising from the loans of the DCCB's for agriculture, including their direct loans to individuals and units other than PACS, would be borne by the Union government. The DCCBs, however, would have to bear losses arising out of any other direct loans made by them, on the ground that all decisions pertaining to such loans have been taken by them.

4.57 The accumulated losses from the loans of DCCBs to other cooperatives, should be shared by the State Governments as a part of these losses in proportion of (uninvoked) guaranteed loans to total outstanding loans of the same category with the Union government taking on the balance. A similar method is proposed for the accumulated losses of the SCBs.

4.58 The recommendations of The Task Force on the sharing of the accumulated losses is not based on artificially fixed proportions, but on the origin of such losses within a flexible matrix.

4.59 Based on the above recommendations, the aggregate liability of the Revival Package of Rs 14,839 crore would be shared as follows:

(Rs crore)

Elements	Responsibility of		
	GoI	State Govt.	CCS units
Accumulated losses due to			
• All credit business of PACS + agricultural credit business of DCCBs/SCBs	3,922		
• Non-agricultural credit business of DCCBs/SCBs	841	93	401
• Non-credit business of PACS (PDS etc.)		1,425	
• Unpaid invoked guarantees		1,164	
• Other receivables from state governments		720	
Return of government equity			1,243
Minimum CRAR of 7%			**
Human resource development + special audits	154		
Computerisation including software	516		
Implementation costs	360		
Total	5,793	3,402	1,644
Share of liability	53 %	31 %	16 %
Means of Financing	Grant by GoI	Soft loan by GoI to state govt. if needed	Soft loan by GoI to CCS units if needed
Total	10,839		
Add Contingencies	4,000		
Grand Total	14,839		

** This amount can be estimated only after recapitalised balance sheets for the CCS units are available

4.60 The percentage shares indicated represent the aggregated approximations at the macro level. It is clarified that these percentage shares at the state level would depend on the pattern of loan portfolio and accumulated losses in each CCS unit, the extent of guarantees issued by state government and the amounts of other receivables from the state government.

Chapter-5

Institutional, Legal and Regulatory Reforms

The need for Reforms

5.01 Financial assistance alone cannot revive cooperatives and empower them to realise their full potential to reach adequate credit to villages and the rural population there (especially the asset-poor, the asset-less and the disadvantaged). Cooperatives can only be revived if they become democratic, self-governing, self-reliant organisations for mutual thrift and credit. The scope for the government's involvement and interference in their internal functioning should be eliminated. Enactment of a liberal law by the State Governments to enable cooperatives to function as fully member driven institutions is an essential and critical requirement.

5.02 The responsibility for using resources of societies (made up of members' funds and borrowings) efficiently and prudently, must be left to democratically elected managements, accountable to members. At present, most institutions of the Cooperative Credit Structure restrict membership, with full voting rights to borrowers. Depositors are categorised as nominal members without voting rights, or are not given any membership status. This is not only inconsistent with cooperative principles and democratic functioning. It is also logically inconsistent, as those whose money is intermediated have no say in the management of their own money. It is, therefore, essential that all users – depositors and borrowers – be made full members with equal voting rights. This is also essential to strengthen the mechanisms of internal supervision and enforcement of credit discipline.

5.03 Ideally, mutual thrift and credit societies are supposed to operate on the principle that members should deposit their savings with the society to be lent to members in need of credit. Failure on the part of members to keep a close watch on the working of the society could erode resources they have put into the society. A strong incentive exists, therefore, for members to take an active interest in the working of their societies. If that happened, there would be no need for external regulation of internal management of cooperatives at the primary level.

5.04 However, the reality is that even if all villagers were to be members and were willing to deposit their savings with the cooperative, the magnitude of resources available may not, and in most cases will not, be adequate to meet all the credit needs of the community. This is all the more likely when those who have savings do not choose to be members and even when they do, may not want to put all their savings in the society. The cooperatives, therefore, must be free to borrow from other financial institutions, to supplement their own resources on the basis of their credit worthiness in the market.

5.05 The quantum of such borrowings and the terms is best determined by the quality of credit portfolio, financial performance and repayment record of the societies. Direct state funding or interference in the financial management of the system, rampant at present, is inimical to the health of the system, and must be eliminated. Restrictions on availability of and access to NABARD refinance for the thrift and credit societies (that have come up under the new parallel Acts), should, also be removed. While there is no justification for external regulation of the financial matters of such societies, it is desirable to lay down clear norms of capital adequacy and provisioning, to ensure their good health.

5.06 In principle, higher tier institutions (DCCBs and SCBs) can also choose to adopt this model and accept deposits only from members. Once they cease to have public deposits (defined as deposits by people who have no voting rights), they need no longer be subject to licensing and regulation under the Banking Regulation (BR) Act. As long as cooperative banks accept public deposits, however, they should be licensed and observe prudential norms applicable to banking institutions.

5.07 The State Governments need to make legislative amendments to enable the Reserve Bank of India (RBI) to exercise its regulatory powers under the BR Act directly, and not through the Registrar of Cooperative Societies (RCS), if the cooperative banks are to be regulated effectively. The State Governments should in the meantime, enter into an appropriate memorandum of understanding (MOU), agreeing to desist from interfering directly or indirectly in the management of the finances of these banks.

