A newsletter of Centre for Professional Excellence in Cooperatives (C-PEC), BIRD, Lucknow Volume III (1), April-June 2018

From the Director's Desk

I am extremely happy to take charge as Director, BIRD, Lucknow on 21st May 2018. BIRD is an institution of excellence catering to the training, consultancy and research needs of Financial Institutions and also other organisations working in the areas of Rural Credit and Rural Development.

I am pleased to share e-newsletter of C-PEC for the first quarter of FY 2018-19 highlighting the activities and plans of C-PEC during the first quarter (April-June) of 2018-19. I am also pleased that C-PEC has announced 04 Certification cources manually CPCB-I, CPCB-II, CTFC and CPS for the financial year 2018-19.

The first section of this newsletter is highlighting new initiatives of C-PEC for expanding its outreach.

The second section of the newsletter is a gist of study conducted on **Mobilisation of Share Capital by DCCBs in the State of Kerala,** which was presented during the National Seminar on Best Practices in STCCS held on 5th and 6th January 2018 at BIRD, Lucknow.

I welcome suggestions from all the stakeholder to make C-PEC, truly a Centre for Professional Excellence in Cooperatives.

Thanking you!

Smt. T. S. Raji Gain

What's new in C-PEC?

- *Accreditation Board has revised the* ***validation format*** *in the month of June 2018. It was also decided that accreditation from now onwards would be done as per the new format. This year C-PEC is planning for accreditation 4 new CTIs and re-accreditation of 6 CTIs whose validity period of accretion is over this year.*

- *All the 04 certification courses under* ***Examination*** *viz. 4th batch of Certified Professional in Cooperative Banking (CPCB) level-I, 3rd batch of, 3rd batch of CPCB-Level-II, 3rd batch of Certified PACS Secretary (CPS) and 10th batch of Certified Trainer for Financial Cooperative (CTFC) have been announced for the Financial Year 2018-19. The enrollment process for CTFC, CPCB-I and CPCB-II is closed now. For CPS, the last for enrollment is 16th July 2018. The Study Material for CPCB level-I and CTFC has been dispatched to the candidates. The examination for the said courses will be held in January/February 2019.*

- *C-PEC has approved/****standardized*** *the following 07 programme and 02 study materials:*
  - *02 Training Programmes on operational and functional activities (Induction Programme) for ACSTI Bhopal, Madhya Pradesh (M.P.) for the employees of MPStCB after merger of MPStCB and M.P. Land Development Bank and for the*

employees of DCCBs after merger of DCCBs of M.P. and DCARDBs of M.P.

- *01 Training Programme on Banker Customer Relationship for ACSTI Bhopal, Madhya Pradesh.*
- *01 Training Programme on Project Appraisal and Loan Documentation- Farm & Non-Farm Sector along with a Study Material for TSCAB- CTI.*
- *03 Training Programmes for ACSTI, Lucknow on Management of Senior Executive Functions of DCCB, Inspection and Control functions of PACS & Branches of DCCB, Customer Service and Human Relations.*
- *01 Study material standardised on Technology Driven Payment System for ACSTI-Bengaluru.*

- *03* ***Regional Stakeholder Seminar*** *on "Professionalization in Cooperatives Institutions" have been planned at Agra, Kanpur and lakhimpur-Kheri. 02 seminars have been successfully conducted in Agra on 22-06-2018 (DCCBs of Agra, Etah, Etawah, Firozabad, Mathura and Mainpuri participated in the seminar) and in Kanpur on 29-06-2018 (DCCBs of Kanpur, Lucknow, Hardoi, Unnao and Farukhhabad participated in the seminar). Third seminar would be held at Lakhimpur – Kheri for Sitapur, Lakhimpur-Kheri, Philibhit, Bahraich and Bareilly .The objective of these seminars is to disseminate information on C-PEC's initiatives to participants DCCBs and also how C-PEC can support in providing solutions pertaining to these issues.*

- ***03 training programmes were conducted in Andaman and Nicobar viz.*** *Training of Auditors of Cooperation Department, A & N during 7 to 9 May 2018, Programme on capacity Building of Staff of Andaman StCB on 10 May 2018, Sensitization workshop on NPA management of Board of Directors (BoDs) of Andaman StCB on 11 May, 2018.*

