

INDIAN INSTITUTIONAL PROTECTION SYSTEM (IIPS) FOR THE SHORT TERM COOPERATIVE CREDIT STRUCTURE

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**INDIAN INSTITUTIONAL PROTECTION SYSTEM (IIPS)
FOR
THE SHORT TERM COOP. CREDIT STRUCTURE.**

1) Introduction:

The adoption of New Economic Policy and the resulting Banking Sector Reforms followed by the application of Prudential Norms and Capital Adequacy Measures to the banking industry in general and the Cooperative Banking Sector in particular, among other things, have largely brought into light the inherent weaknesses and financial deficiencies of the banking industry in the country. The Cooperative Banking Structure stood further scanned under these measures, in spite of the diluted form of Prudential Norms made applicable to them.

While the entire requirements of the recapitalisation of Commercial Banks have been taken care by the Central Government through separate budgetary allocations, similar requirements of the Cooperative Banking Sector is still under discussion. The Capoor Committee constituted after much deliberation on the issue has made recommendations to this effect, which are yet to be accepted by the parties concerned. Meanwhile, the total funds requirement of the Cooperative Credit Structure for recapitalisation and to cleanse the Balance Sheet has crossed Rs.10,000 crores.

While the acceptance and implementation of the Capoor Committee recommendations is in the pipeline, it is felt that the time is ripe for the Cooperative Credit Structure itself to evolve its own strategies to take care of the present and future 'system failures' which will affect the basic viability of its operations. Being one of largest Cooperative Banking network, the structure is yet to develop a protection mechanism to safeguard the interest of the Cooperative Credit institutions.

Talking of protection mechanism and safeguarding the interests of the customers and the institution, probably Germany is one of the first and foremost countries to develop an 'Institutional Protection System' in the aftermath of the great depression and the subsequent failure of the banking system in that country during the 1930s. Germany has three major banking sectors, viz., Private Commercial Banks, Savings Banks, and the Cooperative Banks. Each of these sectors has established their own '**Voluntary Deposit Insurance System**' to maintain the

sector's financial stability. **The Association of the German Cooperative Banks (BVR) in Germany** which is similar to the **NAFSCOB in India** have established a separate 'Institutional Protection Division' which acts as a holding company as far as the liabilities of the member institutional are concerned and undertakes to cover the losses which may occur within the enterprises of the Banks.

A graphical account of the '**German Deposit Insurance System**' and the '**German Institutional Protection System**' is given in the **Annexure – I** for better appreciation of the proposal at the Indian level.

Under the present circumstances it has become essential and imperative for the Cooperative Banking Structure in India to have its own '**Indian Institutional Protection system**' (**IIPS**) established mainly through the contributions and participation of the member institutions particularly at the Apex and intermediary level of the S.T. Cooperative Credit Structure i.e. SCBs and DCCBs, for long term structural balancing as well as establishing a sound 'protection system' to ensure long term sustainability of the entire Short Term Coop. Credit Structure.

2. Composition of the Resources of IIPS

In view of the risks that are being faced by the Short Term Cooperative Credit Structure particularly in financing the agricultural sector, the corpus of the IIPS needs to be substantial so that each and every member cooperative institution receives adequate support under the IIPS. Apart from the funding support from the Central and State Governments the major and regular contributions should come from the member institutions such as SCBs and DCCBs.

In Germany, under a similar system that is in operation the contributions are raised at the rate of 0.05 percent to 0.20 percent of the loans issued by the concerned member cooperative bank. In the Republic of Korea also the cooperative banking sector have established a 'Mutual Credit Insurance System' and every member cooperative organisation is required to pay a premium of 0.05 percent of its total deposits towards the said '**Mutual Credit Insurance System**'.

In India so far we have the '**Deposit Insurance and Credit Guarantee Corporation of India**' (**DICGC**), providing insurance cover to deposits up to Rupees

One lakh and the DICGC charges 0.25 percent as premium towards the sum insured. However, there is no fool proof mechanism to take care of the credit issued and protect the interests of the cooperative institutions which are issuing such loans. In case of failure of the banks also the corpus formed at the level of DICGC takes care of the demands by the depositors only to a limited extent.

