ADB

Progress Report on Tranche Release

Project Number: 36343
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India: Rural Cooperative Credit Restructuring and Development Program

Asian Development Bank

CURRENCY EQUIVALENTS
(as of 24 November 2010)

Currency Unit	–	Indian rupee/s (Re/Rs)
Rs1.00	=	$.02193
$1.00	=	Rs45.5850

Currency Unit	–	Euro (€)
€1.00	=	$1.3368
$1.00	=	€.74805

ABBREVIATIONS

ADB	–	Asian Development Bank
APR	–	action plan for revival
BDP	–	business development plan
CAS	–	common accounting system
CCS	–	cooperative credit structure
CEO	–	chief executive officer
CRAR	–	capital to risk weighted asset ratio
CSA	–	cooperative societies act
DAP	–	development action plan
DCCB	–	district central cooperative bank
DICGC	–	Deposit Insurance and Credit Guarantee Corporation
DLIC	–	district-level implementation committee
GDP	–	gross domestic product
MIS	–	management information system
MOU	–	memorandum of understanding
NABARD	–	National Bank for Agricultural and Rural Development
NIMC	–	National Implementation and Monitoring Committee
PACS	–	primary agricultural credit society
PDS	–	public distribution system
RBI	–	Reserve Bank of India
RCCRDP	–	Rural Cooperative Credit Restructuring and Development Program
RCS	–	Registrar of Cooperative Societies
RRB	–	regional rural bank
SCB	–	state cooperative bank
SLIC	–	state-level implementation committee
STCCS	–	short-term cooperative credit structure

NOTES

(i) The fiscal year (FY) of the Government ends on 31 March. FY before a calendar year denotes the year in which the fiscal year ends, e.g., FY2007 ends on 31 March 2008.

(ii) In this report, “$” refers to US dollars.

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I. INTRODUCTION

1. The Asian Development Bank (ADB) approved the Rural Cooperative Credit Restructuring and Development Program (RCCRDP)[1] loan for an amount of $1 billion to India on 8 December 2006. The loan became effective on 21 February 2007. The goal of the RCCRDP is to support a sustainable cooperative credit structure (CCS) and help the Government of India carry out CCS reforms to improve rural households' access to affordable finance. The RCCRDP loan was programmed to be released in four tranches subject to compliance with tranche release actions. The first tranche ($250 million) was released in February 2007 and the second tranche ($250 million) in December 2008. The third tranche ($300 million) was originally programmed for release within 12 months of the second tranche. The fourth tranche ($200 million) is programmed for release within 12 months of the third tranche. In parallel with the ADB loan, KfW has financed (€130 million) of the RCCRDP and released the first tranche of its loan (€52 million) with the second tranche of the RCCRDP. The release of KfW's second tranche (€39 million) will coincide with the release of ADB's third tranche on the basis of ADB's progress report.

2. The RCCRDP is a reform initiative responding to the weak state of CCS institutions through policy and institutional reforms in order to achieve financial inclusion of the rural sector. In particular, the program seeks to create an enabling set of conditions to extend access to credit to an increasing number of rural households in a sustainable manner. The RCCRDP builds on the recommendations of a task force[2] to develop a countrywide revival package[3] for the short-term cooperative credit structure (STCCS).[4] The revival package focuses on legal, institutional, and financial reforms to enable STCCS institutions to function as autonomous, member-centric, and member-governed entities. The National Bank for Agricultural and Rural Development (NABARD) was designated the implementing agency for the revival package.

3. This report presents the status of compliance with the third tranche release actions for the RCCRDP. ADB missions reviewed the progress toward meeting third tranche release conditions in November 2009, April 2010, and October 2010.

II. STATUS OF PROGRAM IMPLEMENTATION

A. Overview of the Program

4. The credit cooperative revival package entails one-time assistance for financial restructuring of institutions, under defined eligibility criteria,[5] to state governments that agreed to the package terms. The terms of the revival package were based on recommendations of the Vaidyanathan Committee report (footnote 3) on revival of cooperatives. While participation was

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[1] ADB. 2006. *Report and Recommendation of the President to the Board of Directors on Proposed Loan to India for the Rural Cooperative Credit Restructuring and Development Program*. Manila.

[2] Under the Chairmanship of Prof. A. Vaidyanathan (Emeritus Professor Madras Institute of Development Studies).

[3] Government of India, Ministry of Finance. 2005. *Report of the Task Force on Revival of Rural Cooperative Credit Institutions.* New Delhi. http://www.nabard.org/departments/departmentforrevivalsreforms.

[4] The STCCS has at its base the 105,735 primary agriculture credit societies (PACSs), dealing mainly in credit. The PACSs are federated into 368 district central cooperative banks (DCCBs), which in turn are members of 31 state cooperative banks (SCBs). For the long-term credit system, there are 20 state cooperative agriculture and rural development banks with 887 branches and 768 primary cooperative agriculture and rural development banks, or retail branches federated with the state cooperative agriculture and rural development banks (SCARDBs). In some states, the CCS for short-term credit has no DCCBs, while in others the CCS for short-term credit also covers the long-term structure.

[5] In the case of PACSs, recapitalization (restructuring) will be full and direct for PACSs with recovery levels of 50% and above. PACSs with recovery levels between 30%−50% will receive assistance in three back-ended installments subject to their achieving an incremental increase in their recovery rate by at least 10% against benchmark recovery. The entire assistance will be released to a PACS achieving 50% recovery without waiting for the year-to-year recovery benchmarks. In the case of DCCBs and SCBs, those institutions that have deposit erosion of less than 25% after factoring in the cleansing of balance sheets of PACSs are eligible for assistance.

optional, once agreed upon, the state government and the CCS had to accept the whole package including the conditions of institutional, regulatory, and financial reform and establish implementing and monitoring mechanisms. In this context, participating states established state-level implementation committees (SLICs) and district-level implementation committees (DLICs)[6] to coordinate reforms at SCBs and DCCBs and address implementation issues with the National Implementation and Monitoring Committee (NIMC)[7] and NABARD.

5. While the revival package is applicable across the country, the RCCRDP supports Andhra Pradesh, Bihar, Madhya Pradesh, Maharashtra, and Rajasthan. The process of implementation begins with the signing of the memorandum of understanding (MOU) between the national government, the state government (participating state), and NABARD, outlining responsibilities, financing obligations, and legislative changes required from the signatories. The revival package envisages a bottom-up approach aimed at first bringing PACSs to acceptable financial health through cleaning of the balance sheets and strengthening the capital base, and then moving to upper tiers. This will enable PACSs to clear dues to upper tiers and reduce the accumulated losses of DCCBs, and similarly for SCBs. The RCCRDP reforms include (i) establishing a policy reform and implementation framework; (ii) building a facilitating legal, regulatory, and governance framework; and (iii) institutional reforms for sustainability.

B. Scale of Program and Achievements of First and Second Tranche Actions

6. In the five participating states under the RCCRDP, there are 143 SCBs and DCCBs and close to 40,000 PACSs or nearly 40% of the national total. Thus, as per the revival package and RCCRDP third tranche conditions (Section C), the following actions are required for about 40,000 separate institutions: (i) special audits to determine the extent of accumulated losses, (ii) the removal of cadre-based secretaries, (iii) the holding of elections to boards and appointment of professionals, (iv) reduction in government equity, and (v) release of recapitalization payments are required for around 40,000 separate institutions. Further, the CCS structure in all five participating states was governed under cooperative societies acts (CSAs) that were passed decades earlier. The operationalization of CSA amendments requires the adoption of by-laws and rules by over 40,000 separate institutions. Finally, training in accounting standards and management information system (MIS) is needed for over 70,000 board members (about 40,000 in Maharashtra alone) and over 35,000 chief executive officers (CEOs).

7. The first and second tranche actions laid the ground work for achieving third tranche actions including among others (i) establishing implementation and monitoring mechanisms; (ii) commencing the process of conducting special audits to access accumulated losses; (iii) development of a computerization and human development plan and issuance of the same to STCCS institutions; (iv) finalization and issuance of accounting standards and MIS including training guides; (v) preparing plans for holding elections in all CCS tiers; and (vi) identifying amendments to the Banking Regulation and NABARD Acts. In this context, under the second tranche, the government share released through NABARD for cleaning the accumulated losses in PACSs, amounted to \$0.32 billion for Andhra Pradesh; \$0.11 billion Madhya Pradesh; and \$0.17 billion for Maharashtra. Release of recapitalization assistance was predicated on completion of special audits to assess accumulated losses in over 30,000 PACSs and DCCBs. The release of assistance reflects progress subsequent to signing of MOUs and acceptance of responsibilities. An overview of the scale of the reform program is provided in Appendix 3.

[6] Thus, in line with the number of DCCBs, (22 in Andhra Pradesh, 25 in Bihar, 38 in Madhya Pradesh, 31 in Maharashtra, and 26 in Rajasthan), DLICs were set up in the five states. The difference in the number of districts and DLICs is accounted for by the fact that only one DLIC is needed for DCCBs covering more than one district.

[7] The NIMC, headed by the secretary of the Department of Financial Services (DFS), is responsible for the overall policy and strategic direction of reforms.

8. Under the second tranche, there were two partially complied actions namely (i) participating states commence the reduction in the equity to a maximum of 25% of the capital at any level of the CCS and convert the equity over 25% to grants to the CCS; and (ii) special audits (to assess the extent of accumulated losses as of 31 March 2004) completed in at least two SCBs in participating states. The second tranche progress report indicated that the same would be fully complied by third tranche release. These two actions have now been fully complied with.

C. Third Tranche Conditions Compliance Status

9. The third tranche contains 29 tranche release actions. The summary compliance status is in Appendix 1, status of program covenants in Appendix 2,[8] and supporting documentation in Appendix 4. The following presents a summary of status of compliance of the 29 third tranche release actions. Despite implementation delays due to state level or local factors such as state elections, governments at state and central levels remain strongly committed to reforms. This is reflected in achievement of full compliance with 13 tranche actions and substantial compliance with 10 tranche actions. Significant progress has also been made on the remaining 6 partially complied with tranche actions and full compliance of the same is expected by the final tranche.

