

## **K C Chakrabarty: Strengthening co-operative credit institutions in India**

Keynote address by Dr K C Chakrabarty, Deputy Governor of the Reserve Bank of India, at the Review Meet on Implementation of Revival Package for Short Term Rural Cooperative Credit Structure, organised by the National Federation of State Co-operative Banks (NAFSCOB), New Delhi, 29 April 2010.

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### **Introduction**

1. At the outset, I congratulate the National Federation of State Co-operative Banks for organizing this review meet on implementation of revival package for short term co-operative credit institutions under the Vaidyanathan Task Force and I deem it a privilege to be present amidst this august gathering. I am sure, in these two days, you must have taken stock of the progress made in this regard and deliberated on the benefits accruing to the co-operative institutions from the package. I am also sure that the few States which are yet to enter the MoU with the Government of India and NABARD and avail the benefits of the package are convinced about the advantages of joining the mainstream in the interest of the co-operative institutions in their States.

2. The co-operative movement started in our country more than 100 years ago. The co-operatives are the oldest rural credit institutions in India with widest network covering every State and Union territory of the country and the first institutional arrangement for financial inclusion. These were virtually the only institution for rural credit in most of the areas until the nationalization of 14 banks in 1969. Although Regional Rural Banks came into existence in 1976, and commercial banks and RRBs have opened large number of branches in rural areas, their reach in the countryside, both in terms of the number of clients and accessibility to the small and marginal farmers and the poorer sections, is far less than that of co-operatives. Co-operatives continue to be the single most important institutions, which touch the life of villagers and rural farmers, most. While there are around 15400 branches of RRBs, there are about 95000 Primary Agricultural Credit Societies (PACS). Besides delivering credit to farmers, PACS also serve as outlets for distribution of agriculture inputs and food and other essential items to the villagers. Thus, PACS are in a far better position to further financial inclusion agenda than any other institution. There is, therefore, a compelling need to find ways for strengthening the cooperative movement and making it a well-managed and vibrant medium to serve the credit needs of rural India.

3. When first conceived, PACS were expected to be rural thrift and credit cooperatives, dependent primarily on member savings for meeting the agricultural credit needs of their members. However, subsequently, members stopped seeing these cooperatives as their own, and saw them as channels through which to access credit. They stopped saving with PACS. On their part, barring a few States like Kerala, PACS did not make effort to mobilize deposits but act as channel for disbursement of loans by availing refinance.

## **Prof. Vaidyanathan Task Force**

4. Despite serving the people for decades, co-operative credit institutions remained financially weak and operationally inefficient and ineffective. Their operations have been reviewed by various Committees in the past and recommendations were made for strengthening them. Various measures were taken from time to time for improving the operations of the co-operative institutions. However, the recommendations of the Prof. Vaidyanathan Task Force and rolling out of revival package by the Government of India on the basis of the recommendations are likely to be part of the most important chapter in the history of co-operative credit institutions in the country. Implementation of the package including the reforms measures in letter and spirit is the biggest challenge before all stakeholders and same has to be met effectively.

5. As you all are aware, the revival package seeks to:

- a. provide financial assistance to bring the system to an acceptable level of health;
- b. introduce legal and institutional reforms necessary for its democratic, self reliant and efficient functioning; and
- c. take measures to improve the quality of management.

6. It is a matter of satisfaction that 25 States have signed the MoU and progressed towards implementation of reform agenda. Although the time period prescribed by the Government for entering into MoU has lapsed, the remaining States may approach the Government in this regard, if they so like, and complete the process. The package was rolled out in January 2006 and it was envisaged that all regulatory actions including compliance to Section 11(1) of the Banking Regulation Act, 1949 (as applicable to Co-operatives) should be kept in abeyance for three years. Three years have already passed. However, only 14 States out of 25, which have signed MoU have been able to amend the Co-operative Societies Act. This has resulted in slow implementation of the package. As the financial assistance under the package has to be released only on the implementation of legal and institutional reforms, as against total estimated financial assistance of Rs.13,596 crore envisaged in the revival package, NABARD has, so far (by the end February 2010), released an amount of Rs.7,561.39 crore towards Government of India's share for recapitalisation of 41,295 PACS in twelve States, while the State Governments have released Rs.688.82 crore as their share. It is imperative for all the States that have executed the MoU for implementation of the package to carry out necessary amendments to the respective State Cooperative Societies Acts without any further delay. Any delay only delays capitalization and make the system further weaker.