5.08 In short, a radical change is necessary in the way cooperative credit societies are constituted, managed and regulated at present. That such change is essential for reviving and revitalising the system has been strongly emphasised by the Capoor, Vikhe Patil and Vyas Committees. The need for change in the Cooperative Credit Structure (CCS) has also been widely appreciated by chairmen and chief executives of cooperative institutions, senior officials of state cooperative departments, and leading public figures, who have argued for reform, as well as representatives of trade unions of cooperative sector employees – all of which has been of little avail. State Governments have shown little inclination towards the needed reforms. There is, as a matter of fact, a strong opposition to reforms from entrenched vested interests, who stand to lose control over the very considerable resources channelled through the cooperatives.

5.09 Exhortation will not lead us far. Strong inducements are imperative. To break the impasse and induce essential and basic institutional reforms, it is essential to link eligibility for assistance and its release to the implementation of reforms in the Revival Package. The vision of the Task Force is that in the long run, the financial cooperatives should turn into the self reliant, member centric institutions, envisaged by the Self Reliant/Mutually Aided Cooperative Societies Act. It has to, however, take into account that the Cooperative Societies Act (CSA) has been in vogue for so long, that it has acquired a settled status.

5.10 The Task Force is of the view that rural financial cooperatives should be dealt with as a distinct and separate class and recommends incorporation of a separate chapter in the extant Cooperative Societies Act, for the cooperative banks. The Task Force believes that the introduction of a separate chapter will at last pave the way for focused attention on cooperative banks and their superintendence and governance. Having said this, the Task Force reiterates, indeed exhorts, State Governments to take steps to ensure that the suggested measures acquire the force of law, as expeditiously as possible.

5.11 In the interregnum and in view of the fact that the process of revitalising the CCS cannot be delayed, the Task Force recommends that the State Governments enter into MOUs with Regulatory and Supervisory agencies, for facilitating an appropriate governance and superintendent structure. Accordingly, the Task Force, has prescribed a working draft of a Model Bill (Annexure XX). The Task Force has also prescribed the provisions to be incorporated as a special chapter in the extant Cooperative Societies Act in Annexure XXI, and an indicative list of items, which should be included in the MOU between the State Government and RBI in Annexure XXII.

Conditionalities relating to Reform measures

5.12 The Revival Package for the CCS entails assistance for financial restructuring of the cooperative societies, provided of course their State Governments agree to participate in the package. It is also imperative that the State Governments make a formal commitment to make specified changes in their legal and administrative framework, relating to the functioning of cooperative credit institutions. Although, the willingness for participating in the Revival Package will be totally optional, once exercised, the concerned State Government and the CCS units will have to accept the entire package in toto. There cannot be a pick and choose method for various components of the package. The key elements of which are:

- State Governments should accept the Union Government's scheme in full, including the legal and regulatory changes, institutional reform, and their share of financial commitment
- State Governments not in agreement now may be given two years to consider, after which participation in the Union Government's scheme may stand closed
- PACS, DCCBs and SCBs to also have the option to exercise options available in the scheme

5.13 Release of funds will be linked to the progress in actually implementing the Revival Package, by taking the following steps on credit societies in their jurisdiction:

(i) State governments retire their contribution to the share capital of such credit societies.

(ii) Boards of management are reconstituted to ensure that they are elected, and that they do not include any State Government nominees.

(iii) DCCBs and SCBs accept the fit and proper criteria (to be prescribed by the RBI) of eligibility for Board membership and for co-option of a specified number of professionals as full members with voting rights, if members with such qualifications do not get elected.

(iv) Professionally qualified CEOs (qualifications to be prescribed by RBI and selected candidates, to be also approved by the RBI) are appointed at cooperative banks and properly trained personnel as secretaries to PACS.

(v) Abolish the cadre system of all employees at all levels

(vi) Ensure that CEOs and all staff of credit cooperatives (including cooperative banks) at all levels, are appointed by the cooperatives themselves and that they also decide on their service conditions. All employees are answerable only to the Boards of the credit cooperatives.

(vii) In all cases limit the powers of the Board to overall policy and reviewing loan decisions, leaving the CEO and his staff free to screen, appraise and decide on individual loan applications and to take such action as is necessary, to ensure prompt and full recoveries.

5.14 The Task Force also recommends that, in the interests of prudent management,

- All thrift and credit cooperatives including primaries and their federal structures be required to increase owned capital, so as to ensure a minimum CRAR of seven per cent to begin with, and to raise it to 12 per cent within another five years;
- Encourage the Cooperative Credit Structure to set up its own system of technical support, supervision, and even deposit protection;
- Societies to have full freedom to choose institutions from which they can borrow and in which they can deposit their funds, and also to decide on affiliating with, or abstaining from a federated structure of their choice;
- Entrust audit to chartered accountants at all levels of CCS

The State Governments and CCS institutions should further agree to:

- The principle that assistance will be available only to viable or potentially viable societies (as prescribed by the Task Force) and that those which are defunct or non-viable should be liquidated;
- The determination of the quantum of assistance to which individual institutions are eligible, will be based on a special audit of their accounts for the year 2003-2004, under the supervision of the implementing authority to be created for the purpose;
- Participate in programmes to train personnel, upgrade internal accounting, reporting and control systems at different levels to better equip them for credit management.