1. Establishing a Policy Reform and Implementation Framework

10. **Action 1. The government completes the first stakeholder consultation on the assessment of the CCS reform undertaken by an independent agency and, as required, advises stakeholders on appropriate measures to address related feedback on the assessment**. **(Fully complied with.)**[9] The independent assessment has been undertaken by the Indian Institute of Management-Bengaluru for Maharashtra and Rajasthan, and by Institute of Social and Economic Change, Bengaluru, for Andhra Pradesh, Bihar, and Madhya Pradesh. As per the terms of reference of the independent agency, the independent assessment will assess the efficacy of the revival package and remove shortcomings in implementation of the program and in the compliance with requirements of the various covenants contained in the MOU. The stakeholder consultation workshop was held on 26 November 2010.

11. The assessments evaluate the overall impact in terms of autonomy and reduced state control, structure, process flows, and financial performance including recovery aspects. Further, the assessments assess the impact of the human development and capacity building initiatives under the revival package in improving the democratic character of the CCS institutions and in enhancing good governance, management, and organizational effectiveness. The said assessments evaluate the acceptance of the common accounting system (CAS) and MIS in PACSs, and internalization and consequent impact on the efficiency of the entity and its management in meeting stakeholder aspirations.

12. **Action 2. The government makes budgetary provisions to support CCS reforms. (Fully complied with.)** Budgetary provisions by the government have been made and released for recapitalization assistance to PACSs for the amount of Rs44.88 billion ($1.08 billion). The amount has been released after completion of necessary reform actions. Thus is this case, the action has gone beyond making budgetary provisions and includes release of assistance. Under the revival package, financial restructuring will start with first bringing the PACSs to an acceptable level of financial health through cleaning of their balance sheets and strengthening of

[8] The tranche conditions are classified as fully complied with, substantially complied with, and waiver sought for partially complied with actions. While full compliance status is accorded to those actions where all conditions have been met, cases of substantial compliance imply a very high degree of compliance of an irreversible nature.

[9] The assessment reports are being received by Department of Financial Services and NABARD, and the stakeholder consultation was held on 26 November 2010.

their capita base, and then move to the upper tiers. This will enable PACSs to clear their dues to the upper tiers and reduce the accumulated losses of the DCCBs. Under the sharing arrangement of the revival package, the government bears 100% of the losses arising out of the agricultural credit business of PACSs, DCCBs, and SCBs, and a portion of losses arising from nonagricultural credit business; and 50% of losses due to the public distribution system (PDS) and input distribution as well as the cost of resources required to raise the capital to risk weighted asset ratio (CRAR) to 7% (para 13). State governments' share in case of SCBs and DCCBs is significantly smaller than is the case with PACSs.

13. **Action 3. All participating states make budgetary provisions to support CCS reforms. (Fully complied with.)** All participating states have made budgetary provisions and released Rs3.55 billion ($79 million) with respect to 30,329 eligible PACSs. In this case as well, the action taken has gone beyond the condition of making a budgetary provision to include actual release of recapitalization assistance. Also, the release of the government's share is contingent on the achievement of reform benchmarks as articulated in the MOU signed by the participating states. Under the sharing arrangement, the participating state bears the cost of losses on account of PDS and input distribution, all dues pertaining to invoked and uninvoked guarantees and other receivables. NABARD, under the guidance of NIMC, is monitoring compliance with benchmark conditions.

2. Building a Facilitating Legal, Regulatory, and Governance Framework

14. **Action 4. Participating states enact legislation amending the cooperative societies acts (CSAs)**. **(Fully complied with.)** The CSAs have been amended and notified and are in force in all the participating states.[10] The root cause of the poor financial state of CCS institutions lies in poor management and governance. Accordingly, the CSAs were reformed to (i) ensure full voting membership rights to all users of financial services including depositors in cooperatives; (ii) remove state intervention in all financial and internal administrative matters in cooperatives; (iii) provide for a cap of 25% on participating states' equity in cooperatives and limiting participation in the boards of cooperative banks to one nominee; (iv) allow transition of cooperatives registered under the existing CSA to the new amended CSA; (v) withdrawing restrictive orders on financial matters; (vi) allowing cooperatives in all three tiers the freedom to take loans from any regulated financial institution and not necessarily from only the upper tier, and, similarly place their deposits with any regulated financial institution of their choice; (vii) limit powers of participating states to supersede boards; (viii) ensuring timely elections; (ix) facilitating regulatory powers of the Reserve Bank of India (RBI) in the case of cooperative banks; and (x) providing for prudential norms, including CRAR, for all financial cooperatives including PACSs, as per directions of RBI. As may be seen from the required actions, several provisions of the amended CSAs form tranche release actions under the RCCRDP.[11] Thus, participating states that have amended the CSAs will have to comply with the said actions to ensure that they are not contravening provisions of their own amended CSAs.

15. **Action 5. Participating states issue rules and regulations as required under the amended CSAs. (Substantially complied with.)** All participating states, except Rajasthan, have issued rules and by-laws for PACSs, which have also been adopted.[12] Andhra Pradesh, Madhya Pradesh, and Maharashtra have also issued amended by-laws with respect to DCCBs and SCBs and the process is ongoing in Bihar and Rajasthan. Amendments to by-laws for SCBs and DCCBs are carried out by the institutions themselves and have to be passed in the Annual

[10] The state government notifications orders were issued on 16 April 2007 (Andhra Pradesh), 30 April 2008 (Bihar), 13 December 2007 (Madhya Pradesh), 2 May 2008 (Maharashtra), and 3 April 2008 (Rajasthan).

[11] A case in point is the requirements that participating states have to reduce their equity holding to 25% in the CCS, which is a provision in the amended CSA.

[12] The state assembly elections were conducted in 2008, which resulted in a change in state government.

General Meeting (AGM). Hence, the process is lengthy to allow for due process and especially in light of the number of PACSs involved in each state (federated to DCCBs). In case of Bihar, while SCBs and DCCBs have to adopt new by-laws, the process requires newly elected boards, which will formally adopt by-laws and place them before the AGM. Hence, by-law adoption by SCB and DCCB in Bihar will be complete when elections are held to SCBs and DCCBs.[13] In Rajasthan, the CSA has been amended only in April 2010, and as such, the process is ongoing. Thus on an overall basis, issuing amended rules and by-laws in the case of PACSs, DCCBs, and SCBs have been substantially complied with. The eighth NIMC meeting has also issued guidance in this matter, and is being pursued by SLIC(s).

16. **Action 6. Based on the assessment under earlier tranche, if required, the NABARD Act, 1982 is amended**. **(Partially complied with.)** Under the assessment carried out as a second tranche action, an amendment to the NABARD Act is necessary to render direct financing to CCS institutions. While there is an existing provision under the NABARD Act to provide refinance to DCCBs directly,[14] the replication to other tiers is difficult due to existing provisions in the NABARD Act. The proposed amendments to the NABARD Act have been drafted and have also been reviewed by the NABARD board which has suggested further changes. The same are under consideration by the NABARD management. Once approved by the NABARD board, the required amendments will have to be cleared by RBI. Once approved by RBI, the Law Ministry will prepare the revisions to the Act which will be placed before a select Parliamentary committee, which may return the draft Act for further revisions or submit the same to the Parliament.

17. **Action 7. Based on the assessment under earlier tranche, if required, Deposit Insurance and Credit Guarantee Corporation (DICGC) Act, 1961 is amended**. **(Fully complied with.)** Based on the assessment under the second tranche, amendment to the DICGC Act was considered to be not required.[15]

18. **Action 8. The Banking Regulation Act, 1949 is amended. (Partially complied with.)** To bring the CCS on par with the rest of the banking system with regard to regulation, changes in the Banking Regulation Act are required. The required changes have been identified and incorporated in the proposed amendments.[16] The Banking Regulation Act amendment bill (as finalized by the RBI and Ministry of Finance) will need parliament approval and is with a select Parliamentary committee.[17] However, through an Executive Order, RBI has already issued “fit and proper” eligibility criteria on appointment of chief executive officers and board members of SCBs and DCCBs, which in effect introduces the reforms without having to wait for the actual

[13] A key reason for the lack of complete progress in Bihar is the conduct of state assembly elections in October and November 2010 and account of overlap cooperative elections were stayed by the courts in some cases (action 12).

[14] Under sections 21 and 22 of NABARD Act which had been amended in 2003.

[15] The assessment carried out as a second tranche action, acknowledged that only deposits of banks including SCBs and DCCBs are insured by the Deposit Insurance and Credit Guarantee Corporation (DICGC) and deposits mobilized by PACSs from members are not covered. However, instead of amending the DICGC Act to cover the deposits of individual members of PACSs, NABARD has developed a deposit protection scheme for the deposits mobilized by PACSs from its members. The draft scheme prepared by NABARD covers all the PACSs receiving recapitalization assistance under the CCS revival package and mobilizing deposits from members. The draft scheme proposes a maximum protection cover of about $1,000, the institution of a deposit protection fund, and a deposit safety agency to administer the scheme and the deposit protection fund. The proposed scheme is being fine-tuned based on stakeholder consultation.

[16] These changes include (i) SCBs and DCCBs to be regulated by RBI; (ii) RBI to prescribe fit and proper criteria for elections to boards of SCBs and DCCBs; (iii) CEOs with minimum qualifications prescribed by the RBI alone to be appointed to SCBs and DCCBs; and (iv) cooperatives other than cooperative banks approved by the RBI are not to accept nonvoting member deposit or use words like “bank” or its derivatives in their registered names.

[17] The amendment bill with the select parliamentary committee is not a public document.

amendment of the Banking Regulation Act.[18] Further, RBI has made prudential norms for capital adequacy, income recognition, asset classification, and provisioning mandatory, and has enforced these norms on the DCCBs and SCBs through the licensing process (action 9). Banks that do not meet the stipulated benchmarks of RBI by 31 March 2012 would be delicensed. Prudential norms on par with banks have also been issued to PACSs.

