

Co-operative banks: Is dual regulation the problem?

PARLEY

Coming under both RBI and State Registrars, these banks pose specific supervisory challenges

In late September, the Reserve Bank of India (RBI) imposed restrictions on withdrawals from the Punjab and Maharashtra Cooperative (PMC) Bank, one of the largest urban cooperative lenders. Over the past week, bank customers have been in a state of panic and the central bank has sought to assuage concerns about the banking sector's health. Usha Thorat and S. Mahendra Dev discuss the measures needed to restore confidence among customers in a conversation moderated by Vikas Dhoot. Edited excerpts:

How are cooperatives overseen and what could have allowed the PMC Bank to get away with such large bad loans for years?

Usha Thorat: One needs to go back to history. Cooperative banks came directly under the RBI's radar in 1966 but faced the problem of dual regulation. The Registrar of Cooperative Societies (RCS) is in control of management elections and many administrative issues as well as auditing. And the RBI brought them under the Banking Regulation Act as applicable to cooperative societies, which included all the regulatory aspects, namely, the granting of the licence, maintaining cash reserve, statutory liquidity and capital adequacy ratios, and inspection of these banks. So, in a sense, urban cooperative banks have been under the radar of the RBI, but because of dual regulation, one always had a feeling that one did not have as much control over these banks in terms of supersession of boards or removal of directors, as the RBI has over private sector banks.

The Madhavpura Mercantile Cooperative Bank issue turned out to be huge because it had a significant percentage of its assets as loans to Ketan Parekh, not unlike the case we are seeing now. And because it was an active bank in liquidity and money markets, Madhavpura used to provide liquidity to many other banks, so a huge number of cooperative banks had deposits with Madhavpura. So, a closure of that bank would have meant the closure of several other banks too. There was a lot of talk between the RBI, and the Central and Gujarat governments and a package was put together for

Madhavpura. It was challenged, but finally it did go through with a staggered repayment of deposits and infusion of funds from the Deposit Insurance and Credit Guarantee Corporation (DICGC). I don't recall whether the legal challenge was finally disposed of.

Why I am talking of Madhavpura is that maybe some parts of its resolution can be examined today. After this episode, RBI decided to squarely deal with the problems of cooperative banks. It issued a vision document in 2004-05 and stopped all licences of new branches and new bank entities. There was a proliferation of licences issued between 1991 and 1998. Under the vision document, a Memorandum of Agreement was entered into by the RBI with each of the States, where the State accepted an audit by professional auditors, and constituted a Task Force for urban cooperative banks. The TAFUCB was co-chaired by the RCS and the RBI Regional Director and was required to provide a bank-by-bank solution to those banks that were not maintaining minimum capital ratios. Not giving any new licences or new branches also pushed existing cooperative banks to come forth to take over the weak ones. This worked very well and a number of cooperative banks were delicensed, merged or liquidated. By 2017-18, as stated in the RBI Financial Stability Report, there were only four urban cooperative banks with capital adequacy ratios below the regulated threshold.

Given this background, what do you think led to the PMC Bank crisis? Was it because of some regulatory aspects falling between the two stools of the RBI and RCS?

UT: I don't think so. As I said, there was a forum for the RBI and the RCS to work together. Moreover, since 2004, a number of banks have been brought under all-inclusive directions where there have been significant weaknesses. So, the RBI has been taking action when it is clear that a bank is not able to carry on its operations in a manner that protects the interests of the depositors. But in PMC's case, it is a fraud, total hiding [of the problem] – a huge ex-



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posure to a single entity in the real estate sector was camouflaged under a whole lot of dummy accounts. Reporting to RBI and probably the auditors too was false. So, primarily, the CEO and the Board are responsible. It is not due to dual regulation. How could this happen? Does this throw up fresh challenges on the kind of information the RBI should be looking for? Should it be doing a forensic audit? Is it possible to do this for more than 1,400 urban cooperative banks? How do you realise there is a problem brewing? I think there is a serious need to understand how the exposure was camouflaged, how did this not get reflected in other returns filed, etc.

Professor Dev, given the role played by cooperative banks over the years to extend credit in rural India, what do you make of suggestions that they may have outlived their utility?