- *Training Programme on* ***Corporate Governance*** *for the* ***newly elected BoDs of DCCBs of state of Uttar Pradesh*** *was organised during 25th -27th June, 2018 at BIRD, Lucknow. Hon'ble minister of cooperation, Government of U. P. in the programme on all 03 days.*

- *04 books have been published by BIRD in April 2018 on* ***Cash Reserve Ratio (CRR) & Statutory Liquidity Ratio (SLR) for Scheduled and Non Scheduled StCB, DCCBs and RRBs****. BIRD intends the material and knowledge publication be reach to ultimate users viz. StCB, DCCBs, Officers working at Head Office and Regional Offices of NABARD, Officers posted in DoS/IDD etc. as priced publication at discounted rates. Special discounts are being offered to C-PEC members.*

- *On the request of NCCT, BIRD conducted a* ***Workshop on preparation of case studies and Management cases for the faculties of NCCT from 16-18, May 2018*** *in which 17 Faculty Members from Training Intuitions associated with NCCT participated .The programme provided inputs on how to make good case studies, case study method of teaching and how to administer case studies.*

What future beholds?

- *C-PEC is planning to do* ***Research Studies*** *in critical operational areas in Financial and Non –Financial Cooperatives collaboration with CTIs across the Country:*

  Critical areas of Financial Cooperatives:
  - *Making PACS ready for computerization*
  - *Issues in Investment Portfolio in Cooperatives*
  - *Impact of Interest Subvention Scheme on crop loan financing*

Critical areas Non-Financial Cooperatives

  - *Fisheries Cooperatives*
  - *Handloom Cooperatives*
  - *Dairy Cooperatives*

- ***C****-PEC has been assigned to organize workshops for* ***Comprehensive turnaround*** *weak DCCBs, of C & D category in two years (2018-19 and 2019-20). Weak Banks will be identified in consultation with StCB and RCS. We are planning to organize 02 workshops in the month of July and August 2018.*

- *C-PEC is planning to announce 03 training of* ***Trainers (ToT) Programme*** *on Corporate Governance in PACS, Investment and Treasury Management and Business Development in PACS in month of September, October and November 2018.*

- *C-PEC is also planning to organize* ***03 Stakeholder Seminar*** *in three States viz. Assam, Madhya Pradesh and Rajasthan.*

- *The* ***First Contact Class of Certified Trainer for Financial Cooperatives (CTFC)*** *will be held from 27th August to 1st September 2018 at BIRD, Lucknow on Modules Training Skills and Design and Evaluation Training.*

Section II
Mobilisation of Share Capital by DCCBs in Kerala, a case study by BIRD

Financial institutions play a significant role in the economic development of a country, broadly, by promoting mobilisation of resources and allocating these resources in the form of loans and advances. To ensure financial stability of the rural cooperative banking system and to strengthen the capital structure of StCBs/DCCBs, the RBI decided to prescribe a minimum CRAR for StCBs/DCCBs and also opened up new avenues/instruments to raise additional share capital. Relaxation in the extant Capital Adequacy norms by permitting nominal shares, admission fees, etc., as part of Tier I capital, were also extended to these banks. StCBs/DCCBs were advised to maintain a mandated minimum CRAR of 7% on an ongoing basis with effect from March 31, 2015 and 9% on an ongoing basis with effect from March 31, 2017. As on 31/03/2016, 81 DCCBs [out of 370] and 5 StCBs [out of 33] were having CRAR less than 9%.

The Short-term Co-operative Credit Structure in the State of Kerala is very unique. As per data available with NAFSCOB, as on 31st March 2015 [latest available], there were 1,642 PACS in Kerala. The major objective of this Study was to assess the share capital availability of the DCCBs in Kerala State and to understand the approaches adopted by them to enhance the share capital contributions.

The study was restricted to the Short Term Co-operative Credit Institutions in the State of Kerala. Due to wide geographical spread [14 DCCBs and 1,600+ PACS], the sample for field visits and interactions was restricted to 3 DCCBs (Thrissur, Kozhikode and Malappuram) and a few PACS / Non-credit societies. The study was based on both primary and secondary data. Primary data has been collected directly from the banks concerned as also during the field visits and interactions with the officials of select DCCBs and PACS.