19. **Action 9. Supervision and regulation of CCS institutions classified as banks are undertaken in the participating states in accordance with the amended CSAs. (Fully complied with.)** Supervision and regulation of CCS in participating states are being undertaken in accordance with the amended CSAs. Under action 10, regulatory norms are already in force in the DCCBs and SCBs, and the RCS has been issued with detailed guidelines. In terms of the supervision guidelines adopted by NABARD, the inspectors examine bank compliance with relevant laws, regulations, and by-laws.[19] In case of DCCBs and SCBs, their adherence to the provisions of CSA and the Banking Regulation Act is also examined and deficiencies are brought to the notice of the concerned bank for remedial action. Similarly, statutory audits examine bank compliance to CSA provisions.

20. **Action 10. Prudential norms for CCS (SCBs and DCCBs) and eligibility of board of directors and chief executive officers are developed based on amended Banking Regulation Act, 1949 and are applied on the CCS (SCBs and DCCBs). (Substantially complied with.)** Prudential norms of PACSs were issued by NABARD in July 2009[20] and prudential norms applicable to the commercial banks were extended to DCCBs and SCBs from FY1996 onwards[21] and subsequently updated in December 2007.[22] Norms have been issued with respect to income recognition, asset classification, and provisioning,[23] and detailed guidelines have been issued to the RCS.[24] Fit and proper criteria for CEOs and directors have been issued by RBI and are being followed by the CCS institutions. Thus, while awaiting Banking Regulation Act amendment itself, executive action has ensured that the reform process has been taken forward.

21. Regarding assessment of net worth, charter accountants, appointed by SCBs and DCCBs as per the panel supplied by NABARD, are conducting audits, which will include all financial parameters, including net worth and norms prescribed by RBI. Accordingly, DCCBs and SCBs also disclose CRAR in the balance sheet. Taken together, the prudential norms and fit and proper criteria for appointment of directors and CEOs will ensure a degree of professionalism and reform governance structures of the CCS institutions.

22. **Action 11. Participating state government nominees on PACSs board withdrawn. (Substantially complied with.)** There are no government nominees on the boards of PACSs in Bihar, Madhya Pradesh, Maharashtra, and Rajasthan which all now have elected boards at the

[18] Issued by RBI in June 2008 and came into effect in March 2009. RBI has clarified that the fit and proper criteria would have the same force as directions issued under the Banking Regulation Act and therefore, any violation would attract penal provisions under the Act.

[19] Under the revised strategy, a sharper focus of the NABARD's inspection was given on the core areas of the functioning of banks pertaining to Capital Adequacy, Asset Quality, Management Earnings, Liquidity and Systems Compliance (CAMELSC). Thus, NABARD's focus in its statutory on-site inspections is on core assessments leaving the collateral appraisals to supplementary inspections. A system of off-site surveillance has also been introduced, supplementary to on-site inspection, to identify areas of supervisory concern and to identify early warning signals and risky areas requiring further attention. http://www.nabard.org/rolefunctionssupervisory.asp.

[20] Circular No. 186 / DoS-38 / 2009.

[21] RPCD.No.BC.155/07.37.02/95-96.

[22] Circular no. RPCD.CO.RF.BC 40/07.38.03/2007-08 and circular no. 247/DoS 39/2007.

[23] NABARD circular no. HO. POL. 1577/P.57/2002-03 and RBI circular no. RPCD.CO.RF.BC 40/07/07.38.03/2007-08.

[24] Guidelines have been issued with respect to norms for treating loans and/or advances as nonperforming for the purpose of asset classification, income recognition for cooperative banks, norms for asset classification, and provisioning norms on the basis of asset classification.

PACSs level. In these states, board composition is in line with the amended CSA in the case of PACSs. In Andhra Pradesh, government nominees remain only to complete their tenures and do not have voting rights under the amended CSA. [25] The withdrawal of state government nominees will reduce the direct or indirect interference of state governments, which have been a major cause for the deterioration of the CCS institutions. Interference occurs through directives on deposit and lending rates, lending priorities, investment decisions, etc. The withdrawal of government nominees is critical to ensuring independence of the boards and developing a sound corporate governance framework and is in accordance with CSA amendments. Independent boards will be expected to develop a business model based on prudential norms and market factors.

23. **Action 12. Participating states hold elections in the CCS and install new boards of directors and office bearers in all the SCBs and half of the number of DCCBs. (Partially complied with.)** Elections for boards have been carried out in almost 100% of DCCBs in all participating states except Bihar, where elections to a significant number of DCCBs have been stayed by the courts. With regard to SCBs, while Andhra Pradesh, Madhya Pradesh, and Maharashtra have elected SCBs, the elections to board of the Bihar SCB have been stayed by the courts,[26] and the absence of an elected SCB board in Rajasthan is being pursued by NABARD as it required under the amended CSA and guidance issued by NIMC to this effect. The elections have been conducted by the independent election commission, and the state department of cooperatives has been kept out of the election process. Under the revival package, boards of the CCS institutions will have to be reconstituted to ensure that they are elected and thus, responsive to client needs.

24. **Action 13. Participating states complete reduction of equity to a maximum level of 25% of the capital at any level of the CCS and convert the equity over 25% to grants to the CCS. (Partially complied with.)** In Maharashtra, which has the largest number of CCS institutions in India, no CCS unit has state government equity share in excess of 25%. In the case of Andhra Pradesh, there are 8 DCCBs out of 22 where the share of state government equity is in excess of 25%.[27] In the case of Madhya Pradesh, less than around 25% of PACSs and 16% of DCCBs have state government equity share of over 25%, and the SLIC has taken up the issue with the state government. In Rajasthan, despite the CSA being amended only in April 2010, there is no excess equity in the SCB while about half the DCCBs have state government equity share of over 25%. In Bihar, with ongoing elections and bifurcation of PACSs in 2008, data compilation is ongoing and the process to refund excess equity or convert it into a grant has been initiated and is being monitored by the SLIC, as reduction in state equity share to less than 25% is required under the amended CSA. Reduction in equity holding by participating state will reduce state influence in the CCS and the reduction of government equity share will pave the way for CCS institutions to return to their original mandate of member-driven and member-centric institutions. At the eighth NIMC meeting, all participating states were instructed to complete the process of reducing the state equity share to 25% or less, reflecting the government's determination to carry out reforms.

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[25] Rules and by-laws have been issued in this regard. The by-laws provide for the representation from various stakeholders such as depositors, marketing societies, etc. Thus, government nominees are removed as per by-laws as they come into effect.

[26] The court granted a stay on elections to CCS institutions on account of the overlap with the assembly elections in the state. Now that the general elections are over and the election results were due in late November 2010, the way for elections to CCS institutions has been cleared.

[27] It has been determined by SLIC that sudden withdrawal state equity would result in the failure of the DCCBs to comply with CRAR requirements, and these DCCBs cannot raise share capital within a short period. Accordingly, the SLIC will request the state government to park the excess capital in a designated share capital account, which is treated as capital from a regulatory standpoint.

25. **Action 14. Participating state government nominees on boards of SCBs and DCCBs limited to one. (Partially complied with.)** While in participating states of Andhra Pradesh and Maharashtra, there is only one state government nominee on the SCB and DCCB boards, there are four state government nominees in the case of Madhya Pradesh. As per the amended CSA, the participating state is required to restrict the number of government nominees to one to comply with its own amended CSA and to represent the sub−25% government share in equity. The position is under review in Bihar and Rajasthan and is being pursed by NABARD and SLIC.

26. **Action 15. Directors on boards of all CCS institutions (SCBs and DCCBs) not meeting the approved criteria are to be identified by participating states. (Substantially complied with.)** In the participating states of Andhra Pradesh, Maharashtra, and Madhya Pradesh, about 80% or more of SCBs and DCCBs have directors and CEOs as per the approved criteria. In the remaining participating states, the process of identifying directors and CEOs who do not meet the approved criteria and appointing professionals is at an advanced stage. In the case of Rajasthan, the RCS has also issued instructions to DCCBs and the SCB for co-option of professional directors and appointment of CEOs as per RBI's fit and proper criteria (footnote 19). The process is ongoing in Bihar. The revival package requires the SCBs and DCCBs to adopt the approved (fit and proper) criteria for eligibility for board membership, and for co-option of a specified number of professionals as full members with voting rights, if members with such qualifications do not get elected. Application of fit and proper criteria is expected to professionalize management and result in credible recruitment of staff.

27. **Action 16. CCS institutions (SCBs and DCCBs) terminate the tenure of directors on CCS boards representing defaulting PACSs. (Fully complied with.)** The termination of directors on the boards of SCBs and DCCBs is an ongoing process and is executed when a PACS becomes a defaulting entity and the tenure of the director representing the said PACS on a DCCB or SCB board is terminated. Termination of such directors is a routine matter as this has already been provided for in the amended CSA and the by-laws, and is monitored by the RCS in the light of the changing recovery position from time to time. NABARD's supervision and statutory audits verify compliance with the CSAs.

28. **Action 17. Rating of SCBs conducted by approved rating agency. (Fully complied with.)** A supervisory rating has already been provided by NABARD and a statutory rating has been provided by independent chartered accountants based on rating scales covering regulatory, financial, operational, and management parameters developed by NABARD as a second tranche action.[28] In addition to the independent ratings by chartered accountants, the ratings provided as part of the statutory inspection of SCBs and DCCBs under section 35(6) of the Banking Regulation Act would continue. Additional rating may be requested by lenders to the SCBs. Issuance of a rating will enable the SCBs to independently access the market and the issuance of a rating is in line with initiatives to amend the NABARD Act, 1982 to enable CCS institutions to have a broader access to finance. The introduction of ratings will also further incentivize SCBs institutions to maintain the process of financial and governance reform.