The Jagdish Capoor Committee in its recommendations has proposed for constitution of a **'Mutual Assistance Fund'** at each state level through annual contributions from the Cooperative Credit Institutions (SCBs, DCCBs, SCARDBs, and PCARDBs) in each of the states **at the rate of one percent of the profits or 0.25 percent of their management expenses, whichever is higher.**

However, establishing a **'Mutual Assistance Fund'** apart, it is essential to formulate a sound mechanism of **'Institutional Protection System'** for the Short Term Cooperative Credit Structure which would not only take care of the depositor's interest but also equally ensure the interest of the share holders, loans and advances issued by the cooperative institutions in the sector as well as the very viability of the Cooperative institutions. Jagdish Capoor Committee, among others has also recommended for constitution of a **'Cooperative Rehabilitation and Development Fund'** in NABARD with an initial contribution of Rs.500 crores from the Central Government as indicated in the Budget speech.

Taking this as the cue, **the composition of the resources of the proposed IIPS for the Short Term Coop. Credit Structure could be as follows:**

- (a) **'Cooperative Rehabilitation and Development Fund'** with an initial contribution of Rs. 500 crores as proposed in the Union Budget for the year 2002-2003 and contribution of Rs. 500 crores for a period of next five years.
- (b) **The premium paid by the SCBs and DCCBs to DICGC and the interest accrued therein.**
- (c) **One percent (1%) of the 'Total Business' transaction at the level of SCBs and DCCBs put together and to be contributed by/through the SCBs subject to a minimum amount of Rs. 10 lakhs and maximum amount of Rs.1 crore per SCB in three tier and a minimum amount of Rs.25 lakhs per SCBs in the two tier Structure.**

OR

i. The SCBs and DCCBs may be rated by an independent rating agency such as CRISIL, etc. to assess the performance of the bank and categorise them into various categories basing on the risk involved or basing on the criteria of the 'Working Capital', 'Total Business' etc. . The pattern of contribution under this criteria could be on the principles of 'higher the risk, higher the contributions'.

OR

ii. A contribution of 20% of the 'Management Cost'

OR

iii. A contribution pattern based on the 'Working Capital' strength of the SCBs and DCCBs subject to ceiling of Rs.10 lakhs as minimum and Rs. 1 crore as maximum for the SCBs in the three tier and Rs. 5 lakhs as minimum and Rs. 25 lakhs as maximum for the SCBs in the two tier structure.

OR

iv. Contributions at a fixed rate basing on the quantum of 'Loans' (outstanding) and 'Deposits' together or separately.

(d) The States, wherever there is three tier Coop. Credit Structure shall make an effective one time contribution of Rs. 25 crores and the States with two tier Coop. Credit Structure shall make an effective one time contribution of Rs. 10 crores to IIPS through appropriate budgetary allocations.

(e) Yearly contribution of Rs.10 crores from NABARD.

3) Scheme of Assistance under IIPS:

Assistance under IIPS to the member institutions shall be in the form of **soft loans @ 0.50 % above the Bank Rate.**

b. The specific areas of assistance under the IIPS shall be as follows:

- i. Guarantee to cover the deposits up to a limit of Rs.1 lakh per depositor.
- ii. Guarantee to cover the loans to the extent of the outstanding principal amount.

- iii. To cover a portion of losses arising out of natural disasters such as floods, droughts, to the extent that is affecting credit operations of the bank.
- iv. To cover a portion of losses, if any, arising out of legislative measures/ actions such as re-phasing of loans, remission of interest amount, loan write off, loan conversion, etc. (However the losses, if any, arising out of man made internal and/or external factors which are deliberate in nature and have caused pecuniary losses to the structure shall not be eligible for any assistance from IIPS.)
- v. To cover the erosion in the risk bearing assets such as Reserve Funds etc.
- vi. To assist the member institutions to bring about a turn around in their situation in case of failure of the bank to ensure continuity of stable and viable operations as well as protect the interest of the investing general public.
- vii. To effectively intervene to strengthen and revitalise the member institutions to face and absorb the future market shocks and become active players in the ever changing market economy.
- viii. To create appropriate level of awareness and prepare the structure for preventing recurrence of instances wherein the IIPS has to intervene frequently.
- ix. To any other eligible area of assistance as may be decided by the NSC from time to time.