7. Further, after amendment to the Co-operative Societies Act, all States should follow the spirit behind the amendment whole-heartedly so that the rural co-operative credit structure can operate in a healthy way. Legal and institutional reforms have been recommended under the package to bring about improvement in credit discipline and financial management of the cooperative credit structure. They are expected to enable and induce rejuvenation of the structure by promoting voluntary, democratic, member-centric, self-governing mutual thrift and credit institutions. The State Government's role in this scenario is expected to be not one of intrusive patronage, but one of promoting good and skilled management. This process may be slower than one would wish, but it would certainly result in a stronger and healthier structure to serve the needs of the rural people.

8. As you are aware, a large number of State Co-operative Banks and Central Co-operative Banks were functioning without a banking license for decades. The Committee on Financial Sector Assessment recommended that no unlicensed co-operative banks should be allowed to function beyond 2012. Reserve Bank took a decision to license those co-operative banks which have Capital to Risk Weighted Assets Ratio (CARA) of 4% and above. The revival package also helped in this regard. I am happy to share with you that within a period of last five months, we have issued license to 8 StCBs and 105 CCBs.

However, 9 State Co-operative Banks and 191 Central Co-operative Banks still remain unlicensed. With recapitalization of these institutions, many of them would be eligible for a license. All co-operative banks should endeavour to become eligible to get a license before March 2012.

### **Financial inclusion and co-operatives**

9. The Financial inclusion agenda being pursued vigorously by the Government of India and Reserve Bank of India cannot be accomplished without the involvement of rural co-operative institutions. Rather, they have the biggest role to play in this regard. Leveraging Information technology is a must for achieving financial inclusion and delivering efficient service to the people. Full computerization of all tiers of the co-operative institutions along with use of information and communication technology and issue of biometric cards to members has to be achieved to enable to serve the people.

### **Way forward**

10. You all are aware that all conceivable reform measures have been embedded in the proposed amendments to the Co-operative Societies Acts. However, I want to highlight certain issues, which need to be addressed with urgency.

- i. PACS are at the base of the entire short-term co-operative credit structure and their health affects the higher tiers. Efforts to be made to make them efficient and profitable.
- ii. We have to go back to good old days of making PACS thrift oriented institutions. PACS generally do not make an effort to mobilize deposits but act as a channel for disbursement of loans by availing refinance. They should make efforts to mobilize deposits from members in order to become self-sustaining. This would also promote savings habit among members. Increasing member stake through savings in PACS will result in better involvement of members and a much more alert membership and much better performance of PACS including higher loan recovery.
- iii. Co-operatives should function in the true spirit of co-operation and managed by duly elected members. Elections should be held regularly. In order to improve the quality of management, Directors and CEOs should be appointed on the basis of professional competence, integrity and merit. Administrative interference in day-to-day management should be stopped.
- iv. The reform package envisages freedom to all tiers of the structure to avail loan from any of the RBI regulated entities at competitive rates of interest. I am not sure, if any effort has been made in this regard. This must be tried to derive the cost benefit and profitability. Freedom should be given for pricing in a fair and transparent manner.
- v. Audits should be done timely and Audited Statements should be presented to the General body at the AGM.
- vi. Full computerization of all the institutions under the three tier structure should be achieved quickly. This will improve the efficiency, internal control system and Management Information System.
- vii. Training and capacity building of the personnel should be a focus area. NABARD and College of Agricultural Banking have to revamp the training system to prepare the co-operative personnel to meet new challenges and take forward financial inclusion agenda.

11. It is an accepted fact that the rural co-operative credit institutions with vast network of PACS have a great potential to increase flow of credit to agriculture especially to small and

marginal farmers. Total financial inclusion is not possible without the involvement of co-operatives. In the past, they failed to deliver due to various weaknesses. It is the opportune time now make them vibrant medium to serve credit needs of rural India and at the same time mobilize deposits from rural people to become self-reliant. These institutions should run like banks with professional management and governance. RBI has already prescribed fit and proper criteria for the Directors and Chief Executive Officers, which need to be followed. Over a period of time, all co-operative banks would be at par with commercial banks as far as regulatory norms are concerned and all prudential norms would be made applicable to them. A beginning has already been made in this regard by way of issuing licenses only those State and Central Co-operative Banks, which have Capital to Risk Weighted Assets Ratio (CRAR) of 4% and above. I hope, a new chapter will begin for the rural co-operatives and they will serve the people in the true spirit of co-operation.

Thank you.