3. Institutional Reforms for Sustainability

29. **Action 18. In all participating states NABARD implements (i) the accounting standards, (ii) management information systems including internal control and audit systems, (iii) the computerization plan, and (iv) the human development plan for CCS. (Substantially complied with.)** NABARD has developed and circulated a common accounting system (CAS) and MIS for PACSs in all participating states. Registers for the CAS and MIS are printed and circulated in four participating states, and are in progress in Bihar. Manuals have

[28] NABARD Circular No. 247/DOS 39/2007 dated 31 December 2007.

also been provided for the CAS and MIS by NABARD to operationalize the systems. The CAS has introduced accounting practices in CCS institutions in line with banks and, similar to the introduction of fit and proper criteria for directors, this enables an aspect of reform even before the passage of the Banking Regulation Act amendment by Parliament. Training has also been undertaken in participating states to create trainers and to train PACSs staff and board members.

30. **Action 19. Special audits (to assess the extent of accumulated losses as of 31 March 2004) of PACSs is completed in all participating states. (Fully complied with.)** All five participating states have completed the special audits of PACSs and the scale of the exercise can be gauged from that fact that almost 40,000 PACSs have been audited.[29] The revival package envisages that support for financial restructuring must enable CCS institutions to clear accumulated losses, maintain minimum capital, and retire equity contributions by participating states. Accumulated losses in CCS institutions cover (i) nonrepayment of agricultural, business, and consumer loans; (ii) losses on account of noncredit businesses such as the PDS; (iii) nonrepayment of loans under guarantees where the state government has not yet paid the CCS institutions even though the guarantee has been invoked; (iv) nonrepayment of dues from governments on account of waivers or subsidies; and (v) losses due to fraud, etc. The revival package requires that the magnitude of the losses be assessed by special audits based on uniform accounting criteria including for nonperforming assets and release of assistance linked to the special audits under action 23.

31. The revival package envisages that financial restructuring will start with first bringing the PACSs to an acceptable level of financial health through cleaning of their balance sheets and strengthening their capital bases, and then move to the upper tiers. This will enable PACSs to clear their dues to the upper tiers and thereby reduce the accumulated losses of DCCBs. The DCCBs will then be provided assistance to clear the balance of accumulated losses, if any, and to reach minimum capital adequacy norms. The same process will apply to SCBs.

32. **Action 20. Participating states implement plans to phase out cadre-based secretaries in PACSs. (Substantially complied with.)** No cadre-based secretaries exist in Andhra Pradesh, Bihar, and Rajasthan. Madhya Pradesh and Maharashtra have issued gazette notifications ordering withdrawal of cadre-based secretaries on 27 August 2010 and 11 December 2008, respectively, to comply with the covenants of the MOU signed by all participating states. The revival package envisaged the abolition of cadre system in PACSs, so that PACSs appoint their own secretaries and determine their own salary structures. Under the revival package, cooperative societies will handle recruitment, and common cadres and recruitment boards are not envisaged. Under the cadre system, the secretaries to PACSs did not see themselves as accountable to the PACSs but to the external cadre-controlling authority. Abolition of this practice is expected to lead to greater accountability in the functioning of PACSs. The NIMC has also instructed the participating states to complete the process of phasing out cadre-based secretaries.

33. **Action 21. Eligible PACSs adopt Action Plans for Revival (APRs) and/or development action plans in all participating states. (Fully complied with.)** To strengthen STCCS institutions, in FY1994 NABARD introduced a development action plan (DAP) and/or MOU mechanism aimed at strengthening institutions through specific measures related to finance, strategy, and business planning. The performance obligations arising out of DAPs formed the basis of the MOU between stakeholders and are considered as a systematic approach for business planning and include tangible performance measures.[30] During the third

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[29] The DLICs have been responsible for vetting the special audit results and certifying final recapitalization claims.

[30] State MOUs are executed among the SCBs, participating states, and NABARD and district MOUs are entered into between the SCBs and DCCBs.

phase of DAP and/or MOU covering the period FY2004−FY2006, PACSs were introduced to business planning process for the first time. The business development plans (BDPs) concept introduced in 2007[31] was refined in 2010 and a new format has been introduced under which PACSs are now required to prepare viability action plans (named as BDPs) and enter into an MOU with the DCCB. The mechanism of DAP and/or MOU has helped in building appreciation and awareness for strategic planning facilitating sustainable viability at all levels. BDPs have been prepared by 1,930 out of 2,738 PACSs in Andhra Pradesh, 4,196 out of 4,523 PACSs in Madhya Pradesh, 9,482 out of 20,791 PACSs in Maharashtra, and 5,147 out of 5,259 PACSs in Rajasthan. The process is about to start in Bihar.

34. **Action 22. A plan for ineligible PACSs developed and implementation commenced in participating states that have ineligible PACSs. (Partially complied with.)** Andhra Pradesh, Madhya Pradesh, and Maharashtra have identified ineligible PACSs, and the process is ongoing in the remaining two states as advised by all participating states at the eighth NIMC meeting. The participating states have indicated that the plan for ineligible PACSs will include an analysis of the impact of the Agricultural Debt Waiver and Debt Relief Scheme of 2008.[32]

35. **Action 23. Support is provided by NABARD for cleaning accumulated losses of eligible PACSs in participating states that meet benchmark requirements of the MOUs. (Fully complied with.)** NABARD has released recapitalization assistance as per the terms of the MOUs to all five participating states. The number of PACSs assisted and amounts released are as follows: Andhra Pradesh, 2,580 PACSs, $360.0 million; Bihar, 6,633 PACSs, $58.1 million; Madhya Pradesh, 3,134 PACSs, $223.4 million; Maharashtra, 15,219 PACSs, $319.0 million; and Rajasthan, 2,763 PACSs, $54.1 million.

36. **Action 24. Eligible DCCBs adopt APRs and/or DAPs. All eligible DCCBs have adopted APRs and/or DAPs. (Fully complied with.)** DAPs for FY2007−FY2011 have been prepared by SCBs and DCCBs that have signed MOUs with NABARD as per NABARD guidelines.[33] The plans are refined each year to take into account recent business developments, costs of investments, and competition. The DAPs are regularly monitored and reviewed during state-level task force meetings.[34]

37. **Action 25. Special audits (to assess the extent of accumulated losses as of 31 March 2004) of DCCBs are completed in all participating states**. **(Substantially complied with.)** Special audits of DCCBs have been completed in Andhra Pradesh, Maharashtra, Madhya Pradesh, and Rajasthan and ongoing in Bihar. Given the hierarchical structure of the CCS institutions with PACSs forming the base, special audits of DCCBs are undertaken as a sequel to the special audits of the PACSs, as DCCB receivables are PACSs liabilities.

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[31] NABARD Circular No. 104/IDD.03/2007 dated 26 June 2007.

[32] The agricultural debt waiver scheme enabled some PACSs to recover a substantial part of the defaults through the intervention. While the states want these PACSs to be included under the recapitalization package, NABARD and the NIMC are of the view that their recovery was not from members, but from the government. In light of this, the options that states and banks are exploring are (i) let PACSs that are now financially strong after the waiver continue, without recapitalization from the revival package, if they have the potential to carry out viable operations; (ii) where PACSs, despite the waiver, are financially weak, merge the same with other PACS to make them viable; and (iii) in the remaining cases, liquidate PACSs to weed out the weak, loss making units without potential.

[33] NABARD enters into MOUs with state governments and cooperative banks specifying their respective obligations to improve the affairs of the banks in a stipulated timeframe. NABARD also monitors implementation of DAPs of SCBs and DCCBs and fulfillment of obligations under MOUs.

[34] NABARD has constituted a task force in each state in terms of the provision 8(d) of the MOU comprising chief general manager of the NABARD regional office, RCS, general manager of the RBI regional office, and CEO of the SCB. The state-level task force periodically reviews the performance of the SCB and DCCBs in the state, with regard to good governance, compliance with statutory requirements of regulatory and supervisory norms, and actions of RBI and/or NABARD, and suggests improvements in their functioning, including human resources development.

38. **Action 26. Support is provided by NABARD for cleaning accumulated losses of DCCBs in participating states that meet benchmark requirements of the MOUs. (Substantially complied with.)** The benchmark requirements include release of committed liabilities by participating states governments to DCCBs including invoked guarantees and this should precede the release of financial assistance for cleaning accumulated losses as contained in the MOU. The participating states of Andhra Pradesh, Madhya Pradesh, and Maharashtra have not released committed liabilities, and as recorded in the minutes of the eighth NIMC meeting, the states are required to honor their commitments in this regard. NABARD is awaiting the release of state government commitments before the release of recapitalization assistance for which it has earmarked funds. Thus, support will be provided by NABARD during post completion of benchmark requirements. The NIMC has also directed these states to release the committed liabilities to the DCCBs and SCBs concerned. Further, based on the task force report (footnote 3), while accumulated losses of DCCBs aggregated to around $1 billion (prior to the special audits) as of March 2003, the same have to be set against the accumulated losses by PACSs estimated at around $520 million. The balance losses represent (i) residual losses on account of loans to PACSs for other purposes, (ii) DCCBs lending to societies other than PACSs, and (iii) direct lending by DCCBs to individuals for agricultural and nonagricultural purposes. The precise estimate of the said losses can only be made after completion of special audits of DCCBs which is ongoing in Bihar (action 25).

39. **Action 27. SCBs adopt APRs and/or DAPs**. **(Fully complied with.)** As under action 24, the DAPs have been prepared by SCBs for FY2007−FY2011 who have signed MOUs with NABARD. The state-level task force, the district-level monitoring and review committee, and the state-level monitoring and review committee vet and monitor the DAPs and BDPs on an ongoing basis.

40. **Action 28. Special audits to assess the extent of accumulated losses as of 31 March 2004 of SCBs completed in all participating states**. **(Substantially complied with.)** Special audits of SCBs have been completed in Andhra Pradesh, Madhya Pradesh, Maharashtra, and Rajasthan and ongoing in Bihar. The NIMC has also highlighted the importance of completing the special audits of Bihar SCBs and is pursuing the matter.

