Deepali Pant Joshi: Fortifying cooperatives – efforts to strengthen the short term cooperative credit structure

Speech by Dr Deepali Pant Joshi, Executive Director of the Reserve Bank of India, at the Orientation Programme on Investment in Government Securities, organized for State/Central Cooperative Banks in Maharashtra, Mumbai, 28 October 2014.

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Ladies and gentlemen!

1. I am very happy to be here today to share with you the present status of co-operatives in general and the role of rural cooperative banks as an institution, in particular. I feel honoured to be here with you all and inaugurate this Orientation Programme on Investment in Government Securities. Let me, at the outset, convey my thanks to the Regional Director for Maharashtra and Goa for inviting me to speak on this important occasion.

2. The three tier Short Term Cooperative Credit Structure (STCCS) consists of about 92,000 primary agricultural credit societies, (PACS), 371 District Central Cooperative Banks (DCCBs) with 13,000 branches and 32 State Cooperative Banks with more than 1000 branches. They have tremendous penetrative network and presence in small towns and villages across the length and breadth of this country. They primarily cater to the credit needs of small / marginal farmers and rural artisans. The contribution of cooperatives helps the rural people in a major way to keep away from informal sources of finance. If the inherent strength of cooperatives is realized, they are here to play a meaningful and sustained role in rural development. Against this background, let us discuss some of the emerging challenges and the role of cooperatives in today's circumstances.

Why are the cooperatives lagging?

3. There are few issues affecting the performance of cooperatives in the country calling into question their viability and sustainability. I will briefly cover the more important ones.

(i) Falling share of agriculture credit

The share of STCCS which once played a major role in the growth of agriculture by supporting small and marginal farmers is steadily declining. Until the early 1990s, cooperatives provided almost 62 per cent of the agricultural credit in the country, but over the years, their share has declined, going down to 16 per cent by 2010–11.

(ii) Weak financials

Mounting losses, growing NPAs and poor resource base are factors contributing to the decline in the performance of the cooperatives at the grass-root level. The institutions at the lower/middle level mostly depend on the higher agencies for financial support, i.e. PACS have to borrow from DCCBs and Central cooperative banks, in turn, have to borrow from the apex banks. There is thus, a chain of dependency at all levels of the cooperative credit structure for resources from the outside. If one institution underperforms, it affects the entire chain.

Core banking solution

4. Technology has become a major factor in determining the efficiency of modern banking. Cooperative banks are still far behind the commercial banks and Regional Rural Banks (RRBs) in adoption of technology. Cooperative banks must realize that banking in today's world cannot be independent of technology, not so much because of competition

from commercial banks alone, but because that is what the modern customer – rural or urban – demands. As the rural cooperatives are now exposed to competition from the commercial banks/RRBs who are foraying into rural areas aggressively under the Financial Inclusion Plans, only financially strong and technologically competent cooperatives would be able to sustain and face the competition. Cooperatives must, therefore, catch up with others in regard to adoption of technology to retain and increase their niche clientele.

5. It is heartening to see that out of 380 licensed banks, 373 banks had implemented CBS as on September 30, 2014. Remaining banks are expected to complete the implementation shortly.

Advantages of CBS

- Entire bank will operate as one unit (Single General Ledger).
- Customer can have, more convenient, easier and anywhere banking.
- It facilitates other services such as ATM, Internet Banking, Mobile Banking, Payment Gateways, Referral Business, etc.
- It provides economical way for MIS, instant information availability for decision support
- Facilitates quick implementation of policies
- Improves recovery process leading to reduction of recovery costs, NPA provisions.
- Innovative, refined processes (e.g. Inter-branch reconciliation) cause reduction in manpower requirement at Head Office, reduction in software maintenance costs at branch and Head Office
- Centralized printing and backup leads to in reduction in capital and revenue expenditure.
- Facilitates electronic transactions with other financial institutions
- Increased speed in working provides more business opportunities and ensures compliance with regulations.
- Limited professional manpower can be utilized more effectively. Reduction in manpower requirement at branch-level by 15–20% facilitates deployment of staff for business development such as marketing, recovery and personalized banking.

Applicability of CRAR

6. As you are aware, RBI had relaxed the criteria for licensing of rural cooperative banks stipulating CRAR of just 4%. However, StCBs and DCCBs cannot continue to operate in the banking environment with such a low capital base. These banks were introduced to the concept of Capital to Risk weighted Assets Ratio (CRAR) in December 2007 and advised to disclose the level of CRAR every year as 'Notes on Accounts' to their Balance Sheets. However, no minimum CRAR was prescribed under Basel-I framework for these banks. After infusion of recapitalisation assistance under the Government of India package (Vaidyanathan Committee-I) and licensing of a large number of banks, the matter was reviewed by RBI.

