10 October 2019

Shaktikanta Das
Governor,
Reserve Bank of India
Mumbai

Subject: Memorandum with regard to frequent failure of cooperative banks (multi-state and others), in the context of Punjab and Maharashtra Cooperative Bank.

Dear Mr Das,

Moneylife Foundation, a Mumbai based non-profit consumer organisation, along with knowledgeable consumer activists, ex-bankers and trade unions would like to draw your attention to the plight of thousands of people whose hard earned money is stuck in several co-operative banks which have been placed under restrictions by the RBI.

We are disturbed at the frequent failure of cooperative banks, largely on account of division of regulatory responsibility between RBI and the Central Registrar of Cooperative Societies.

We thank you for your public statement and commitment not to allow any cooperative banks to collapse. This has raised expectations that PMC Bank and its deposits will also be salvaged through some tough action.

The attached memorandum is the view of a group of knowledgeable consumer activists and NGOs requesting urgent action to safeguard depositors' savings.

We are confident you will have the memorandum examined and initiate action at the earliest. We look forward to active engagement and an opportunity to meet you in person to discuss the issue.

A line of acknowledgement from your office would be greatly appreciated.

Yours Truly,

Debashis Basu	Sucheta Dalal	Yogesh Sapkale
Harsha Roongta	Ajit V Shenoy	Abhay Datar
Rajendra M Ganatra	Joe Athialy	

(Other signatories have given their consent over email)

CC:

1. Shri Narendra Modi
   Hon. Prime Minister of India
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2. Smt Nirmala Sitharaman,
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   Ministry of Finance,
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Recommendations

1) Co-operative Banks have been regularly failing in India and yet neither the RBI, not the ministry of finance, nor the state governments have tried to change the policies. (Annexure 1: Rampant Failure Of Cooperative Banks)
2) It is now imperative that we adopt a single regulation by RBI for all cooperative banks, starting with all multi state cooperative banks.
3) The RBI needs to publish an urgent status update (or at least a preliminary report) on HDIL loan recoverability and security within the next one week.
4) The 35-year-old PMC bank has 137 branches across multiple states and operates with almost 1800 employees. The bank employees are uncertain about their jobs and salaries. The RBI needs to study feasibility of selling the bank along with its assets in order to save jobs and as a part of immediate course correction. The RBI needs to make urgent and sincere attempts to sell the bank branches and operations to other banks (which are looking to expand) in case there are no chances of being able to resurrect the currently crippled bank and putting the bank back on the rails.
5) If 70% depositors are covered by the current withdrawal restriction of Rs25,000, the RBI must release a list of other depositors and amounts stuck.
6) The RBI, the Agriculture Ministry (which is the controlling ministry for multi-state co-operative societies), the Finance Ministry along with the National Federation of Urban Co-operative Banks and Credit Societies (NAFCUB) and other stakeholders should meet at the earliest and take stock of the situation to ensure possible recoveries of the largest NPAs of PMC Bank on an urgent basis and look at other options if the recoveries are likely to be delayed.
8) Investors of all co-operative banks are panicking at the moment and need an urgent reassurance from the RBI as the financial regulator. RBI needs to order an investigation in all other co-operative banks. The investigation report needs to be made public on an urgent basis. The RBI needs to tackle this on a war footing to safeguard UCB customers’ interests.

9) As per the RBI guidelines, all commercial banks and cooperative banks are insured under the Deposit Insurance and Credit Guarantee Corporation (DICGC). Only Primary Cooperative Societies are not covered under DICGC. The customers of PMC bank need to get their stuck money – savings account, FDs refunded as early as possible. In the Madhavpura Mercantile Co-operative Bank case, eventually the insurance payment had been expedited and MMCBL had paid six monthly seven instalments of interest at the rate of eight per cent and two instalments at three per cent along with insurance of Rs100,000 as sanctioned by the RBI.

10) The RBI must look to immediately implement the key measures of the R. Gandhi committee report: amend section 56 of the Banking Regulation Act to give the RBI more powers over co-operative banks, empower the RBI to implement resolution techniques including winding up and liquidating banks without involving other regulators under the cooperative societies' laws. All urban cooperative banks voluntarily wanting to convert into small finance banks must be allowed to do so if they fulfil the RBI's criteria. The RBI must act on this on priority and mandatorily convert systemically important urban cooperative banks into small finance banks.