41. **Action 29. Support is provided by NABARD for cleaning accumulated losses of SCBs in participating states that meet benchmark requirement of the MOUs. (Substantially complied with.)** While NABARD has earmarked resources to be released to the SCBs, the fulfillment of benchmark activities by the SCBs is a prior requirement, as indicated under action 26.

III. CONCLUSION

42. The RCCRDP is supporting STCCS reforms based on the recommendations of the task force. The achievements of the three tranches completed thus far put the revival program of the STCCS institutions on a firm footing and the reforms on an irreversible path. The program is well on its way to transforming STCCS into financially viable and commercially oriented entities that are governed professionally, insulated from political interference, and have enhanced capacity in business development, financial management, and strategic planning. An additional aspect of reforms is the restoration of the democratic and member-centric nature of STCCS and the training of CCS officials in the conduct of business from a prudential standpoint. RBI guidance in the appointment of key officers in the CCS structure with regard to qualifications criteria and flexibility in staffing─including co-opting of qualified staff from the market─is also expected to significantly improve CCS functioning.

43. In addition, a key aspect is regulatory reform designed to bring STCCS institutions onto par with banks with regard to prudential norms and the enhancement in supervision. Given the envisaged expansion in portfolios and products, enhanced regulatory structures and supervision will enable NABARD to (i) protect the interest of the present and future depositors; (ii) ensure that the business conducted by these banks conforms with the provisions of the relevant acts and rules, regulations, and by-laws, etc; (iii) ensure observance of rules and guidelines formulated and issued by NABARD, RBI, and government; (iv) examine the financial soundness of banks; and (v) suggest ways and means to strengthen institutions to enable them to play more efficient role in rural credit.

44. The RCCRDP reform actions achieved thus far significantly remedy shortcomings in the CCS operating structure through a programmatic approach where the policy reforms are developing a self-sustaining CCS structure that can be sustainable over the medium term. While the independent assessments[35] provide more comprehensive analysis, the recapitalized PACSs have become financially stronger as have the DCCBs and SCBs on account of repayment of advances to them by PACSs. As per the NABARD annual report for FY2009, 320 DCCBs and SCBs were profitable as of 31 March 2009 compared to 261 as of 31 March 2008. After the 2008 waiver, credit growth has increased by 25% in cooperative banks in FY2009 over FY2008. In addition, recoveries increased to 72% in FY2009 compared with 55% in FY2008 despite the growth in credit during the FY2008−FY2009 period.[36]

45. In light of the sequential nature of reforms, the second and third tranche actions provide the enabling environment and conditions for the final tranche. In this context, enabling conditions have also been created with regard to partially complied actions where the process towards compliance has been significantly taken forward or the development agenda is being achieved through executive action. Finally, the failure to meet full or substantial compliance in partially complied cases reflects local rather than systemic factors such as state elections where institutional arrangements are monitoring progress towards full compliance on an ongoing basis.

IV. THE PRESIDENT'S RECOMMENDATION

46. In view of the substantial progress made on the implementation of the Rural Cooperative Credit Restructuring and Development Program, as evidenced by the full compliance with 13 tranche release conditions; substantial compliance with 10 tranche release conditions; and partial compliance with 6 tranche release conditions, the President recommends that the Board approve on a no-objection basis:

(a) the waiver of full compliance with 6 tranche release conditions, which shall be fully complied with by the last tranche release; and

(b) the release of the third tranche in the amount of $300,000,000 for the Rural Cooperative Credit Restructuring and Development Program.

[35] The independent assessment reports are provided in Supplementary Appendices A (Andhra Pradesh), B (Bihar), C (Madhya Pradesh), D (Maharashtra), and E (Rajasthan) and the executives summaries are provided in Supplementary Appendix F.

[36] The commensurate growth in credit by commercial banks was less at 20% during the same period.

SUMMARY OF COMPLIANCE STATUS OF THIRD TRANCHE ACTIONS

Third Tranche Actions	Status
1. Government completes first stakeholder consultation on the assessment of CCS reform undertaken by the independent agency and as required, advises stakeholders on appropriate measures to address related feedback on the assessment.	Fully complied with.
2. The Government makes budgetary provision to support CCS reforms	Fully complied with.
3. All participating states make budgetary provisions to support CCS reforms.	Fully complied with.
4. Participating states enact legislation amending the CSAs.	Fully complied with.
5. Participating states issue rules and regulations as required under the amended CSAs.	Substantially complied with.
6. Based on the assessment under the earlier tranche, if required, NABARD Act, 1982 is amended.	Partially complied with.
7. Based on the assessment under the earlier tranche, if required, Deposit Insurance and Credit Guarantee Corporation Act, 1961 is amended.	Fully complied with.
8. Bank Regulation Act, 1949, is amended.	Partially Complied with.
9. Supervision and regulation of CCS classified as banks are undertaken in the participating states in accordance with the amended CSAs.	Fully complied with.
10. Prudential norms for CCS (SCBs and DCCBs) and eligibility for board of directors and chief executive officers are developed based on amended Bank Regulation Act, 1949, and are applied on the CCS (SCBs and DCCBs).	Substantially complied with.
11. Participating states government nominees on PACSs boards withdrawn.	Substantially complied with.
12. Participating states hold elections in the CCS and install new boards of directors and office bearers in all the SCBs and half of the number of DCCBs.	Partially complied with.
13. Participating states complete reduction of equity to a maximum level of 25% of the capital at any level of the CCS and convert the equity over 25% to grants to the CCS.	Partially complied with
14. Participating states government nominees on boards of SCBs and DCCBs limited to one.	Partially complied with
15. Directors on boards of all CCS (SCBs and DCCBs) not meeting the approved criteria are to be identified by participating states.	Substantially complied with.
16. CCS (SCBs and DCCBs) terminate the tenure of directors on CCS boards representing defaulting PACSs.	Fully complied with.
17. Rating of SCBs conducted by approved rating agency.	Fully complied with.
18. NABARD implements in all participating states the (i) accounting standards, (ii) management information system including internal control and audit systems, (iii) computerization plan, and (iv) human resources development plan for the CCS.	Substantially complied with.
19. Special audits (to assess the extent of accumulated losses as of 31 March 2004) of PACSs is completed in all participating states.	Fully complied with.
20. Participating states implement plans to phase out cadre-based secretaries in PACSs.	Substantially complied with.
21. Eligible PACSs adopt APRs and/or DAPs in all participating states.	Fully complied with.
22. A plan for ineligible PACSs developed and implementation commenced in participating states that have ineligible PACSs.	Partially complied with.
23. Support is provided by NABARD for cleaning accumulated losses of eligible PACSs in participating states that meet benchmark requirements of the MOUs.	Fully complied with.
24. Eligible DCCBs adopt APRs and/or DAPs.	Fully complied with.

Third Tranche Actions	**Status**
25. Special audits (to assess the extent of accumulated losses as of 31 March 2004) of DCCBs completed in all participating states.	Substantially complied with.
26. Support is provided by NABARD for cleaning accumulated losses of DCCBs in participating states that meet benchmarks requirements of the MOUs.	Substantially complied with.
27. SCBs adopt APRs and/or DAPs.	Fully complied with.
28. Special audits (to assess the extent of accumulated losses as of 31 March 2004) of SCBs completed in all participating states.	Substantially complied with.
29. Support is provided by NABARD for cleaning accumulated losses of SCBs in participating states to meet benchmark requirement of the MOUs.	Substantially complied with.

APR = action plan for revival, CCS = cooperative credit structure, CSA = cooperative societies act, DAP = development action plan, DCCB = district central cooperative bank, MOU = memorandum of understanding, NABARD = National Bank for Agriculture and Rural Development, PACS = primary agricultural credit society, SCB = state cooperative bank.

STATUS OF PROGRAM COVENANTS

Covenant	Comments and/or Compliance
Program Implementation and Coordination	
Schedule (Sch.) 5, 1(a) The Ministry of Finance (Banking Division) shall be the executing department (ED) responsible for coordination and management of overall implementation of the Program. National Bank for Agriculture and Rural Development (NABARD) shall be the implementing agency (IA) responsible for day-to-day implementation of the program	Being complied with.
Sch. 5, 1(b) The Government of India shall ensure that the ED, the IA, and all participating states undertake activities and respective responsibilities as included under the loan agreement and related documents in a timely manner to achieve the objectives for the program.	Being complied with.
Sch. 5, 2(a), (b), (c), (d) The government will and will cause NABARD and the participating states to (a) maintain the policies adopted and actions taken prior to the date of the loan agreement for the program, as described in the development policy letter and the policy matrix, for the duration of the program and subsequently; (b) promptly adopt and implement the policies and take the actions included in the program as specified in the development policy letter and policy matrix; (c) ensure that such policies and actions continue in effect for the duration of the program and subsequently; and maintain adequate staff and funds for satisfactory and timely completion of the program.	Being complied with.
Sch. 5, 3(a), (b), (c) The government shall ensure that the program is implemented in a timely and effective manner in accordance with the program implementation mechanism attached as appendix 7 to the Report and Recommendation to the President (RRP) for the cooperative credit structure (CCS) reforms. (a) The government shall ensure that the National Implementation and Monitoring Committee (NIMC) set up under First Tranche requirements serves as the program steering committee for the duration of the Program; (b) the government shall ensure that the State Level Implementation Committees (SLICs) set up by the participating states under Second Tranche requirements shall be responsible for guiding and monitoring the implementation of the CCS reforms package and the Program at participating state levels; (c) the government shall ensure that the District Level Implementation Committees (DLICs) to be set shall be responsible for guiding and monitoring the implementation of the CCS reforms and the program at district levels of the participating states.	The overall level of compliance is good given (i) the scale of the program, (ii) the state assembly elections in Bihar in late 2010; (iii) the bifurcation of PACSs in Bihar in 2008; and (iv) the passage of the CSA in Rajasthan only in April 2010. As per the RRP NIMC, SLIC(s) and DLIC(s) have been set up under the guidance of NABARD.
Counterpart Funds	
Sch. 5, 4. The government will ensure that (a) the counterpart funds will be used for the costs associated with CCS reform under the program and shall, in	The government has transferred the counterpart funds to NABARD and in turn NABARD has released such funds to the