Innovative approaches adopted by DCCBs in Kerala to improve their CRAR are also discussed in the paper. In Kerala, many of the DCCBs had adopted varying approaches to improve their CRAR. Some banks focused on improving their capital base [and thereby increase the size of the numerator figure], which may be considered as the "Numerator Management" approach. A few other banks tried to reduce the capital charge on their assets [and consequently reduce the size of their denominator figure], which can be termed as the "Denominator Management" approach.

The major observations/ suggestions for augmenting CRAR has been grouped under two major heads in the study, viz.

I-Efforts to increase Capital Funds - Numerator Management Approach

*1. **Share Capital mobilisation through Share Linkage: With the mandatory CRAR pegged at 9%, there is a need to:***

- *Identifying such of those Societies which have a shortfall in share linkage in relation to their outstanding borrowings and ensuring that the balance share capital is mobilised.*
- *Re-visiting the maximum monetary caps [viz., Rs. 1 lakh] in share linkage for certain types of loans imposed in some states, so that DCCBs can achieve mandated CRAR levels on a sustained basis.*
- *Increasing further, the share linkage ratio wherever they are set very low [say 1% or 2%], for augmenting Share Capital.*
- *Consider stipulating a slab-wise share linkage based on quantum of loans given to individuals also.*

*2. **Higher Capital mobilisation through "Share Valuation"***

- *Co-operative banks have always issued shares to their members at face value, irrespective of when these shares are issued. To provide a fair reflection of the worth of the shares of a DCCB, there is a need to adopt a transparent Valuation Method, whenever a DCCB issues shares. Considering the unique nature of the Cooperative structure, the most appropriate method would be the "Net Worth Valuation" method. The Net Worth per share [{Share Capital + Reserves} / No. of Shares] will thus be a far more realistic estimate of how much the share of DCCBs/ StCBs is worth, at the time of every instance of share issue. The excess of the share value so arrived at over the face value could be considered as the Share Premium, reckoning for Tier I Capital.*

*3. **Widening avenues for raising "Innovative Perpetual Debt Instruments" (IPDI)***

- *Even though RBI had permitted banks to issue IPDIs to raise additional capital, no banks [DCBs/StCBs] in the country have raised IPDIs till date.*
- *Due to federal nature of the co-operative structure, the lowest/intermediate tiers statutorily maintain certain types of deposits with the immediately higher tier. Deposits such as Reserve Fund [RF], Employees Provident fund [EPF], Staff Security deposit [SSD], etc., are kept perpetually with the banks. While RF is perpetually kept as deposit till their liquidation, EPF and SSD are partially utilised as and when the respective staff retires.*
- *In view of the above, such deposits, particularly the Reserve Fund [RF] of Societies, could be considered to be kept as IPDI with the immediate higher tiers, with the permission of RCS.*

4. Creating CRAR Reserve

- *With a view to facilitate faster and sustainable compliance to the mandated norm of CRAR on "Ongoing basis", StCBs/ DCCBs may be advised to create a new Reserve called "CRAR Reserve" under the provisions of their byelaws, as appropriation from profit, to enable them to increase capital funds and, incidentally, declare less dividend. Issuing of "Co-operative Capital Bonds".*
- *To facilitate the StCBs/DCCBs in raising capital to meet mandated CRAR requirements, these banks may be permitted to float Co-operative Capital Bonds, in the open market, which could be guaranteed either by the respective State Governments or by NABARD.*

5. Creation of Special reserve under Section 36(1) (viii) of IT Act.

- *The Co-operative Banks can take advantage of the extant RBI guidelines which permit reckoning of outstanding amount in Special Reserve created under Section 36(1) (viii) of the Income Tax Act, 1961 as Tier I Capital, and under Section 36 (1) (vii) of the Income Tax Act, 1961.*

6. Investing Fluid Reserves in Long Term (Subordinated) Deposits [LTDs]

- *All PACS are required, as per the relevant State laws, to maintain a certain percentage of their Deposits [usually 20%] as Fluid Reserves with their affiliated DCCBs. PACS may be permitted to invest their Fluid Reserves in LTDs issued by DCCBs. This could be done at State Govt/ RCS level itself, as PACS are presently regulated by them.*