Background

The RBI's sudden direction capping withdrawals from Punjab and Maharashtra Co-operative (PMC) Bank has dealt a severe blow to the over 9.12 lakh depositors who have been left in the lurch. Apart from retail depositors who had parked their life savings with the bank, small businesses have also complained of their business grinding to a halt with RBI directing the bank to stop all lending, investment and business operations for six months.

It is reported that 130 smaller banks and 1500 credit societies have deposits at PMC Bank, and if the lender is unable to return their money, all these small banks will have to mark their deposits as NPAs thus having a huge cascading effect. Several cooperative societies *(including Reserve Bank Officers' Co-op. Credit Society)* and housing societies also had their deposits in this bank.

It is most unfortunate that some customers had to issue suicide threats on social media/TV to the Finance Minister and RBI after which the RBI increased the withdrawal limit. The PMC fraud exposes the multi-level failure of the management / regulators and also the cavalier attitude to financial savers. With the lives of lakhs of customers thrown into disarray, once basic questions over the RBI's role as a regulator has been under scrutiny and how well it has discharged its job as a guardian of financial stability.

PMCB was a category-I authorised dealer with Nostro accounts, NRI accounts and foreign currency dealings. It could give bank guarantees and enter into forward contracts. It could issue credit cards. These were permissions given by the RBI, supposedly after considerable due diligence.

The problems of cooperative banks are multi-fold and well-known. Unlike the commercial banks, Urban Cooperative Banks (UCBs) are regulated by both RBI and the Registrar of Cooperative Societies of appropriate states. **This dual control has resulted in UCBs not being regulated properly and both the bodies passing the buck to each other.**

Further, rampant crony capitalism, frauds and political influence have all contributed to the failure of many cooperative banks. While the issue of PMC has made news because of the size of the bank and since it is one of the top five cooperative banks, many others have died a silent death in the past. Thousands of small depositors have lost their money or are on a never-ending wait to get back their savings. It is high time that we ensure that people do not lose their savings for the regulatory failures which is not their fault.

We, a group of consumers, knowledgeable consumer activists, policy watchers, bankers, trade unions of Mumbai and Moneylife Foundation, the voice of savers respectfully request you to investigate the PMC Bank issue, publish your findings and initiate urgent policy changes to ensure that interests of co-operative bank customers are safeguarded. The RBI as the banking regulator has failed to protect co-operative bank customer interests, we are compelled to be sceptical about mere statements from RBI to prevent recurrence of such a crisis. We need policy action right now.

Systemic Problems Repeated in PMC Bank

PMC Bank was ranked as one of the top five urban co-operative banks in the country. It has now been revealed that depositors' hard-earned money was being put to risk by concentrated lending and undisclosed bad loans, which went undetected by auditors & regulators.

1. Advances to HDIL are said to be Rs6,500 crore which constitute about 73 per cent of the bank's entire loan book. The quantum is more than four times the limit allowed as per the RBI's regulation. The RBI's 2015 master circular provides for

the single borrower exposure limit in case of cooperative banks at 15 percent of the bank's capital funds.

2. The lender also did not classify these loans to the defaulting company HDIL as non-performing assets.
3. It is shocking that the bank used more than 21,000 fictitious accounts to hide loans it made, when opening each account entails elaborate KYC and other procedures. Industry experts say there were also mismatches between the data uploaded on the RBI server and manual entry data maintained by the bank.
4. A confession letter by the bank's former MD exposes poor standards applied by the RBI during bank inspections. In fact, the RBI officials who conducted inspection of PMC Bank prior to 2017, did not even bother to check details of stressed legacy account, reveals the confession from Joy Thomas, now-suspended managing director of PMC Bank.
5. A simple search on the RBI website on urban co-operative banks (UCBs) currently shows that 24 such local area lenders from all four corners of the country have either been placed under fresh central bank directions or have received an extension, requiring them to freeze lending and cap withdrawal of deposits. These include Bidar Mahila Cooperative Bank from Karnataka, Sri Anand Co-operative Bank from Pune, Kolkata Mahila Co-operative Bank from Kolkata.
6. **RBI's supervision of cooperative banks is not as stringent as that of commercial banks.** Typically, the state government audits cooperative banks while RBI inspects their books once a year. Since co-operatives come under the purview of state governments, neither does RBI participate too much into it, nor can they keep away because of deposit holders. With so many cooperative banks facing problems, it is always the deposit holders that suffer ultimately. **The RBI must compulsorily convert systemically important cooperative banks into small finance banks and universal banks.**

Who is responsible?