Covenant	Comments and/or Compliance
particular, transfer the counterpart funds generated under the loan, through NABARD, under normal arrangements for transferring external assistance to the participating states and shall treat such counterpart funds as an additional to its transfers allocated to the participating states; and (b) all participating states make available on a timely basis, the counterpart funds required for the program through timely budget appropriations/allocations and in accordance with relevant memoranda of understanding (MOUs) and/or agreements.	participating states that have met the precedent conditions for release of such funds. Correspondingly, the participating states have made available their share of the cost of reforms.
Participating States	
Sch. 5, 5(a) Notwithstanding the inclusion of four identified participating states under the first tranche, in the event that any one such identified participating state has not achieved or is not likely to achieve the subsequent tranche (i.e., the second tranche) conditions in time and that may cause delay in release of the second tranche for the benefit of other identified participating states, and unless otherwise required by Asian Development Bank (ADB), the government may substitute such participating state with another participating state subject to the following principles: (i) The participating state proposed to be included shall have fulfilled the conditions under the first tranche as also shall be in compliance with the actions listed in the policy matrix and loan agreement, as of the date of such substitution; (ii) The substitution shall be limited to only one participating state and shall not be revocable; (iii) The substitution shall not be beyond a date six months after release of the first tranche, or of the date of second tranche, whichever is earlier; (iv) The substitution shall not disturb the adjustment costs already incurred towards release of first tranche under the program; and (v) It shall also be required that under such substitution arrangements, the government shall: (1) continue to finance and support the participating state that has been taken out from the program, towards cooperative credit structure (CCS) reforms as reflected in the development policy matrix; (2) provide government's share of financing under the program to the newly included participating state; (3) and will require all participating states (including that taken out and newly	Being complied with. As per requirements Bihar was identified as a participating state as per the second tranche and program is being implemented therein as per requirements.

Covenant	Comments and/or Compliance
included) to be included in reports to be provided to ADB for program performance management system (PPMS), accounts and related reforms and reports as required under the loan agreement.	
Sch 5, 5(b) The government shall also ensure that the additional participating state to be included as stipulated in the second tranche release is included not later than six months of release of first tranche.	Bihar was included as the fifth participating state on 12 July 2007, i.e., within six months of release of first tranche.
CCS Policy Reforms	
Sch. 5, 6(a) The government and the participating states will ensure that the reforms under the program, including institutional, legal, and financial reforms, and respective MOUs and/or agreements between various agencies under the CCS reform package are formulated, finalized, and implemented to the satisfaction of ADB.	The reform actions under the program so far have been as per the agreement between ADB and the government.
Sch. 5, 6(b) As part of the legal and institutional reforms and compliance of various tranche releases, the government will ensure and cause the participating states to undertake the necessary amendments referred to in the development policy letter and ensure their implementation in an effective and timely manner.	Legal actions expected from participating states up to the third tranche have progressed well.
Sch. 5, 7. The government will ensure that CCS will have autonomy in all financial and internal administrative matters as outlined in the MOUs and/or respective agreements.	While amendments to Cooperative Societies Acts (CSAs) enhance autonomy, the changes to rules and regulations have to be notified (all participating states) to give effect to autonomy. CCS has been directed to provide credit at predetermined interest rates to certain class of borrowers. The government has provided the related costs to the CCS to compensate the deficits in margin as a result of such lending.
Sch. 5, 8. In case of natural calamities and unforeseen circumstances that affect the equity and liquidity of the CCS, ADB will be consulted immediately and a remedial action plan acceptable to ADB prepared.	The government's announcement of ADWDR Scheme for mitigating farmer distress as a public policy measure was widely publicized. The government announced the advance release of funds for ADWDR scheme to ease implementation constraints. All participating lending institutions are expected to receive funds for the waivers and relief granted to eligible farmers.
Accounts and Disbursements	
Sch. 5, 9(a) Without limiting the generality of paragraph 4 of schedule 3 of the loan agreement, in addition to the deposit account, the government through ED, shall cause NABARD to maintain separate records and accounts on the use of program funds following sound accounting principles, and shall have such accounts and records audited annually by auditors acceptable to ADB, and shall furnish, within six months of the close of the financial year, certified copies of the	Being complied with.

Covenant	Comments and/or Compliance
audit reports together with the auditor's opinion to the ED, ADB, and KfW.	
Sch. 5, 9(b) Considering the large number of entities covered by the program, NABARD shall additionally confirm to the ED, the usage of funds for the purposes of the program (recapitalization, audits, human resources development, and implementation costs) in the participating state.	Being complied with. NABARD submits audited accounts with regard to expensed incurred for CCS reforms in the participating states.
Safeguards and Social Issues	
Sch. 5, 10. The government through the ED shall cause NABARD and participating states to ensure that activities under the program, if become applicable, shall be carried out in accordance with the applicable safeguard policies of ADB (i.e., involuntary resettlement policy, 1995, environment policy, 2002, and indigenous peoples policy, 1998) and related laws and regulations of the government and/or participating state.	No resettlement activities are envisaged.
Information Sharing, Review	
Sch. 5, 11. Without limiting the generality of sections 7.04 and 7.05 of the loan regulations, (i) The government will keep ADB informed of modifications if any in the CCS reform package in so far as these may impact the program in any manner. (ii) As and when CCS reforms are supported by other agencies, the ED shall facilitate coordination amongst the various agencies. (iii) The ED shall regularly exchange views and information with ADB and KfW on any problems, constraints encountered during the program implementation to address any changes to overcome or mitigate these.	No substantive modifications have been made. The high-level NIMC periodically reviews implementation and takes measures as necessary for facilitating implementation.
Stakeholder Participation	
Sch. 5, 12(a) The government will ensure that all activities, documents, and enactments under the program are undertaken in consultation with relevant stakeholders and their feedback incorporated as appropriate in finalizations; through proper institutional mechanisms in place for communication and feedback on all relevant policy actions from stakeholders.	Different mechanisms set up for stakeholder involvement has been used such as the NIMC, SLICs, DLICs, and state level task forces. Opportunities for receiving feedback has also been created through the democratically elected boards of different tiers of the CCS where user members of the of the CCS hold office.
Sch. 5, 12(b) The government will take all steps necessary to ensure that relevant enactments including amendments to existing laws under the agreements reached with the government are (a) undertaken with full stakeholder participation and views thus provided are incorporated as appropriate; (b) tabled in the Parliament and/or state legislatures, respectively, for consideration and enactment well in time and in sync with related tranche release requirements, and (c) brought into force, and implemented effectively.	The legislative changes have been discussed with cooperatives in the different states even at the time of signing the MOU with the government and NABARD. In some states NABARD had discussions with representatives of CCS to explain the benefits of proposed changes to the CSA and the need for state governments to agree to the reform agenda. The CSA was amended on this basis. Consultations and the need to arrive at

Covenant	Comments and/or Compliance
	consensus have taken more time but have been useful in taking the CCS reform agenda forward.
Performance Monitoring, Reports	
Sch. 5, 13(a), (b), (c) Without limiting the generality of Section 7.04 of the loan regulations (a) The government shall through the ED, cause NABARD to set up by not later than January 2007, a PPMS was agreed on with the ADB and cause it to be operated by NABARD throughout the program implementation at the participating states. Under PPMS, the government through the ED shall periodically review the program, drawing on requirements, benefit monitoring, progress, and achievements under the program; (b) The government through the ED shall require NABARD to provide biannual PPMS reports to the ED and ADB within two months of the end of each half-year; and (c) Regular review missions and midterm review mission around June 2008 shall be undertaken by ADB, KfW, the government through the ED, NABARD, and participating states, that shall include evaluation of program scope, implementation, progress, reform agenda, capacity building, disbursements to end beneficiaries, governance, anticorruption risk assessment and related matters. The reviews shall include modifications and improvements in achieving the overall objectives of the program.	The monitoring mechanism set up by NABARD (SLIC and DLIC) produces monthly participating-state wise progress updates. The government also reviews the progress through NIMC meetings. The benefit monitoring will be set during further implementation since impacts would be available once the reform process has run it its full course. NABARD updates the progress every month on its website. Midterm review was undertaken to coincide with the completion of tranche three actions.
Technical Assistance	
Sch. 5, 14(a) In carrying out policy measures and activities under the program and policy matrix, the government through the ED shall cause NABARD and participating states to ensure that recommendations provided under the technical assistance are duly considered for appropriate adoption in a timely manner in consultation with ADB; and (b) as and when other agencies support the program for the CCS reforms the ED shall facilitate coordination of related inputs.	Technical assistance activities under the program were cancelled after consulting with all stakeholders.
Compliance Status with Particular Covenants in Loan Agreement	
Section 4.01 (a) The government shall cause the program to be carried out with due diligence and efficiency and inconformity with sound administrative, financial, environmental, and rural credit practices. (b) In the carrying out of the program, the government shall perform, or cause to be performed, all obligations set forth in schedule 5 of the loan agreement	Being complied with.
Section 4.02 The government shall make available, promptly as needed, the	Being complied with.