4) Pre- requisites for assistance from IIPS:

- a. In order to avail assistance from the IIPS the participating member institutions/States shall have to fulfill certain **pre-requisites**, which are as follows:
 - i. The assistance under the IIPS shall not be made during the initial period of five years.
 - ii. During the period the members shall continue to make contributions at the rate prescribed.
 - iii. IIPS shall pay interest at the Bank Rate or at the rate, which may be fixed by the National Steering Committee of IIPS, from time to time.
 - iv. Amendments to 'Bye-Laws' of the institution concerned with regard to implementation/participation and contribution to IIPS and make it mandatory for each and every SCB to participate in the IIPS.

- v. 'Organisational Restructuring' through measures such as VRS/CRS to bring in professional management in the Cooperative Credit institutions.
- vi. Establishment and operation of a comprehensive 'Information System' at the level of each SCB and DCCB.
- vii. Strengthening of 'Audit and Supervisory' mechanism to ensure transparency, sound inspection and follow up mechanism at each member institutional level.
- viii. Strengthening of 'On-site and off-site surveillance system' in the bank to prevent future financial and managerial mishaps.
- ix. Each of the member institutions shall have to enter into MOU with the respective 'State IIPS Committees' and the 'State IIPS Committees' with the 'National Steering Committee on IIPS' giving an undertaking with regard to their interest, participation, commitment as well as better performance of the Coop. Credit System in the State.
- x. 'National Steering Committee on IIPS' shall also try and introduce a 'Rating System' with the help of a professional 'Rating Agency' to assess the risks faced by each of the member institutions and grade them into different categories basing on their strengths and weaknesses as well as establish an early warning system to take adequate precautions.
- xi. The formula for contributions to IIPS in such a case shall be 'higher the risk, lower the grade' and 'higher the risk, higher the contributions'.

5) Management of Resources of IIPS:

- a) The IIPS for the 'Short Term Cooperative Credit Structure' may be managed through a separate entity in the form of a '**National Steering Committee(NSC) on IIPS**' either at the level of NABARD or at the level of NAFSCOB.
- b) Under the '**National Steering Committee**' there shall be '**State Steering Committee'(SSC)**' at each State level to administer the IIPS in its letter and spirit.

6). 'National Steering Committee' (NSC) and the 'State Steering Committees' (SSC):

a) The suggested composition of the **National Steering Committee on IIPS** is as follows:

- i. Chairman, NABARD.
- ii. Chairman, NAFSCOB.
- iii. Representative of Reserve Bank of India.
- iv. The Joint Secretary, Ministry of Agriculture, Government of India.
- v. The Joint Secretary, Ministry of Finance, Government of India.
- vi. One Non-Official Chairman of the member State Coop. Bank representing each of the Six Regions as specified by NAFSCOB.
- vii. Director, NIBM (Financial Expert/Chartered Accountant).
- viii. Convener/Member Secretary (NABARD/NAFSCOB)

7. Functions of 'National Steering Committee (NSC) on IIPS':

a) NSC shall be the nodal agency for formulating appropriate scheme/s of assistance under IIPS for protecting the operations of the member institutions so as to prevent them from facing financial hardships and attract restrictive legal provisions, which may prevent them from performing normal banking activities.

b) NSC shall determine the formula/criteria for the collection and the quantum of contributions from the member institutions towards the corpus of IIPS, which will be maintained at the level of NSC.

c) NSC shall be the apex agency for negotiating with the Central Government, State Government, higher financing agencies International donor agencies etc. for mobilising resources etc for the IIPS Corpus.

d) NSC shall be the agency, which will determine the terms and conditions as well as the quantum of assistance to the member institutions from the IIPS Corpus.