5.15 Extensive direct or indirect interference by State Governments have been a major cause for the deterioration of the cooperative credit system. Interference in the credit cooperative system occurs through directives on deposit and lending rates, lending priorities, investment decisions, taking up non-credit activities etc. or granting interest subsidies, postponing waiver of recovery of interest on loans and repayment of loans given by cooperatives. It is, therefore, important that governments, both at the Centre and in the States, desist from these practices and adopt a firm policy to prevent these practices and introduce appropriate changes in law .

5.16 States should formally agree, through an explicit MOU with the Reserve Bank of India, to be formalised by appropriate amendments to their cooperative laws, to leave all financial regulatory functions to the designated authority under the BR Act, and to abide by their decisions in these matters.

5.17 For its part, the central regulatory authority should take steps to

(i) Let cooperative societies in all tiers choose not to take any public (or non-voting member) deposits and thereby, be free from the purview of the BR Act; and at the same time

(ii) Tighten the financial regulation, including prudential norms and procedures applicable to cooperatives accepting public deposits, by bringing the norms (relating to minimum capital capital adequacy, NPA, CRR-SLR) closer to, or identical with, those applicable to commercial banks; and

(iii) Consider linking premium rates for deposit insurance cover under DICGC, the scale and terms of refinance through NABARD (or commercial banks/RRBs) as well as access to the national payments system to the financial health of the cooperatives as well as degree of compliance with regulatory norms.

5.18 Each participating State must take credible steps to fulfill these conditions. The Task Force recognises that all these issues cannot be tackled immediately or at one stroke. The Reforms will, therefore, have to be phased. The release of assistance should, however, be linked to progress in fulfilling the agreed sequence of reforms, within a clear time frame. In specifying these, it is important to recognise that the situation (in terms of legal and administrative framework, and the nature and severity of the problems) vary widely from state to state. It is also important to recognise the fact that, there can be no "one-size-fits-all" model. The States, therefore, should have reasonable freedom to decide the pattern they want to follow to realise the basic aims of the Restructuring Programme within a reasonable period.

Main features of the Proposed Legal and Regulatory Reforms

5.19 Fulfilling the conditions of the Restructuring Programme will require drastic changes in the State laws, that govern Cooperative Credit Societies and a clear undertaking by the State Governments to accept the authority of the Reserve Bank of India (RBI) in all matters concerning financial regulation of cooperative banks.

5.20 Some conditions, like retiring the State's contribution to equity and withdrawing nominees from the boards can be done by Executive Order, pending formal amendment of the existing law and through voluntary restraint. So can training and tightening of audit. The changes meant to redefine and limit the role of RCS to registration, conducting regular elections and annual general meetings, ensuring independent audit and liquidation proceedings, as well as those precluding government interference in matters relating to financial management, will call for drastic amendments to the existing law. Implementing the prudential regulation of DCCBs and SCBs can be achieved to some extent, in the meantime, through appropriate MOUs between the State Government and the RBI.

5.21 Since a new enactment is a time consuming process, the Task Force has identified and recommended specific parameters on actions that can be initiated, by participating State Governments, by means of Executive Orders issued under the extant CSA. Such an Executive Order would cover the following:

- Ensuring full voting membership rights on all users of financial services including deposits
- Removing State intervention in administration and financial matters
- Withdrawing restrictive orders, if any, on financial matters
- Permitting cooperatives wider access to financial institutions
- Permitting cooperatives registered under parallel Acts (in States applicable) to be members of cooperatives, registered under the CSA and vice versa
- Limiting the exercise of powers of the State Governments to supersede Boards

- Ensuring timely elections and audits
- Facilitating effective exercise of the regulatory authority of the RBI, in case of cooperative banks
- Exiting state equity and participation on Boards of financial cooperatives
- Prescribing prudential norms, including CRAR for PACS on lines suggested

5.22 The Task Force has analysed the reasons for the opposition to amendments earlier proposed to the B R Act. It has concluded that the opposition was because of apprehension that the proposed amendments sought to bring in improvements in the governance of the banking cooperatives, by disregarding the cooperative character of the banking cooperatives, which is distinct from banking companies.

5.23 The Task Force has, therefore, recommended that while professionalism is necessary in the governance and management of financial cooperatives, it needs to be done with due regard for the characteristics of the membership of the financial cooperatives. The Task Force recommends that steps be taken by the RBI to have the B R Act suitably amended to ensure the following:

- Bringing cooperative banks on par with commercial banks in terms of prudent financial regulation
- Prescribing fit and proper criteria consistent with the membership of cooperatives for election to the Boards. To ensure professionalism in the Boards, however, three or four members with prescribed qualifications should be co-opted with voting rights in case members with prescribed qualifications do not get elected
- Prescribing minimum qualifications for CEOs of the cooperative banks and approving their names

- Prescribing capital adequacy norms for cooperative banks (to be implemented in a phased manner)
- Prohibiting any cooperative other than a cooperative bank from accepting public deposits from any person other than its members.
- Prohibiting any cooperative other than a cooperative bank, from using the words "bank", "banker", "banking", or any other derivative of the word "bank", in its registered name.