Details from the RBI's website helped us to understand the scope of the powers of its Department of Co-operative Bank Supervision (DCBS). **Co-operative lenders are often seen as a state government's responsibility because the Registrar of Cooperative Societies (RCS) of each state has a certain statutory role in relation to registration, administration, audit, supersession of the board and liquidation.**

However the RBI's DCBS has specific powers in the following areas:

- Laying down prudential norms on capital adequacy, accounting standards, classification of assets, provisioning etc.
- Fixing single/group exposure norms and sectorial exposures
- Conducting on-site and off-site supervision
- Calling for statutory/other returns
- Off-site monitoring of the financial position of banks.
- Initiating supervisory actions against individual UCB to improve the financial position.
- Giving directions and operational instructions
- Imposition of penalty.

Clearly, RBI has extensive powers to monitor the working of UCBs. This power has evolved over years of experience and based on reports of several expert committees, its supervision has been fine-tuned with the recommendations of successive study groups like the Malegam Committee (2011) and the R. Gandhi Committee (2015).

In continuance of the advice given by the Malegam Committee and reiterated by the Gandhi Committee, in June 2018, **the RBI had announced new measures "with a view to strengthening governance" in UCBs by setting up a board of management (BoM) for each bank. The BoM would be a professional team of management with**

autonomy on the functioning of the bank under the oversight of the board of directors.

RBI would have the power to remove the members of or supersede the BoM. The guidelines were to be made applicable to UCBs with Rs100 crore of deposits within one year. At the time, it was reported that UCBs vehemently opposed the RBI's proposal and it is unclear whether this system has been put in place widely.

To protect the interests of depositors, an RBI panel under R Gandhi had proposed reforms that included the creation of an umbrella organisation for cooperative banks and instituting a board of management. Experts believe suggestions from this high-powered committee on Urban Cooperative Banks (UCBs), formed under former deputy governor R Gandhi must be taken into account.

The suggestions made in this report include:

- An amendment of the Banking Regulation Act to give more powers to RBI over cooperative banks.
- Empowering the RBI to implement resolution techniques such as winding-up and liquidating banks, without involving other regulators under the cooperative societies' laws.
- Allowing conversion of UCBs into small finance banks subject to their fulfilling RBI norms

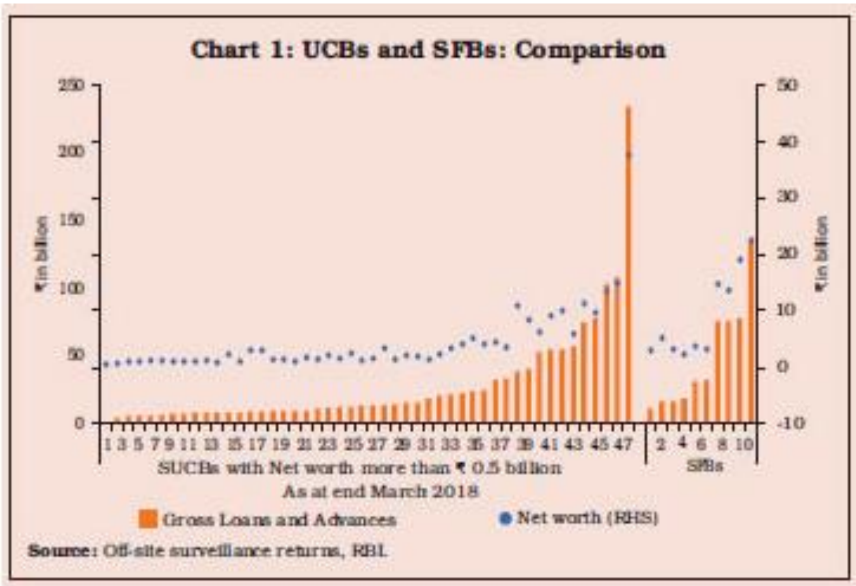
RBI has also been trying to evaluate the health of UCBs in terms of the now standardised CAMEL parameters. The RBI'S 2017-18 Report on Trend and Progress of Banking in India said this:

> The financial robustness of UCBs is assessed through CAMELS (capital adequacy; asset quality; management; earnings; liquidity; and systems and control) ratings. (Chap 5, para V. 18)

On September 27, 2018 the RBI announced a scheme for voluntary transition of eligible UCBs into small finance banks (SFBs) in line with the recommendations of the high-powered committee (Chairman: Shri R Gandhi). This would enable them to roll out most of the products which are currently permissible to commercial banks and help them in getting a pan-India presence.