- e) NSC shall be responsible for proper and profitable management of the funds of IIPS for earning better returns as well as optimum utilisation of the Corpus for maximum benefit to the member institutions.
- f) The NSC shall be the final authority for scrutinising the request/demand for financial assistance under the IIPS received from various member institutions with due recommendation from the respective 'State Steering Committee'.
- g) NSC shall be the agency for negotiating/dealing with all the policy making bodies, financial agencies, Central Government etc. on behalf of the member institutions with regard to IIPS.
- h) NSC shall play an important role in the policy formulation at the national level to protect and safeguard the interest of the member institutions.
- i) NSC with the assistance of the SSC shall ensure that the interest of each member institutions is protected irrespective of their contributions, financial standing, etc.
- j) NSC shall consider appropriate rebate but not exceeding 5-10 percent of the actual, contributions if a member institution has not availed assistance from IIPS for a continuous period of two years.

8. State Steering Committee (SSC) on IIPS :

a. Each State will have a '**State level Steering Committee on IIPS**' to be constituted by the Board of Directors of the SCB, alternatively this Committee may be constituted by the NAFSCOB. The suggested composition of the committee shall be as follows:

- i. Chairman of the SCB.
- ii. Finance Commissioner.
- iii. Agriculture Production Commissioner.
- iv. Registrar of Cooperative Societies.
- v. Three Chairmen of DCCBs to be nominated by the SCB on yearly rotation.
- vi. Chief General Manager, RBI Regional Office.
- vii. Chief General Manager/General Manager, NABARD Regional Office.

- viii. Director/Principal of a reputed Economic/Banking Research Institute in the State/Financial Expert/Chartered Accountant.
- ix. Chief Executive of the SCB –Member/Convener.

9. Functions of State Steering Committees (SSC) on IIPS:

- a) Each of the State and Union Territory, wherever, there are SCBs shall have its own 'State Steering Committee on IIPS'. The SCB shall be the Convener of the SSC and the Chairman of the SCB shall be the Convener of the SSC.
- b) The SSC shall monitor the operations and financial performance of the SCB as well as each of the DCCBs in the state under three tier structure and SCBs and their branches as well as Primary Coop. Credit Societies on selective basis in the two tier structure.
- c) The SSC shall be the permanent invitee in the meetings of the Board of Directors and the Loan Committee of the SCB as well as the DCCBs in the State. The SSC will be represented by a nominee of the committee who will be the person other than the one who is not already on the Board/Committee of the SCB concerned in a different capacity. SSC will attend the Board and the Loan Committee meetings of the SCB on regular basis and Board and the Loan Committee meetings of the DCCBs shall be attended on selective basis with emphasis on the weak DCCBs.
- d) The SSC shall be responsible for the concurrent audit of the SCB and the DCCBs. The observations of these audits shall be discussed in the meeting of the Board of Directors of the concerned SCB/DCCBs and the SSC. The Compliance on these observations shall also be submitted to the SSC.
- e) The Regional Offices of the higher financing agencies such as NABARD, SIDIBI etc. shall have close coordination with the SSC and vice-versa.
- f) The SSC shall closely monitor the compliance of findings of the statutory inspections conducted by higher financing agencies such as NABARD etc.
- g) The SSC shall be responsible for the collection of annual fees, contributions etc. payable by the member institutions to the NSC on IIPS.

- h) The SSC shall be the state level authority to assess and scrutinise the demand for financial assistance under IIPS and forward the same to the NSC for final sanction of such assistance.
- i) The SSC shall ensure necessary amendments to the State Cooperative Societies Act and the Bye-Laws of the institutions concerned to enable the institutions concerned to become members of the IIPS and make contributions as per the criteria framed by the IIPS to the Corpus of the IIPS etc.
- j) Any other functions as may be laid down by the NSC.