5.24 As cooperative banks are at present, being concurrently supervised by the NABARD, the Task Force also recommends that NABARD be empowered suitably to improve the effectiveness of its supervision.

Changes in cooperative laws

5.25 While some of the necessary changes can be implemented through Executive Order, under the existing State laws, formal legislation to repeal or modify existing laws will be necessary. The Model Coop law, suggested by the Brahm Perkash Committee, and endorsed by all recent committees which have gone into this issue, is consistent with the kind of regime, which we think is necessary for healthy functioning of cooperatives as democratic, member-driven and self reliant organisations.

5.26 Even though several States have enacted new laws on this pattern, they have not made much of an impact. In all these States, most societies continue to operate under the regime of the extant CSAs, with hardly any effort to enable or encourage existing societies to come under the new law. Part of the reason is the absence of provisions in the pre-existing law to permit and enable existing societies to come under the new law. A stronger reason is, perhaps, the non–availability of refinance to such cooperatives, registered under the new Acts.

5.27 The draft law suggested by the Task Force, is based on the Constitutional right of citizens to form associations. It provides space for citizens (especially disadvantaged communities who need to work in cohesion for their own advancement), to work together on the economic front. As in the case of the Companies Act, potential members are required to register their agreement with one another, their Memorandum and Articles of Association, and thereby to acquire body corporate status. The power of the RCS should be limited to ensuring that the memorandum and bylaws are consistent with the basic principles of governance laid down in the law. There should be no requirement that the details and specifics of these documents be subject to government approval.

5.28 During interactions, it was pointed out to the Task Force that the Acts governing credit cooperatives need not be detailed legislation. In the light of the complexities in the existing legislations, however, the Task Force is of the opinion that the legislation for financial cooperatives needs to be simple, but comprehensive. It should also preclude any subordinate legislation, while ensuring that decisions on financial matters are vested only with the cooperatives and their regulation fully vested with the RBI, in case they are cooperative banks.

5.29 The proposed Model Law indicates (a) the essential basic principles of constitution and internal governance which societies must observe; (b) specifies the governments' role in ensuring that the spirit of the law is observed, that elections and annual meetings are held regularly and audited accounts of prescribed standard are presented at these meetings; and (c) should restrict the State Government from interfering directly or indirectly in the internal management of societies, especially in matters affecting the financial health of the societies. It should explicitly recognise the RBI as the sole authority to use its powers under the BR Act to ensure observance of prudential norms by Cooperative Credit Societies, that accepting public (i.e. non-member) deposits.

5.30 It is an enabling, not a regulatory law. Considering the almost non-existent rate of conviction under most cooperative laws, other regulatory laws will be fully applicable in cases of criminal action. At any rate, an enabling piece of legislation ought not to transgress on what specialised regulatory laws are better equipped to deal with.

(i) The law is based on internationally accepted principles of cooperation and ensures that cooperatives function in a democratic manner.

(ii) The draft is member-centric. It ensures that members are in control of their organisation, and that they can hold accountable those they elect. It places responsibilities on members, and it gives them the right to manage their own affairs, based on the responsibilities that they choose to fix for themselves.

(iii) It places responsibilities on elected Directors in such a manner, that elected positions are positions of responsibility and not of power and authority. Accountability of the Directors to the General Body is in-built, and any lapse is treated seriously. Directors' behaviour is expected to be reported to the General Body for its scrutiny.

(iv) The Model Law makes it clear that cooperative societies are not creatures of the State – nor are they statutory creatures. Membership in these societies is voluntary, not involuntary as in a Gram Panchayat. The question of establishing Election Commissions for holding their elections, therefore, was considered inappropriate by this Committee. As in the case of companies, societies, trade unions, and unincorporated associations, elections will be an internal affair of each organisation.

(v) For similar reasons, an Audit Board is not envisaged under this law. The General Body of each cooperative society will appoint an auditor, and the responsibilities of the auditor have been made explicit. Presentation of copies of the audited statements of accounts for the previous year, along with audit objections, to each member has been made compulsory.

(vi) Recruitment of staff will be the responsibility of each cooperative society. Common cadres, and recruitment boards are not envisaged. Just as other forms of citizen organisations (companies, societies, trade unions, unincorporated associations) take responsibility for staff recruitment and personnel management, so, too, cooperative societies should have the right to make all staff related decisions. Labour laws are expected to apply.

(vii) Profit (surplus) and loss (deficit) are to be shared among members. Cooperatives are expected to be professionally managed in the truest sense of the phrase, as Directors have to face their General Body each year and recommend surplus/deficit sharing to members.

(viii) The law is for cooperative societies based on mutual aid among members. While cooperative societies are permitted to accept member savings and deposits, and borrowings from others, they are not permitted to accept savings from non-members. In case a cooperative wishes to accept public (non-voting member) deposits, however, it will have to be licensed by the RBI and follow such other regulatory norms as prescribed by the RBI.