UCBs with a minimum net worth of INR 0.5 billion and a CRAR of 9 per cent and above are eligible for the voluntary transition. Upon commencement of business, the converted entity must have a minimum net worth of INR 1 billion, and the promoters should hold at least 26 per cent of the paid-up equity capital. They also need to maintain a CRAR of 15 per cent on a continuous basis. Additionally, they are required to comply with all SFB guidelines such as ensuring that 75 per cent of adjusted net bank credit (ANBC) goes towards priority sector lending (PSL) and 50 per cent of the loan portfolio constitutes loans up to INR 2.5 million.

At end-March 2018, scheduled UCBs (SUCBs) were comparable with SFBs in terms of net worth and gross loans and advances.



In terms of the regulatory regime, both SFBs and UCBs comply with the same CRR and SLR norms as SCBs; however, while UCBs are subjected to Basel I norms, SFBs and UCBs transiting into SFBs need to be Basel III compliant, maintaining a liquidity coverage ratio and a net stable funding ratio in line with SCBs. Amongst the 54 SUCBs, 45 already have a net worth of INR 1 billion or more. Besides, 50 SUCBs and 1,450 non-scheduled UCBs (NSUCBs) (out of a total of 1497 NSUCBs) have a CRAR of more than 9 per cent.

UCBs are increasingly facing competition from new players like payments banks, small finance banks and NBFCs. In order to remain competitive, it is necessary for them to adopt robust information technology (IT) systems, inter alia, by leveraging on the RBI's IT support. As regards governance, the separation of executive and supervisory roles is essential to improve the interests of depositors," the RBI had noted in its report on Developments in Cooperative Banking in December 2018.

It is fairly obvious that RBI has been aware of the shortcomings of UCBs and the need to take corrective measures to put them on a sound footing. Through its multiple powers and its on-site and off-site monitoring of the PMC, the RBI should have picked up the warning signals. The PMC Bank's very large exposure to a single client clearly did not happen overnight. Evidently, the exposure was growing and the RBI definitely had the means to know it.

It is equally unbelievable that as a regulator, the RBI had no knowledge of the grave danger the PMC was exposed to due to its excessive lending to a single borrower and its associates. The RBI's notification restricting the withdrawals and granting of advances for six months now is akin to bolting the stable after the horse has fled. This current embarrassing mess now highlights the urgency of long-term measures and effective regulatory oversight by the central bank as guardian of the financial system. If that is done, another PMC may not recur.

Questions That RBI Needs To Address Urgently

1) Frenetic large cash withdrawals by a few large depositors have been reported following a whistleblower leak after 17th September 2019. The RBI must disclose the details of all those allowed to withdraw funds in 3 days preceding RBI Directions on 23 September 2019.
2) RBI's Officers' Co-op Credit Society Ltd (3500 members) has a fixed deposit (FD) of Rs 105 crore with the Mumbai-based bank, as per its FY2019 balance sheet. The Reserve Bank Staff & Officers Co-operative Credit Society Ltd (8300 members) has Rs 86.50 crore fixed deposit with the bank. Were these RBI Officers co-operative Credit Societies among those who withdrew funds between 17th - 23rd September? We haven't heard any complaint from them.
3) For UCBs, the RBI provides bank-wise data every year, on the performance of certain key metrics which makes it even easier to filter the good cooperative banks or at least ones that can be avoided due to weak financials. On the RBI portal, we found the financial metrics for PMC bank: Select Financial Parameters of Scheduled UCBs & Major Indicators of Financial Performance of Scheduled UCBs **(File uploaded on RBI portal on 28th December 2018: refer link https://m.rbi.org.in/scripts/PublicationsView.aspx?id=18755), all financial parameters for the PMC bank appear to be very good and there were no apparent problems.** Does the RBI still stand by this data? What is the RBI's accountability for this financial metrics data, which is being shared on the RBI portal? What is the action taken against the RBI's Department of Co-operative Bank Supervision (DCBS) which is also guilty in the shoddy cover up?