S. Mahendra Dev: Cooperative institutions play a significant role in credit delivery to unbanked segments and financial inclusion. But their role has declined with the expansion of scheduled commercial banks and adoption of technology. Even urban cooperative lenders are facing competition from payment banks, small finance banks, and NBFCs (non-banking finance companies). We have about 1,500 urban cooperatives, but there are nearly 96,000 rural banks, including primary agriculture credit societies. Long-term credit extended by them is declining, but there is still a role in agriculture for rural cooperative societies. On the urban front, however, there is a need for change partly because of some of these scams that Ms. Thorat mentioned.

In the case of PMC Bank, as per

The challenge in banking supervision and regulation lies in knowing the quality and engagement of the Board, the key personnel and their conflicts of interest and connections.

RBI, there are three problems – major financial irregularities, failure of internal control and systems, and underreporting of exposures. It is well known that PMC Bank has extended 73% of its assets to HDIL, which has created a panicky situation for depositors. The RBI has had to clarify that Indian banking is safe. The problem is, of course, dual control by the RBI and the RCS, with the State government also playing a role and politics sometimes entering the space. The management, Board and auditors are responsible. It's a governance and transparency issue that also affects public sector banks, private banks, and NBFCs.

So, what should be done? I am in favour of merging and converting some of the cooperative banks to small finance banks. The RBI has announced a scheme for voluntary transition of urban cooperative banks into small finance banks, in line with the recommendations of a high-powered committee chaired by former Deputy Governor of the RBI, R. Gandhi. This would enable them to have most of the products available with commercial banks, and help get a pan-India presence. But there are many conditions on share capital, loan sizes and loans to priority sector. So, you can't convert all of them but there can be a gradual move towards that.

Ms. Thorat, do you think small finance banks would be better governed?

UT: Let's again look at the things the RBI has tried to do in the last four-five years. First, there was a committee under H. Malesgam which recommended a board of management of fit and proper persons, other than the board of directors. Directors are elected by members and very often the borrowers get to nominate their own persons, while depositors are not really represented as these banks accept deposits from non-members. So, the idea was to have a board of management in actual control of operations as opposed to elected directors. I think this must be done immediately as an incentive for those who want to continue to grow. We should perhaps tell these banks, you must put this in place, otherwise there will be no more branch licences and we can impose restrictions on your loan book. There must be a push for a fit and proper management, otherwise the elected director can get away with fraud. Then all we can do is cope with the aftermath of his or her actions.

Having said that, you will find that a majority of the cooperative banks have been doing a good job – meeting the needs of small businesses and even rural credit – very much what we call inclusive finance. Just about 50 or 60 of these 1,500 banks are large. So the RBI's supervisory resources have to be really focused on these larger banks mostly operating across the country like commercial banks.

Second, the RBI has given the choice to urban cooperative banks to convert to small finance banks. That option is there for those players with more than ₹50 crore capital and 15% capital adequacy. This is an incentive as they will then be able to grow their capital by issuing shares at a premium. Today, the biggest hurdle for an urban cooperative bank is to raise capital. For them, the RBI might like to incentivise conversion into small finance banks. It can say that for further growth the larger urban cooperative banks should either appoint a board of management that meets the RBI's norms for fit and proper or become small finance banks. The challenge in banking supervision and regulation lies in knowing the quality and engagement of the Board, the key personnel and their conflicts of interest and connections.

Third, RBI has also said that for urban cooperative banks there

could be an umbrella organisation promoted by the banks themselves to raise capital as a joint stock company from the markets.

This incident poses a challenge for supervision. It comes back to how exposures can be hidden, which can be done in any bank or NBFC, not just a cooperative. The supervision system should be able to catch much more underreporting or false reporting and ensure accountability of the Board and the auditors. Criminal action has been initiated against the managing director, but what about all the directors? Is it possible that the directors or the Board were not aware of the exposure? In any case they are liable.

I think we should also look at the extent of deposits of other cooperative banks in such large urban cooperative banks. Perhaps it is time to review whether an urban cooperative bank should accept deposits of other urban cooperative banks. Because this means depositors of smaller banks may also suffer.

The frequency and intensity of supervision has to be clearly based on the size of the bank and the assessment made of the governance standards in the banks. All banks – small finance banks, cooperative banks and leveraged institutions like NBFCs – are open to the risk of poor governance. There is no option but to look at the fit and proper character of the directors.