(ix) The manner of recovery of dues from members is required to be in-built in the articles of association.

5.31 The special chapter to be included in the existing State Cooperative Societies Acts as given in Annexure XXI contains overriding provisions for ensuring proper financial regulation of cooperative banks. This chapter provides that notwithstanding any provisions to the contrary in the existing Cooperative Societies Acts -

(i) the provisions of the Banking Regulation Act (as applicable to cooperative societies) shall apply to a cooperative bank

(ii) no cooperative society, other than a cooperative bank, shall use, as part of its name, the words “bank” , “banker” or “banking”.

(iii) no cooperative society, other than a cooperative bank shall accept deposits from any person other than its members, or accept deposits withdrawable by cheque.

(iv) no cooperative bank shall change its name, open a new place of business or change its existing place of business outside the city, town or village where it is located without the prior approval of the Reserve Bank.

(v) every cooperative bank shall have at least three of its directors who have special knowledge or experience in the field of accountancy, law, banking, management, agriculture or rural economy.

(vi) the Chief Executive Officer, by whatever name called, of a cooperative bank shall have such qualifications as may be specified by the Reserve Bank .

(vii) every cooperative bank shall have its account audited by a qualified chartered accountant in each financial year, subject to such directions as the Reserve Bank may issue from time to time.

(viii) every cooperative bank shall abide by the directions, guidelines and prudential norms issued by the Reserve Bank from time to time, in acceptance of deposits, borrowing, lending, investment or any other financial matter.

(ix) no cooperative bank shall be given exemption from the provisions of this chapter by the State Government in exercise of its powers to exempt societies from the provision of the Act, without the prior approval of the Reserve Bank.

(x) the Reserve Bank may in public interest, or for preventing the affairs of the cooperative bank from being conducted in a manner detrimental to the interests of the depositors, or for securing the proper management of the bank, order the supersession of the board and appointment of an Administrator for such period or periods, not exceeding five years, as may from time to time be specified by the Reserve Bank. The Administrator so appointed shall, continue in office after the expiry of his term of office, until the day immediately preceding the date of the first meeting of the new committee.

(xi) no order for supersession of the board of a cooperative bank shall be made by the Registrar, without the prior approval in writing of the Reserve Bank.

(xii) an order of supersession of the board and appointment of an Administrator by the Reserve Bank shall not be liable to be called in question in any manner .

5.32 To facilitate the passage of the Model Law, the Task Force recommends the following course of action for the State Governments:

- First, the introduction of a parallel liberal law (similar to the working draft of the Act provided as an Annexure XX to the report)
- Second, States which do not pass the Model Law should include a Special Chapter for Agricultural and Rural Credit Societies in the extant Cooperative Societies Act incorporating the provisions of the Model Law. The said chapter shall also include the provisions for DCCBs and SCBs as set out in Annexure XXI.

- Third, the entering into an MOU with Regulatory and Supervisory Agencies as indicated in Annexure XXII .

Chapter - 6

Implementation Mechanism

6.01 To ensure success in restructuring the weak cooperative credit institutions, it has been recommended that the National Bank for Agriculture and Rural Development (NABARD) be designated the Nodal Implementing and Pass Through Agency (NIPTA). It will coordinate and monitor the progress of the programme. It will represent the Government of India (GoI). Vested with due authority from the government, it will be able to give the cooperative banks and primary agricultural cooperative societies (PACS) undergoing restructuring, guidance and instructions for proper implementation of the programme, including mid course corrections, wherever necessary.

6.02 The NABARD will guide the field level implementation teams in approving bank specific restructuring programmes, enter into agreements with individual banks covering the terms and conditions of the programmes, and follow up its progress with the bank and other concerned agencies. Among other things, it will also have the authority to operate the Funds earmarked by the GoI and ensure its proper use. To provide overall guidance and to monitor the progress of the process at the national and State levels, however, it is necessary to have independent committees of stakeholders with defined responsibilities.

National level

6.03 At the national level, there would be a National Guidance and Monitoring Committee. This committee will be chaired by Secretary (FS), GoI, and will include as its members Additional Secretary, Ministry of Agriculture, GoI, Chairman, NABARD, two eminent cooperators, one representative from the Reserve Bank of India (RBI) and one representative from the State under review. This Committee will act as the clearing house for policy references and monitor the implementation of the Scheme, on an All India basis. The National Committee will report to the Finance Minister on a quarterly basis. A dedicated team in NABARD's headquarters (HQs) will support this committee. The secretariat to the committee will also be provided by NABARD.

6.04 At the field level, i.e., at the level of the PACS, DCCBs and SCBs, the programme will be implemented by a two tier structure, one at the State level and the second at the district level.