Covenant	Comments and/or Compliance
funds, facilities, services, and other resources which are required, in addition to the proceeds of the loan, for the carrying out of the program.	
Section 4.03 The government shall ensure that the activities of its departments and agencies with respect to the carrying out of the program are conducted and coordinated in accordance with sound administrative policies and procedures.	Being complied with.
Section 4.04 (a) The government shall maintain, or cause to be maintained, records and documents adequate to identify the eligible items financed out of the proceeds of the loan and to indicate the progress of the program. (b) The government shall enable ADB's representatives to inspect any relevant records and documents referred to in paragraph (a).	Being complied with.
Section 4.05 (a) as part of the reports and information referred to in section 7.04 of the loan regulations, the government shall furnish, or cause to be furnished, to ADB all such reports and information as ADB shall reasonably request concerning (i) the counterpart funds and the use thereof; and (ii) the implementation of the program, including the accomplishment of the targets and carrying out of the actions set out in the policy letter. (b) Without limiting the generality of the foregoing or section 7.04 of the loan regulations, the government shall furnish, or cause to be furnished, to ADB biannual reports on the carrying out of the program, and on the accomplishment of the targets and carrying out of the actions set out in the policy letter.	Being complied with.

ADB = Asian Development Bank, ADWDR = Agricultural Debt Waiver and Debt Relief, CCS = cooperative credit structure, CSA = cooperative societies act, DLIC = district level implementation committee, ED = executing department, IA = implementing agency, MOU = memorandum of understanding, NABARD = National Bank for Agriculture and Rural Development, NIMC = National Implementation and Monitoring Committee, PPMS = program performance management system, RRP = report and recommendation of the President, SLIC = state level implementation committee.

Source: ADB. 2006. *Report and Recommendation of the President to the Board of Directors: Proposed Program Loan and Technical Assistance Grant for Rural Cooperative Credit Restructuring and Development Program in India.* Manila.

OVERVIEW OF THIRD TRANCHE REFORM ACTIONS ACROSS STATES

A. Introduction

1. The Rural Cooperative Credit Restructuring and Development Program (RCCRDP) provides support to strengthen the short term cooperative credit structure (STCCS) to enable it to become a vibrant and viable agency for supporting the rural economy. The RCCRDP has four tranches that provide a phased release of assistance to recapitalize the cooperatives in five states, subject to meeting tranche release conditions. The tranche conditions are sequenced to enable governance, financial, and operational reform of the cooperative institutions. With particular reference to the third tranche, several critical reforms actions are envisaged relating to broad-basing the nature of the board composition of the cooperative institutions, democratizing their functioning, assessing accumulated losses, and actual financial strengthening. This appendix seeks to provide an overview of the context of key reform actions under the third tranche.

B. Population, Income, and Public Policy

2. Similar to India's overall pattern, about 65%−75% of the population of the participating states live in rural areas. Grassroots membership in the primary agricultural credit societies (PACSs) is significant in India, covering about 17.5% of the rural population. Andhra Pradesh significantly exceeds this average with 30%, while Gujarat and Rajasthan are significantly below that average with about 10%. Per capita income in Gujarat and Maharashtra largely exceed the national average, while for Madhya Pradesh, Orissa, and Rajasthan, the figures are substantially lower. Except for Maharashtra, where literacy exceeds the national average by 12 percentage points, overall literacy rates in the other participating states are close to the national average. However, a substantial divide exists between male and female literacy. In particular, in Rajasthan, male literacy exceeds that of females by 30 percentage points. Literacy in the rural areas of most of the participating states is slightly below the national average. Compared to the national average, poverty is more pronounced in Orissa and Madhya Pradesh. The characteristics of participating states underline the importance of well-functioning rural finance institutions, especially the cooperative credit structure (CCS) that has very substantial coverage at the grassroots level. Table A3.1 provides an overview of the social and demographic character of the cooperative institutions.

Table A3.1: Social and Demographic Indicators, India and Participating States
(as of 2001, in Rs billion)

Indices	India	Andhra Pradesh	Bihar	Maharashtra	Madhya Pradesh	Rajasthan
Population (million)	**1,027**	76	83	97	60	56
Rural Population (% of total)	**72**	73		55	73	77
Cooperative Members (million)	**135**	17.0		10.3	6.2	4.7
Number of Districts	**604**	23	31	35.	45	32
Number of Villages	**638,000**	26,586	45,103	43,722	51,806	41,353
GDP per capita (Rs)	**20,989**	20,757	5,909	29,204	14,011	14,748
GDP per capita in % of India	**100**	99	27	139	67	70
Population below Poverty Line (%)[a]	**25**	16		25	37	15
Human Development Index 2001	**0.47**	0.42		0.58	0.39	0.42
Literacy Rate (%)	**65**	61	47.53	77	64	61
Male Literacy Rate (%)	**76**	71	60.32	86	77	76
Female Literacy Rate (%)	**54**	51	33.57	68	51	44
Rural Literacy Rate (%)	**59**	55		71	58	56

GDP = gross domestic product.

[a] The Planning Commission defines the poverty line as a per capita monthly expenditure of Rs49 in rural and Rs57 in urban areas at 1973–1974 prices. This corresponds to expenditure sufficient to provide, in addition to basic non-food items (clothing and transport), a daily intake of 2,400 calories in rural areas and 2,100 calories in urban areas.

Source: Census 2001, National Human Development Report (2001).

C. Nature and Scale of the Cooperative Network for Rural Credit

3. The short-term CCS is organized into three tiers─state cooperative banks (SCBs), district central cooperative banks (DCCBs), and PACSs at the village level. While the national CCS at the SCB and DCCB levels draws major resources from deposits, in Andhra Pradesh and Orissa it relies in a major way on borrowings from the National Bank for Agriculture and Rural Development (NABARD). PACSs are not licensed as banks and are prohibited from taking deposits. However, laws of some participating states allow PACSs to operate as mini banks. While SCBs and DCCBs are to supervise the lower tiers of the CCS, inadequate resources and lack of automation currently make it impossible to fulfill this mandate. Table A3.2 illustrates the structure and size of the CCS in the participating states.

4. With more than 106,000 outlets, averaging one ground-level credit cooperative for every six villages, the cooperative system has a total membership of more than 120 million rural people, making it one of the largest rural financial systems in the world. Commercial banks and regional rural banks (RRBs), the two other purveyors of credit in the multiagency framework, have also increased their rural penetration with nearly 50,000 rural and/or semi-urban branches. However, the cooperatives dominate in their reach to the rural hinterland both in terms of the number of clients and accessibility to the small and marginal farmers and other poorer segments of the population. In terms of number of agricultural credit accounts, the STCCS has 50% more accounts than the commercial banks and RRBs put together.

Table A3.2: Structure and Size of the Cooperative Credit Structure
(as of 31 March 2004, in Rs billion)[a]

Item	India	Andhra Pradesh	Bihar	Maharashtra	Madhya Pradesh	Rajasthan
SCB Number	**31**	**1**	**1**	**1**	**1**	**1**
Assets	678	63		178	25	24
Deposits	435	19		134	16	11
Borrowings	162	31		14	6	10
DCCBs Number	**368**	**22**	**20**	**31**	**38**	**27**
Assets	1,257	90		333	65	41
Deposits	792	25		248	39	23
Borrowings	202	47		23	12	13
PACSs[b] number	**105,735**	**4,779**	**5397**	**20,952**	**4,526**	**5,252**
Total Assets	688	53		89	32	17
Deposits	181	3		1	3	1
Borrowings	493	43		71	25	16

DCCB = district central cooperative bank, PACS = primary agricultural credit society, SCB = state cooperative bank.
[a] Financial information provided throughout the cooperative credit structure is not reliable since audits are not conducted independently.
[b] Primary Agricultural Credit Societies in Andhra Pradesh, Madhya Pradesh as of 31 March 2002.
Source: National Bank for Agriculture and Rural Development.

D. Impairment in Governance

5. The PACSs constitute the grassroots tier of the CCS and typically have 1–2 staff. The strength of PACSs lies in their closeness and accessibility to village clients, who would incur high travel costs to access the branch network of the DCCBs. Since the CCS has so far largely functioned as state government supply system for agriculture credit, the business of PACS is not limited to financial services but also includes services of input supply and marketing of crops. Because of the absence of democratic structures for the management of PACSs, onsite controls and accountability through the board is essentially nonexistent. The lack of democratic ownership and

responsibility has been compounded by political interference, lack of skills among PACSs staff, and inadequate supervision by the DCCBs.

6. Where reports exist, these usually point to extremely high levels of impaired assets. Although deposit mobilization is limited at the PACSs, some PACSs mobilize significant amounts without being under an appropriate regulatory umbrella. This creates significant contingent liabilities for the state governments if the PACSs are unable to repay depositors. The National Bank for Agriculture and Rural Development (NABARD) reports that almost 60% of all PACSs were unprofitable, and in Andhra Pradesh and Orissa, about 80% of PACSs are reportedly making losses. In Andhra Pradesh and Rajasthan, virtually no audit reporting exists that refers to the last 3 financial years. The absence of basic business skills, systems, and controls at the PACSs level, and the high level of impaired loans, has led to an almost complete erosion of equity and deposits. As a result, a rigorous audit would likely result in most PACSs being classified as insolvent. It is critical to establish simple accounting and audit frameworks, and conduct audits to establish a bottom line as to which PACSs could become viable and which should be closed or integrated into other local service structures. Once audits are completed, it will be important to recruit and train staff to acquire the basic skills to restore the remaining PACSs into functional entities. Table A3.3 shows the statutory audits as of 31 March 2004.

Table A3.3: Statutory Audits
(as of 31 March 2004)

Institution	Audit Grade[a]	Andhra Pradesh	Bihar	Maharashtra	Madhya Pradesh	Rajasthan
SCBs	A	Yes		…	Yes	Yes
	B	…	…	Yes	…	…
DCCBs	A	2	…	8	10	…
	B	3	…	4	1	22
	C	7	…	…	…	4
	D	10	…	11	27	1
Total Audited		22		23	38	27
% Unsatisfactory (C and below)		77		48	71	19
PACSs	**(31 March 2002)**					
PACSs	A	271	…	…	…	…
	B	409	…	…	…	…
	C	2,764	…	…	…	…
	D	271	…	…	…	…
Total Audited		3,715	…	…	…	…
% Unsatisfactory (C and below)		82		100	100	100

… = not available, DCCB = district central cooperative bank, PACS = primary agricultural credit society, SCB = state cooperative bank.
[a] A is rated best and D is worst. B and C are rated unsatisfactory.
Source: National Bank for Agriculture and Rural Development.