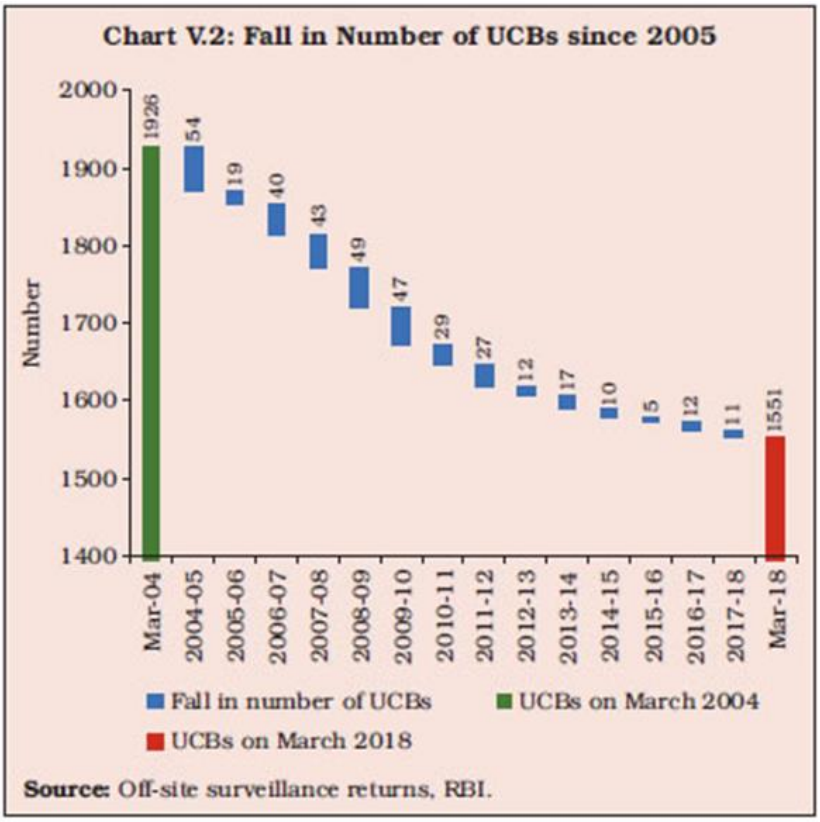
Annexure 1: Rampant Failure of Co-operative Banks

Apart from PMC Bank, the fate following nine lenders still hangs in balance. The directions date back several years, with depositors' money locked in, mostly without any respite from RBI.

1. **Kapol Cooperative Bank:** The Mumbai-based Kapol Cooperative Bank was placed under directions on March 31, 2017. The withdrawal cap was set at Rs 3000 per depositor. The bank continues to remain under directions till January 2020, as curbs were extended several times. Earlier this year, its 2.5 lakh depositors proposed to convert 35 percent of their deposits into the bank's share capital to revive the lender. However, there has been no change in the restrictions yet.
2. **Rupee Cooperative Bank**: The RBI imposed directions on Rupee Cooperative Bank on February 22, 2013. While the bank is still functioning, depositors have not yet been given access to their funds. The bank did release some money for exceptional cases with relaxation from RBI. Attempts are being made to merge the bank with a stronger lender to keep the bank afloat. The bank has been surviving on extensions granted by RBI for its banking licence, which currently stands valid till November 30, 2019.
3. **CKP Cooperative Bank:** The 103-year old cooperative bank was put under directions on May 2, 2012. The RBI-appointed board of administrators ran the bank until April 2015, after which a new board was elected. The depositors have converted a part of their money into share capital since 2015. The bank is still under directions after several extensions over the years. The next review date is on September 30, 2019.
4. **The Needs of Life Cooperative Bank:** The Mumbai-based bank was placed under directions from October 29, 2018. After an extension, its next review date has been set on October 29, 2019. The bank was in news for several frauds and irregularities, including, naming a peon as a director of the bank.
5. **Youth Development Cooperative Bank:** The Kolhapur-based bank was placed under directions on January 5, 2019, for a period of six months. On review, the

regulator extended the restrictions by another six months till January 5, 2020. The bank has 14 branches in the city.