Demonetisation helped push a lot of cash savings into the formal financial sector. But given this fresh crisis of confidence among bank customers, what can the government and the regulator do to restore their faith?

SMD: Many depositors opt for cooperative banks because they give a higher interest rate. Even the RBI's staff cooperative has deposits parked with PMC. The confidence comes from governance and regulation. RBI has been urging cooperative lenders to act professionally. We need confidence-building for all banks, not just for cooperatives, but even NBFCs. A recent study showed that small cooperatives are doing better in terms of non-performing assets and other aspects, while large urban cooperatives are not doing well. So, we have to look at how to supervise large cooperatives better.



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All creatures great and small

It has become clear that the welfare of humans and other animals is closely interlinked

AMBIKA HIRANANDANI

World Animal Rights Day falls on October 4. It coincides with the feast of St. Francis of Assisi, the patron Saint of animals and the environment. As far back as the 12th century, he recognised the importance of extending compassion towards animals. Today, with the help of scientific inquiry we have learnt that it is in our best interest to extend compassion to other living beings, be it by protecting their habitats or refraining from intensively farming them. It has become increasingly clear that the welfare of humans and other animals is closely interlinked.

Pressing problems

Consider, for example, the bee, whose population is declining at an alarming rate today because of climate change, pesticides and habitat loss. Bees pollinate 70 of nearly 100 crop species that feed 90% of the world. Insects help in the decomposition of organic materials, including bodies of the dead, and enrich the soil. Dung beetles evolved 65 million years ago and, as their name suggests, eat dung, recycle nutrients and improve the quality of the soil. Half of the world's species are insects, so if insects go extinct, the consequence would be complete degradation of our soil consequently leading to the disappearance of all remaining life.

A second dimension of concern for animal rights centres on farming. We keep billions of animals intensively confined in factory farms for meat, eggs and dairy. There are serious repercussions of these practices, both for animals and humans. Hens kept in battery cage farms see the sun twice in their lives – once on the way to the farm and the second on the way to the slaughterhouse. These factory farms are responsible for the formation of dead pools around them, have a massive odour, and attract pests. The people who live in the vicinity of these farms suffer from several health issues including breathing problems. Hence, while it may make financial sense to cram animals into factory farms, the consequences can be considerable. To mitigate this, the system of intensive farm animal pro-

duction needs to become more humane and less exploitative, for both animals and people. Governments can take a first step by prohibiting the cruelty of battery cages.

The deleterious impact of animal agriculture, including pastoral activities, is captured in research that shows that the Amazon fires were caused by ranchers who wanted to use the land for cattle grazing and farming. Indian forests are also being degraded by the excessive pressure of animal agriculture. The United Nations has found that "livestock production is one of the major causes of the world's most pressing environmental problems, including global warming, land degradation, air and water pollution, and loss of biodiversity".

Animal welfare

Our legal system treats animals as if they are non-sentient commodities that can be owned and disposed by people. Animal husbandry has an entire department dedicated to it. Thousands of crores are invested in slaughterhouses. Conversely, animal welfare is relegated to one board, which must look after the welfare of billions of animals in the country. Policy reform in this space is such a low priority that while parking fines are at least ₹10,000 in Mumbai, the penalty for beating an animal in India is ₹50. It is time for our government to depute a Ministry and budget for the welfare of animals.

Animal lives can be saved by commercialising the innovations of plant-based and cultured or clean meat. Clean meat is grown in a lab from a small sample of cells taken from an animal. Both plant-based meat and clean meat are free of the negative externalities that animal meat production is responsible for, such as climate change, and are healthier as they are also free of antibiotics.

We hold the future of billions of animals in our hands. We have an opportunity to translate our philosophy of *Vasudhaiva Kutumbakam* into action. We must act in our collective best interest.

Ambika Hiranandani is a lawyer, animal rights activist and environmentalist



NOTEBOOK

The multilingual advantage

It helps to speak in many tongues to get authentic reporting done

SRINIVASAN RAMANI

For journalists who seek to report from various parts of the country, apart from the usual tools and skillsets that are required, having a grasp over many languages helps. When covering subjects that relate to livelihood, the ability to converse, listen and understand in the lingo that people are most comfortable with often brings about authentic reporting.