7. In the context of financial stability of the rural cooperative banking system and with a view to strengthening the capital structure of State and Central Cooperative Banks, it was decided to prescribe a minimum CRAR for StCBs/DCCBs and the banks were advised to achieve / maintain a minimum CRAR of 7% on an ongoing basis with effect from March 31, 2015 and 9% with effect from March 31, 2017.

8. With a view to broadening the avenues for mobilizing additional capital for meeting the higher CRAR, it was decided to permit these banks to issue Long Term (Subordinated) Deposits (LTD) and Innovative Perpetual Debt Instruments (IPDI). We are receiving good response to these measures from several banks.

Applicability of CRR and SLR to State and Central Coop. banks

9. Under the Banking Regulation Act, 1949, banks are required to maintain a prescribed percentage of their demand and time liabilities as cash reserves (CRR) and liquid assets (SLR). These assets act as buffers to meet the emergency liquidity requirements of the banks. Non-scheduled cooperative banks were prescribed CRR of 3% and SLR of 25% in 1966. These prescriptions remained unchanged for several decades. The Banking Laws (Amendment) Act, 2012 amended section 18 and 24 of B.R. Act, 1949 (As Applicable to Cooperative Societies) and granted powers to RBI to prescribe CRR without any floor or ceiling and prescribe SLR without any floor but not exceeding 40%. Scheduled State cooperative banks were required to maintain CRR at rates as announced by RBI periodically under section 42 of the RBI Act, 1934. Pursuant to the amendments to the B.R. Act, 1949 (AACS), CRR and SLR for all cooperative banks were brought on par with scheduled commercial banks from the fortnight beginning July 12, 2014.

10. RBI is now vested with powers to prescribe the form and manner of liquid assets to be maintained for SLR purpose. The practice followed by the cooperative banks for maintenance of SLR assets was reviewed and in the interest of banking policy and with a view to safeguarding the funds of the depositors, it was decided that the cooperative banks should maintain SLR assets in government securities as is the case with commercial banks. Accordingly, StCBs/DCCBs were advised vide our circular of June 5, 2014 to shift their SLR funds to government securities by March 31, 2015. Salient features of the changes announced in our circular of June 5, 2014 are as follows:

(a) CRR for StCBs/DCCBs increased from 3% to 4% of their total demand and time liabilities;

(b) SLR brought down from 25% to 22.5% of their total demand and time liabilities;

(c) CRR/SLR for StCBs/DCCBs will move in tandem with those for commercial banks in future.

(d) The manner of maintaining SLR assets by StCBs/DCCBs has been brought on par with commercial banks;

(e) StCBs/DCCBs were given time till March 31, 2015 to start maintaining SLR assets as per the revised procedure;

(f) StCBs/DCCBs were be permitted to reckon their term deposits maintained with public sector banks and IDBI Bank Ltd. as SLR assets till March 31, 2015, in addition to the SLR assets maintained as fixed/term deposits with the apex banks, in order to ensure smooth switch-over to the revised procedure.

11. As the revised instructions on SLR will require expertise in treasury management, RBI decided to calibrate the process. Accordingly, a road-map for phased implementation of the new dispensation has been provided vide our circular of July 21, 2014 advising the banks to meet investments in Government Securities as per the following timeline:

Date		Investment in Government securities as % of NDTL
By March 31, 2015	–	5 %
By March 31, 2016	–	10 %
By March 31, 2017	–	22.5% or the SLR as may be prescribed by RBI on that date

In the interim period, term deposits maintained by StCBs and DCCBs with public sector banks would be allowed for reckoning for SLR purpose, up to March 31, 2017.

12. At present, all DCCBs, barring a few, are maintaining their SLR assets in the form of time/fixed deposits with the respective State cooperative banks. Therefore, DCCBs lack experience and expertise in making investments in government securities. With a view to familiarizing DCCBs with the basics of investment in government securities, viz. opening of SGL/CSGL accounts, non-competitive bidding, selection of securities/intermediaries, price discovery, valuation, etc., it was decided to conduct Orientation Programmes at our Regional Offices for the benefit of all the DCCBs. Going forward, the knowledge gained from investment operations in government securities will help these banks set up a dynamic Treasury Department in each Head Office and facilitate effective funds management and asset-liability management and improve their profitability.

I express my sincere thanks to NABARD and IDMD for coming forward to extend faculty support for conducting the Orientation Programmes. I hope this training would help the participants in understanding the basics of investment in government securities and carry out their investment operations with more confidence.

My best wishes for the success of the training programme