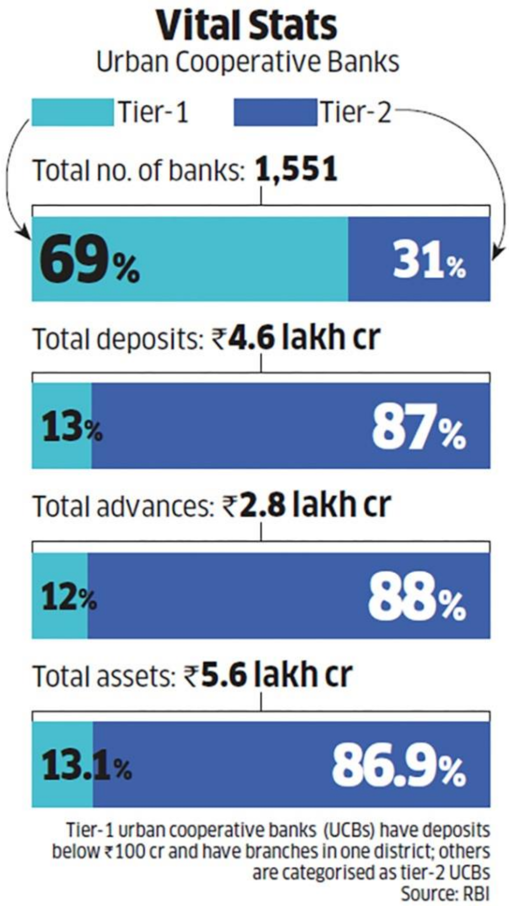
6. **Shivam Sahakari Bank:** The bank based in Ichalkaranji, Kolhapur, was placed under directions on May 19, 2018. After several extensions, its next review date has been set on October 19, 2019.
7. **The City Cooperative Bank:** The Mumbai-based bank was placed under directions on April 17, 2018 and received three extensions. It's next review date is on October 17, 2019. In all, it has 10 branches in Mumbai. It had deposits worth Rs 440 crore as on March 2019.
8. **Maratha Sahakari Bank:** The bank was put under directions on August 31, 2016 and still operating with restrictions. Its next review date is on September 30, 2019.
9. **Karad Janata Sahakari Bank:** The bank was placed under directions on November 7, 2017. After several extensions, the bank's next review date is set on March 2020.
10. **Pen Urban Co-operative Bank**
11. **Kokan Prant Sahakari Bank** – licence cancelled

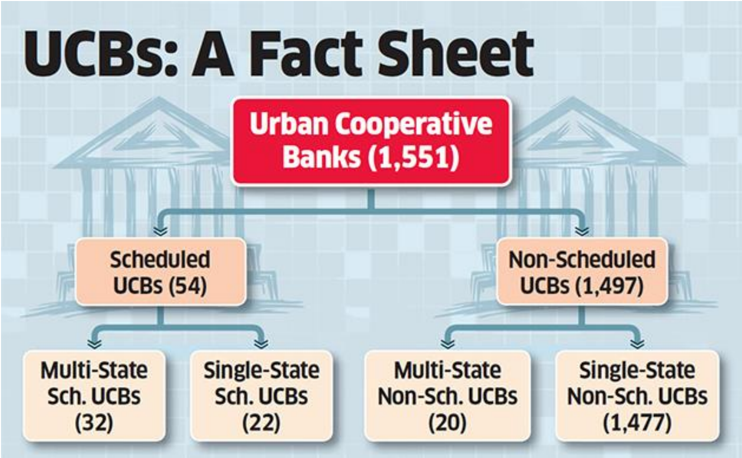


The Madhavpura Cooperative Bank scam in 2001-02 was a clear signal to clean up the mess in the sector but precious little has been done since. When Madhavpura Mercantile Cooperative Bank went bust, 210 other urban cooperative banks landed in trouble and some of them had to be liquidated. UCBs have seen a steady fall in their market share that declined from 6.4% in FY02 to 3.3% in FY17. Failures have been routine, leaving scores of depositors at risk.

Annexure 2: The Importance of UCBs

Urban cooperative banks have specialised in catering to people of limited resources in urban areas. To quote from the RBI's Report on the Trend and Progress of Banking in India for 2018, *"Co-operative institutions play a significant role in credit delivery to unbanked segments of the population and financial inclusion within the multi-agency approach adopted in India."*





According to the same report, there were 1,551 UCBs at end-March 2018. According to a study undertaken by the RBI-appointed Gandhi Committee on UCBs, small loans up to a limit of Rs 5 lakh accounted for over 53% of the total loan accounts of 50 scheduled UCBs and another 27% of the accounts comprised of loans between Rs 5 lakh and Rs 10 lakh. In contrast, the share of loan accounts of Rs 1 crore and above was less than 1%.

This is evidence enough to highlight the reach of UCBs in the age of renewed stress on financial inclusion. This data also proves to be quite shocking when juxtaposed against PMC Bank's exposure to HDIL.

However, due to the general skew in loans given out by UCBs, advances given out to loan accounts greater than Rs 1 crore cover nearly 60% of the total money that has been lent.

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