A case in point was when I visited Wayanad three years ago to file a special report on the fledgling Maoist presence in the tri-junction of Kerala, Tamil Nadu and Karnataka. This area has a substantial tribal population. The assignment was challenging despite the fact that I grew up in many parts of India and can speak four languages – Tamil (my mother tongue), English, Hindi and Bengali – relatively well.

The tribals whom I went to interview were understandably tight-lipped and chary of talking to journalists. Besides, those who were inclined to speak after some prodding and confidence-building could not speak English, and knowing Hindi was of no avail as Kerala is among the States with the fewest Hindi speakers. Thankfully, my colleague, Visual Editor Dinesh Krishnan, who joined me in the assignment as the photojournalist, is from Kerala and helped me get over this barrier.

Apart from the tribals, one of the poorer set of residents in the area who had been frequented by the Maoists for ideological propaganda and possible recruitment were Tamil refugees from Sri Lanka. They had been living there for decades. In this case, it was my ability to converse in my mother tongue with the residents that made it

possible for them to open up about their travails. This helped us garner insights into why the Maoists had sought to tap into the grievances in the area. A young mother mentioned how the Maoists during their infrequent visits, unlike government representatives, also spoke in Tamil with them. A sly listener nearby asked in Tamil if we were Maoists and I had to show them our identity cards to confirm that we were indeed journalists.

As we wrapped up our interviews with the tribals, politicians and police officials, we found that we needed good photographs to capture the cat-and-mouse game playing out between law enforcement agencies and the Maoists in the area. We decided to take pictures of the officers of the special anti-Naxalite division of the Tamil Nadu police in action as they went about their daily

combing routine. The police officials we spoke to asked us to get permission from a senior officer in the district headquarters in Ooty. But the senior official was not keen to give us permission, despite my best efforts to persuade him. Just as I was about to give up and leave, Dinesh noticed that he was from Andhra Pradesh and promptly took over the beseeching duties by talking in Telugu. After giving us a fresh hearing, the kind official gave us permission.

In a country with such a multitude of languages and where citizens feel the most comfortable in interacting in their own tongues, it helps to know and learn more languages and not limit ourselves to just one, that too an imposed one. Our experience told us that the concept of "one nation, one language" would fail the test of convenience.

The Hindu

FROM THE ARCHIVES

FIFTY YEARS AGO OCTOBER 4, 1969

Relevance of Gandhiji's ideals

Miss Angie Brooks, President of the General Assembly of the United Nations, in a tribute to Mahatma Gandhi before the Assembly began its general debate yesterday, said his thoughts and ideals were as relevant to problems before the U.N. today [October 3] as they were in relation to the goals and objectives Mahatma Gandhi pursued in his day. "It is therefore only fitting that we should respectfully recall the memory of this great visionary and leader who will long continue to be a constant inspiration to all of us." The Gandhi centenary was observed by the United Nations yesterday with the President of the Assembly as well as the Chairmen of the various committees of the United Nations paying tribute to the apostle of non-violence at the opening of the session. The External Affairs Minister, Mr. Dinesh Singh, told the Assembly that it was significant that the three causes for which Gandhi struggled non-violently throughout his life were also the three with which the United Nations Charter concerns itself: discrimination, decolonisation and economic development benefiting the underprivileged everywhere.

A HUNDRED YEARS AGO OCTOBER 4, 1919.

Purse to Mr. Gandhi by Women.

Bombay, October 3. – Under the auspices of the Bhagini Samaj, a public meeting of Indian women was held yesterday afternoon in Vanita Vishram Hall to present to Mr. M.K. Gandhi a purse collected by subscription in honour of his silver jubilee. The proceedings were in vernacular. Lady Jugmohandas presided in the absence of Mrs. J.B. Petit, and read her address. In it Mrs. Petit said that they owed a debt of gratitude to Mr. Gandhi for his great efforts in ameliorating the condition of womanhood of India which they could not adequately repay. The question of presenting him with a purse was taken up to mark their appreciation of the ideals which he had placed before them. The sum was not big but the spirit in which it was collected would make up for the smallness of the amount. The purse contained Rs. 20,100 and Rs. 7,000 more were to be realised. The purse was presented to Mr. Gandhi amidst cheers. In accepting it Mr. Gandhi said that he was grateful to them for what they had done for him on his birthday and he would utilise the sum for some object for the amelioration of the condition of Indian womanhood after careful consideration and would ask for suggestions from them.