State level

6.05 A State level Implementation and Monitoring Committee will be put in position with Secretary, Finance (State Government), as Chairman and Secretary, Cooperation (State Government), Executive Director, NABARD, State RCS, MD, SCB and a chartered accountant as members. The task to be attended by this Committee will include, signing an MOU between the State Government, SCB, DCCBs and the RBI, ensuring drawing up of balance sheet and its vetting, assessment of financial assistance required at SCB level, recommending release of assistance on fulfillment of the prescribed conditionalities, and overall supervision and control of the implementation of the scheme in the State. A dedicated team in the NABARD regional office will assist this Committee.

District level

6.06 A district level Planning and Implementation Committee, working under the overall guidance and supervision of the State Level Committee, would be set up in each district. Each district committee would be chaired by NABARD and comprise representatives of the State Government, the concerned DCCB, and a Chartered Accountant. Their work will relate to ensuring conduct of special audit as on March 2004 for all PACS and the DCCB, drawing up and vetting of balance sheets of these PACS and DCCB, getting MOUs signed, institution-wise assessment of financial assistance required, recommending release of such assistance on fulfillment of the prescribed conditionalities and overseeing implementation. The committee will also ensure establishing and stabilising of accounting systems, MIS, and computerisation, and required HRD over a period of two years. A two or three member team of dedicated officers, drawn from NABARD or contracted especially for the purpose, and working full time on implementation of the Revival Package (RP) will support the Committee.

Role of NABARD

6.07 The NABARD will prepare model MOUs, model balance sheet proformae for PACS and DCCBs, get accounting systems designed, get common software and hardware plan prepared, and design training modules and manuals. All implementation costs, including costs of dedicated teams at the district, State and national levels, will be fully met through GoI grant support.

Implementation Time frame

6.08 Once the GoI announces the scheme, it is expected that some States may agree to participate immediately, while some others may do so later. Similarly, CCS units may also take some time to true their balance sheets as on March 2004. The implementation of the scheme is, therefore, likely to be staggered in different States. It is expected that the process, once started in any State, will take between two to three years to complete all the stages of legal and institutional reforms, capitalisation, and institutional and human resources capacity building.

6.09 It is recommended that the scheme be kept open for a period of two years for the State Governments to decide on their participation, and may be closed, for the purpose of accepting participation in the scheme, on 31 March 2008. Similarly, the scheme may be closed for the purpose of any disbursement of assistance after three years from the date of signing of the initial MOU by the State Government with the GoI.

6.10 The Task Force would like to clarify that given the uncertainties involved in State Governments opting to participate in the scheme, the pace at which the reform process progresses, the completion of formalities involved in the documentation processes, it is not possible for the Task Force to predict with certainty the amounts required under the Revitalisation Package. It is also possible that the amount, even when released, may not be utilised in the year concerned. The Task Force, therefore, suggests that GoI may evolve a suitable mechanism for ensuring the continued flow of funds and carry over unspent balances in the Revitalisation Package.

6.11 Restructuring Process - PACS

Phase I

- All PACS to sign MoU with DLIC as per standard format
- Technical Assistance Support to be provided to ensure PACS furnish to the DLIC audited balance sheets as on March 2004 with an estimate of accumulated losses and provisions as prescribed by the Task Force

- DLIC to categorise PACS as per norms prescribed and recommend winding up of unviable PACS to the SLIC for action by RCS
- Action plan to provide for assets and liabilities of such PACS to be taken over by another PACS, coverage of the area if merger is not possible

Phase II

Unviable PACS

- Agreement by all stakeholders on action plan on transferring assets and liabilities and how the area is to be served

Viable and potentially viable PACS

- Retire GoS capital; if required avail a loan under the scheme
- Move to the parallel Act or to amend bye-laws to provide for a uniform membership for all users of the cooperative characterised by voting rights
- Hold elections as per the applicable Act after voting rights issue is addressed
- Amend bye-laws to enable PACS to borrow from any financial institution
- Amend bye-laws to facilitate PACS to affiliate with or abstain from a federal structure of its choice
- Recruit / appoint critical staff as per MOU after cadre system is abolished
- Avail TA assistance to develop institutional action plans to achieve sustainable financial viability in three years

Phase III

- Release of first tranche of financial assistance to PACS which have completed all Phase I and II actions
- Implement agreed institutional actions, including installation of computerisation Plan to be supported through Technical Assistance grant
- Devise and institute staffing and salary structure in tune with margins
- Train staff and elected Board members as programmed under the scheme
- Implement internal control procedures and regular audits
- Second and third tranche financial assistance released on achievement of agreed performance benchmarks

6.12 Restructuring Process - DCCBs

Phase I

- DCCB to indicate willingness to participate in the Revitalisation Package
- Sign required MOU with DLIC and SLIC
- DCCB to furnish to the DLIC audited balance sheet as on March, 2004 with an estimate of accumulated losses and provisions as prescribed by the Task Force after factoring in the impact of the recapitalisation of the PACS affiliated to it
- DLIC to categorise DCCB as per norms prescribed and recommend winding up of unviable DCCB to the SLIC for action by RCS and RBI
- Action plan to provide for assets and liabilities of such DCCB to be taken over by another DCCB, coverage of the area if merger is not possible
- Other DCCBs to sign MOUs with all PACS, SCB, and SLIC