N. B.: A Chart depicting the structure of IIPS is given in the Annexure- II.

10. Obligations of the Participating Banks:

- a) In order to actively participate in the scheme of 'Institutional Protection System', the participating banks are required to fulfill certain basic obligations which are listed below:
 - i. The banks shall agree to repay the loans availed from the funds of IIPS on the fixed time schedule without defaulting to 'Institutional Protections System'
 - ii. The bank shall abide by the rules and regulations and other norms laid down from time to time by the IIPS and shall give and undertaking to that affect.
 - iii. The bank shall undertake to make its regular contributions on time and participate in the IIPS in its own self interest as well as in the interest of the Short Term Cooperative Credit Structure.
 - iv. The banks shall undertake to prepare and implement time bound Action Plans for revival as well as strengthening its financial and operational status.
 - v. The banks shall take into confidence the State Level/Regional Level/National Level Steering Committees of IIPS before embarking upon any ambitious development strategies /loaning programmes, etc.

11. Dissolution of IIPS –SSC and NSC.

a. The IIPS at the national level in the form of NSC and at the State level as SSC may be dissolved at a meeting of all the members of the respective Committee, specially convened for the purpose wherein at least $\frac{3}{4}$ of the members of the committee participate and vote in majority for dissolution.

b. The dissolution of the SSC shall be done only after the due approval by the NSC.

c. **Upon such dissolution of any SSC**, if there shall remain after the satisfaction of all its debts, obligations and liabilities any property and assets whatever, the same shall be:

i. Made over to some other body reconstituted under the constitution of the IIPS, OR

ii. Paid or distributed to the contributing members of the IIPS in proportion to their contributions or as may be jointly decided by the members SSC through a resolution.

d. **Upon such dissolution of the NSC**, if there shall remain after the satisfaction of all its debts, obligations and liabilities any property and assets whatever, the same shall be:

i. Made over to some other body with similar objectives and constituted for similar purpose, OR

ii. Paid or distributed to the contributing members of the IIPS in proportion to their contributions or as may be jointly decided by the members through a resolution.

Pillars of the German Deposit Insurance System

Commercial Banks	Savings Banks	Co-operative Banks
Several Hierarchies of Competing Concerns	One Federation	One Federation
Deposit Insurance	Institutional Protection	Institutional Protection
Four Big Private Banks several Regional and/or Special Duty Banks	1. Savings Banks (Sparkassen) 2. Central Saving Banks (Landesbanken)	1. Primary Co-operative Banks 2. Secondary (Central) Co-operative Banks

Requirements for a System of Institutional Protection

- ✓ Sufficient financial funds
- ✓ Risk Oriented membership fees
- ✓ Agreement on precaution requirements
- ✓ Mandatory auditing, controlling and information system
- ✓ Ways of intervention
- ✓ Contract in case of financial support, especially regarding reimbursement and release
- ✓ Sufficient number of members

Sufficient number of members

BVR Institutional Protection

Requirement for supported banks



Repaying Loans as fast as Possible



Releasing the Fund from its guarantee as fast
as possible



Informing the Fund on the bank's development



Obeying other obligations if necessary, e.g.
merging with another co-operative bank

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NATIONAL STEERING COMMITTEE (NSC) (1)

Chairman, NABARD, Chairman, MAFSCOB, Representative of Reserve Bank of India, The Joint Secretary, Ministry of Agriculture, Government of India, The Joint Secretary, Ministry of Finance, Government of India, One Non-Official Chairman of the member State Coop. Bank representing each of the Six Regions as specified by MAFSCOB, Director, NIBM (Financial Expert/Chartered Accountant), Convener/Member Secretary (NABARD/MAFSCOB)

STATE STEERING COMMITTEE (SSC) (30)

Chairman of the SCB, Finance Commissioner, Agriculture Production Commissioner, Registrar of Cooperative Societies, Three Chairmen of DCCBs to be nominated by the SCB on yearly rotation, Chief General Manager, RBI Regional Office, Chief General Manager/General Manager, NABARD Regional Office Director/Principal of a reputed Economic/Banking Research Institute in the State/Financial Expert/Chartered Accountant, Chief Executive of the SCB -Member/Convener