7. Broadening the base for reckoning of Investment Fluctuation Reserve [IFR]

- *As per extant RBI guidelines, Commercial Banks, based on certain norms, are permitted to treat the entire balance in the IFR as Tier I capital. Cooperative Banks and RRBs may also be extended the benefit of these guidelines.*
- *Additionally, a preferential treatment could be extended to these institutions by allowing the entire balance in IFR to be reckoned as Tier I, independent of the above stipulations, particularly as IFR is a below-the-line reserve, created out of profits.*

8. Share Capital mobilisation through "C" Class shares

- *RBI permits reckoning of C Class share capital contribution towards Tier I capital, subject to certain restrictions. To mobilise more capital under this head, there is a need to consider lifting the restrictions imposed with regard to voting rights and dividend imposed on such shares by the cooperative banks.*
- *Alternately, a certain percentage of the interest paid by C class shareholders on their loans, may be paid as interest incentive, subject to timely repayment of principal amounts.*

9. Share Capital mobilisation through State Govt. contributions

- *In States which are signatory to the VC recommendations, the State Governments' share in the capital of a StCB/DCCB cannot exceed 25% of total capital. Wherever there is head-room on this count, the State Governments should consider contributing upto 25%.*

10. Attracting Share Capital through high dividend pay-out

- *DCCBs can consider enhancing their rate of dividend payouts. They can also consider paying dividend partially in the form of cash and partially in the form of "Shares" or other eligible instruments which can be reckoned towards Tier I/Tier II capital, thereby increasing Share Capital.*

11. Augmenting Capital Funds through Sale of Assets

- *Sale of capital Assets, if any available with the bank, could increase Capital Reserve and help increase in Capital Funds.*

II-Efforts to reduce Capital Charge on Assets -Denominator Management

12. KCC Loans

- *KCC loans form the major portfolio of most DCCBs in the country. However, as these loans are governed by an administered interest rate mechanism [7%, with subvention/incentive benefits], there is a case to bring down the capital charge [risk weight] from 100% to 50% or less.*

13. Subvention Interest Receivable on KCC Loans from GoI / State Govt

- *Interest subvention/incentive on KCC loans receivables from Govt. of India / State Govt, attracting risk weight of 100%, may be treated in the same way as "Interest due on Government Securities", which attract Zero risk weight.*

14. Netting Off "Loans Outstanding": Lien-marked deposits / Credit balances

- *A specific guidance circular could be issued, to enable Societies to lien mark their deposits to the borrowings availed by them, to help the DCCBs [to avail of benefit of RBI guidelines] to reduce their Risk weights, as otherwise also, the banks have the "Right of Set off" against their overdue loans, unencumbered deposits held by such societies with them.*
- *Similarly, DCCBs keep own funds with StCB and such funds also need to be treated similarly, as indicated in para above. This will reduce RWAs*

15. Risk weights for Loans which have borrowings from higher financing agencies

- *StCBs / DCCBs may be given the benefit of calculating the "Asset value of their Loans" by reducing the borrowings availed by them from higher tiers. This will reduce RWAs and consequently lesser CRAR requirements.*

16. Risk weights for Jewel loan CC limits to DCCBs/ PACS

- *RBI vide their circular dated October 29, 2014 had allowed StCB/ DCCBs to provide 50% risk weight on all their Jewel Loans issued to borrowers for upto Rs.1.00 lakh.*
- *RBI may be requested to consider allowing the StCBs/ DCCBs the benefit of lower risk weight of 50% for CC limits sanctioned to their lower tiers for the same purpose of issuing Jewel Loans upto Rs.1.00 lakh.*

17. Reduction in RWA due to relaxation in Exposure Norms

- *The extant exposure norms prescribed by RBI for Housing Loan is 5% of total loan outstandings. There is a case to re-look at this limit, at least for loans given in rural/semi urban areas. Housing Loans, besides being fully secured, also attracts a lower capital charge of 50%.*

(This article is a part of a Research Paper presented in the National Seminar on Best Practices in Short Term Credit Cooperative Structure at BIRD, Lucknow. The research paper was written by Shri Manikumar S and Shri KPR Udupa, Dy. General Managers/Faculty Members, Bankers Institute of Rural Development, Lucknow.)

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