Phase II

- Hold elections as per the applicable Act after voting rights issue addressed
- Retire GoS capital, avail a soft loan under the scheme if needed
- Enable cooperatives under parallel Acts to be members of DCCB and to get equal treatment
- To have the option to convert itself into a cooperative under the parallel or MSCS Acts and stop taking retail public deposits as well as stop giving loans to non members
- To have the option of merging itself with one or more CCBs or dividing itself into suitable federal units at the secondary level
- To have an option of affiliating or disaffiliating itself with an apex tier of its choice
- To have an option of borrowing directly from any financial institution
- Strengthen supervision over PACS
- Develop detailed institutional action plans focusing on sustainable financial viability over a five year period

Phase III

- Release of first tranche of financial assistance to DCCB which has completed all phase I and II actions
- Implement agreed institutional actions by including
  - Co-opting professionals on the Board, if necessary, as per requirements suggested by RBI
  - Appointing CEO as per norms prescribed by RBI
- Install automation for accounting and MIS to be supported through TA grant.
- Devise and institute staffing and salary structure in tune with margins available.
- Train staff and elected Board members on a continuous basis on lines of the recommended package.

- Implement internal controls and professional audits
- Implement an internal supervisory system for PACS
- Second and third tranche financial assistance released on achievement of agreed performance benchmarks

6.13 Restructuring Process - SCBs

Phase I

- Sign MoU with SLIC and DCCBs
- SCB to furnish to the SLIC audited balance sheet as on March, 2004 with an estimate of accumulated losses and provisions as prescribed by the Task Force
- Enable second tier coops under parallel Act to be its member and get equal treatment
- To have the option to convert itself into a cooperative under the parallel or MSCS Acts and stop taking retail public deposits as well as stop giving loans to non members.
- To have the option to merge itself with any similar federal structure or to divide itself into suitable federal units
- Develop business plans focusing, while avoiding competition with lower tiers, for sustainable financial viability over a five year period
- Recruit key personnel and develop phased plan for replacing State employees with SCB employees

Phase II

- Hold elections if needed
- Retire GoS capital, avail a loan under the scheme if needed
- Install professional governance and management by
    - co-opting professionals on the Board, if necessary, as per requirements suggested by RBI
    - appointing CEO as per norms prescribed by RBI

- Implement agreed institutional actions including
- Devise and institute staffing and salary structure in tune with margins available
- Implement internal controls and professional audits

Phase III

- First and second tranches of financial assistance released on achievements of agreed performance benchmarks
- Implement agreed institutional actions including
- Install automation for accounting and MIS to be supported through TA grant
- Train staff and elected Board members on a continuous basis on lines of the recommended package.
- Implement an internal supervisory system for DCCBs
- Nurture DCCBs and PACS as a professional federated structure. Provide efficient services on human resources, processes, product development, and standardisation
- Refinance PACS directly where DCCBs are weak and not being provided refinance
- Third tranche financial assistance released upon achievement of agreed performance benchmarks

CHAPTER- 7

Transitional Problems and Long term Outlook

7.01 There are several issues relating to the transition for ensuring that it is as smooth as possible and with minimum disruption in the flow of credit to rural areas. The exact number of societies at different levels that will be eligible for assistance and the quantum of assistance they are entitled to can be determined only after their latest accounts are properly audited. The number of dormant and non-viable societies is likely to be large. The mechanisms and processes by which they are to be liquidated is one issue. There are several alternatives: merger with nearby healthy societies; take over of ground level lending in the service area of liquidated PACs by neighbouring PACS, DCCBs, CBs and RRBs; or as a last resort take over by the DCCBs as their extension counters functioning under the supervision of their nearest branch.

7.02 All these should be viewed as basically a transition phase to ensure that credit flow to the areas served by dormant and non-viable societies is not impeded. The expectation is that in due course new societies under the model law will come into being and take over the function of providing credit at the local level. The aim should be to create conditions in which the new model cooperatives can emerge in their place, without any restrictions on the number of villages they can serve or on their membership.

7.03 In the case of DCCBs and SCBs, although at present almost two out of five are non-compliant with Section 11, a number of them may become compliant once the accumulated losses of the PACS are taken care of. Even so, they will need close attention and supervision to ensure that they continue to perform to prescribe standard. There may still remain several, that need to be liquidated or merged with the nearest restructured DCCB, which will serve the needs of their service areas.

7.04 To facilitate the above, the Task Force recommends (1) appropriate amendment of existing laws to enable PACs to borrow from CCBs outside their district as well as from CBs and RRBs; and (b) set up a special task force at the State level to actively promote these linkages, so that credit flow to ground level institutions is maintained. Under such an arrangement, PACs will have a wider choice of sources from which they can borrow. The resulting competition between the latter will improve the range and quality of services PACs receive. At the same time when lending institutions decide, as they should, the volume and terms of finance on commercial considerations, PACs will be under pressure to observe stricter credit discipline.

7.05 Over the longer run, while we favour a federal cooperative credit structure, there are questions about the justification for some features of the existing system and in particular about the need for three tiers, the functional and economic viability of the huge (and often overlapping) network of branches of DCCBs and SCBs. There is clearly considerable scope for rationalisation in this respect, both for reducing costs and to improve service quality. We are, however, in favour of this issue being left to be decided, after due study, according to the circumstances and experience of each State.

7.06 The Task Force would like to underscore the fact that institutional credit to rural areas, tend to serve mostly those who have some land and/or other productive assets to offer as collateral. Lending is skewed markedly in favour of the larger and better off segments of rural society. There is reason to believe that available statistics tend to overstate the coverage (in terms of proportion of numbers and credit needs) of small and marginal farmers met by cooperatives. This bias is much more marked with CBs and RRBs.

7.07 Those who have little or no productive assets of their own - consisting of those who own very small amount of land, tenant farmers and the landless - who constitute the large majority of the rural population, hardly benefit from cooperative credit. Remedying this deficiency will be a major challenge for the future. Assessing the credit-worthiness of borrowers in this class, supervising their use of credit and ensuring prompt repayments individually is extraordinarily difficult and costly; and risks are inherently high. We have to find an effective strategy to deal with this problem. Group lending seems to offer a promising solution.

7.08 Self help groups have spread rapidly, grown to impressive dimensions in some parts of the country and demonstrated their efficacy as a medium for encouraging thrift, meeting a wider spectrum of credit needs (including consumption credit) of the group members, ensuring prudent use of credit and prompt repayments among the disadvantaged. These groups have been mostly oriented to women, but there is no reason why the principle cannot be extended to effectively cater to their credit needs.

7.09 Experience of attempts to promote institutional lending to joint liability groups for small and marginal farmers and small non-agricultural enterprises in rural areas are reported to be both limited and mixed. A closer study of this experience to understand the nature of the problems involved and devising ways to overcome them could help to devise strategies to make them more acceptable and capable of widespread application.

710 A deeper problem and one which is viewed with much concern is that of "imbalances", the currently widespread practice, whereby

upper tier institutions appropriate repayments first against interest dues and only the balance against principal, is believed to be the main reason for this phenomenon. However this is basically a reflection of low rates of recovery, the failure to make adequate provisions against risk of delay and default, and (in the lower tiers) the use of recoveries to fund part of operational expenses.

7.11 The Task Force would like to emphasise the importance of addressing these root causes.

7.12 The current practice is to make provisions on the basis of actual repayment record. There are doubts whether prescribed provisioning norms even on this basis is done systematically and adequately. No such norms have been prescribed for PACS. Moreover, the actual repayments are heavily influenced by ad hoc policy decisions, usually at the behest of the government, to suspend, delay or even waive recovery. These decisions are based on particular events of crop shortfall or failure without considering whether the extent of shortfall if within the normal risk band.

7.13 It is important to recognise that risks involved in agricultural lending arise essentially because of the propensity of agricultural production to vary, depending on rainfall and other extraneous factors. While these factors are not controllable, the risks associated with them are amenable to objective measurement. Ideally, lending institutions should make adequate appropriations against this measurable normal risk irrespective of the actual recoveries from year to year and earmark them in a fully funded reserve.

7.14 It is also to be recognised that agriculture is subject to a relatively higher degree of risk than other sectors, and that this risk is variable across space, between crops and between rain-fed and irrigated farms. It would be impractical to assess risks by crops, a category of farm and at village, or perhaps, even taluk levels. But it is possible to estimate objectively the pooled risk on these accounts at the district level, based on statistical analyses of long time series of output behaviour.

7.15 The extent of provisioning should be based on the estimated normal risk rather than the extant practice. Prudential management requires that the risk cost be passed on the borrower. This would mean that the lending rate to the borrower should cover costs of funds, transaction costs as well as the risk cost. Notwithstanding deregulation of interest rates, the Task Force notes that the State Governments continue to prescribe artificial rates which do not factor in the normal risk costs. This should cease.

7.16 The above would cover only normal risks. But there could be, and often are, shortfalls in output well beyond the normal range of variation. In such event, the defaults due to more-than-normal variation should be shared by the CCs and the State, the share of the State increasing as the deviation from the normal increases.

7.17 It is obvious that the magnitude of normal risk will vary across regions. It is, therefore, necessary to think of ways in which they can be pooled over larger areas. It is also possible to think of arrangements for pooling risks across regions. This can be in several ways. By way of illustration, one possibility is for the lower tier institutions to contribute to a common risk fund at higher tiers or through insurance/derivative products through a specialised agency.

7.18 In conclusion, the Task Force would like to emphasise that its recommendations for legal and institutional reforms are means to bring about a big improvement in credit discipline and financial management of the CCS. They seek to enable and induce rejuvenation of the Cooperative Credit Structure constituted by voluntary, democratic and member-centric, self-governing mutual thrift and credit institutions. We would only reiterate the necessity to shift the government's role radically from one of intrusive patronage to one of training, up-gradation of personnel, accounting and audit systems essential for good management, and limiting its role to registration and liquidation, ensuring regular conduct of elections, annual meetings and compliance with essential prudential norms.

7.19 This process cannot and should not be hastened by artificial feeding or under hothouse conditions but allowed to develop organically. The process may be slower than one would wish, but it is likely to result in a stronger, healthier structure.

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