7. **Legal Framework.** Cooperative societies acts (CSA) promulgated by the participating states govern the CCS. The CSAs allow for the constitution of the CCS as member-owned entities. However, the CCS has become an instrument of state intervention in the rural economy. The CSAs assign excessive powers to the registrar of cooperative societies (RCS) in governance and day-to-day business decisions. For example, the RCS in Rajasthan is concurrently the administrator of the SCB, which points to conflicting business and supervision mandates. To restore the true essence of cooperatives, a few states—Andhra Pradesh, Madhya Pradesh, and Orissa among them—have since the mid-1990s established new parallel cooperative acts that expressly preclude state ownership and restrict the powers of the RCS. However, the CSAs do not contain provisions for enabling existing CCS institutions to migrate to parallel cooperative acts. As a result, confusion and operational complications abound at all levels. The clauses in the CSAs enabling states to interfere with the democratic nature of the cooperative institutions has resulted in cooperative boards losing their democratic character as reflected in Table A3.4.

Table A3.4: Board Existence and Selection
(as of 31 March 2003)

Item	Andhra Pradesh	Bihar	Maharashtra	Madhya Pradesh	Rajasthan	Total
SCBs						
Elected Board	…	…	Yes	Yes	…	…
Superseded Boards	Yes	…	…	Yes	Yes	…
of which Nominated Board	Yes	…	…	Yes	…	…
of which Administrator	…	…	…	…	Yes	…
DCCBs (number)	22	…	31	38	27	153
Elected Board	…	…	23	4	…	43
Superseded Boards	22	…	8	34	27	110
of which Nominated Board	22	…	…	…	…	41
of which Administrator	…	…	8	34	27	69

… = not available, DCCB = district central cooperative bank, SCB = state cooperative bank.
Source: National Bank for Agriculture and Rural Development.

E. Financial Condition

8. Notwithstanding their formidable presence in terms of number and reach, financial health has been a matter of perennial concern. While the commercial banks had a gross nonperforming assets level of 3.3% and RRBs had a level of 7.26%, the overdue loans for cooperatives were as high as 32.48% as of March 2006. The poor financial health of the cooperatives raises the questions of whether the cooperatives can be seen as sustainable financial entities.

9. NABARD's inspection and supervision in 2005 identified seven SCBs in India that had substantially eroded capital reserves, and even deposits, as a result of large nonperforming loans. This figure would increase substantially if standards similar to commercial banks were applied. Although SCBs in the participating states are reported to be making profits, the extremely high level of impaired assets and the high proportion of loans classified in the doubtful and loss categories raises questions as to the profitability and solvency of the SCBs, especially in Andhra Pradesh, Maharashtra, Orissa, and Madhya Pradesh, as well as the remaining SCBs if norms at par with commercial banks are applied. The high level of impaired assets mainly reflects the adverse impact of nonperforming loans in the lower CCS tiers on the system as a whole.

10. NABARD reports a high number of loss-making DCCBs, which account for more than 20% of DCCBs in the participating states. NABARD's inspection and supervision in 2005 highlights the extremely poor collection of dues by DCCBs, especially in Andhra Pradesh, Maharashtra, and Orissa, where more than one-third was unable to recover 60% of dues. The high proportion of impaired loans, which ranges from 16% to 29% of the aggregate DCCB loan portfolio, underscores the severity of the problem. The poor portfolio quality raises serious questions as to the liquidity, profitability, and solvency, which would be largely overstated if Reserve Bank of India asset classification and accounting standards are applied. DCCBs are currently unable to adequately underwrite and monitor loans at the district and village levels, and the absence of automation and proper accounting and audit processes undermines the integrity and timeliness of management information.

11. Because of the absence of democratic structures for the management of PACSs, on-site controls and accountability through the board is essentially nonexistent. The lack of democratic ownership and responsibility has been compounded by political interference, lack of skills among PACSs staff, and inadequate supervision by the DCCBs. Where reports exist, these usually point to extremely high levels of impaired assets. Although deposit mobilization is limited at the PACSs level, some PACSs mobilize significant amounts without being under an appropriate regulatory umbrella. This creates significant contingent liabilities for the state governments if the PACSs are unable to repay depositors. NABARD reports that almost 60% of all PACSs were unprofitable, and in Andhra Pradesh and Orissa, about 80% of PACSs are reportedly making losses. In Andhra Pradesh and

Rajasthan, virtually no audit reporting exists that refers to the last 3 financial years. The absence of basic business skills, systems, and controls at the PACSs level, and the high level of impaired loans has led to an almost complete erosion of equity and deposits. As a result, a rigorous audit would likely result in most PACSs being classified as insolvent. It is critical to establish simple accounting and audit frameworks, and conduct audits to establish a bottom line as to which PACSs could become viable and which should be closed or integrated into other local service structures. Once audits are completed, it will be important to recruit and train staff to acquire the basic skills to restore the remaining PACSs into functional entities. Consequently, the RCCRDP provides for a phase wise release of assistance designed to correct deeply embedded political, institutional, governance and financial gaps at all tiers of the CCS institutions that predicate release of financial assistance. Tables A3.5, A3.6, and A3.7 show the key financial indicators of state cooperative banks, district central cooperative banks, and primary cooperative societies, respectively.

Table A3.5: State Cooperative Banks, Key Financial Indicators
(as of 31 March 2004)

Item	India	Andhra Pradesh	Bihar	Maharashtra	Madhya Pradesh	Rajasthan
Total Assets	678.4	63.1		177.7	25.1	24.1
Loans	351.1	51.6		76.4	17.0	15.3
Deposits	434.9	18.7		134.0	15.5	11.4
Borrowings	162.0	31.2		14.0	6.4	9.5
Equity and Reserves	81.5	13.2		29.7	3.2	3.2
Loans to Deposits (%)	81	276		57	110	134
Market Share Deposits (%)	…	2			3	2
Market Share Loans (%)	…	7		10	6	1
Impaired Loans/Loans (%)	19	19		37	10	2
Doubtful and Loss Loans/Loans (%)		3		18	6	2

… = not available.
Source: National Bank for Agriculture and Rural Development.

Table A3.6: District Central Cooperative Banks, Key Financial Indicators
(as of 31 March 2004)

Item	India	Andhra Pradesh	Bihar	Maha-rashtra	Madhya Pradesh	Rajasthan
Total Assets	1,259.6	90.5		333.0	65.0	41.1
Loans	671.5	70.0		173.6	47.8	27.8
Deposits	791.5	24.7		248.2	39.2	22.7
Borrowings	202.1	46.9		23.6	12.4	13.1
Equity and Reserves	263.3	18.9		61.2	13.4	5.3
Loss making DCCBs (%)	…	5		32	37	4
Loans to Deposits (%)	85	284		66	96	125
% of Districts Exceeding l/d of 1/1 (%)	…	100		29	79	70
Market Share Deposits (%)	…	2		6	4	5
Market Share Loans (%)	…	10		22	12	2
Impaired Loans/Loans (%)	23	16		25	29	11
Doubtful and Loss Loans/Loans (%)	…	6		14	13	4

… = not available, DCCB = district central cooperative bank, l/d = loan to deposit.
Source: National Bank for Agriculture and Rural Development.

Table A3.7: Primary Cooperative Societies, Financial Indicators
(as of 31 March 2004, in Rs billion)

Item	Andhra Pradesh[a]	Bihar	Maharashtra	Madhya Pradesh	Rajasthan
Status (financial year)	**2004**		**2003**	**2001**	**2003**
Total Assets	53.0		88.6	32.2	17.4
Loans	43.1		67.9	21.9	12.8
Deposits	3.0		1.3	3.4	1.0
Borrowings	43.0		70.6	25.0	15.9
Equity and Reserves	9.0		16.7	3.8	6
PACSs Reported Loss Making (%)	81		62	57	35
Proportion of Audits Overdue > 3 years (%)	100		35	0	100
Total Impaired Assets	11.3	46.44	…	…	…
In % of Loans Outstanding (%)	28		…	…	…

… = not available, PACS = primary agricultural credit society.
[a] Andhra Pradesh reports on profitability and asset quality are of fiscal year 2001.
Source: National Bank for Agriculture and Rural Development.

F. Conclusion

12. The above analysis seeks to underline the scope and scale of the reform agenda. The absence of a strong reform agenda will weaken the cooperative structure and the financial inclusion agenda of the government. This is under scored by the fact that, with 135 million members (41 million in the five participating states), there is significant scope for using the CCS as a viable instrument for expanding rural credit, especially to the asset poor. The analysis also seeks to highlight the extent of impairment in the CCS structure and the provide data on the extent of impairment. Given the same, it is evident that, without a structured reform agenda, CCS institutions will not be able to undertake their assigned task.

DOCUMENTATION IN SUPPORT OF THIRD TRANCHE ACTIONS

Third Tranche Action	Documentation Received
1. Government completes first stakeholder consultation on the assessment of CCS reform undertaken by the independent agency and as required, advises stakeholders on appropriate measures to address related feedback on the assessment. **(Assessment Report of the independent agency to the government and the report on stakeholder consultation from the government to the Asian Development Bank [ADB]).**	**Documentation** State-wise assessment reports Stakeholder consultations on 26 November 2010
2. The government makes budgetary provision to support CCS reforms. **(Letter indication provisions**)	Letters and documents providing audited amounts of funds released by government
3. All participating states make budgetary provisions to support CCS reforms. **(Letter indication provisions**)	Letters and documents providing audited amounts of funds released by participating states
4. Participating states enact legislation amending the CSAs. **(Amended CSAs as notified and in force)**	Amended CSAs and gazette notifications from participating states.
5. Participating states issue rules and regulations as required under the amended CSAs. **(Rules and regulations issued/notified by participating states)**	Letters from the government indicating participating state-wise status on issuance of rules and regulations by tier.
6. Based on the assessment under the earlier tranche, if required, NABARD Act, 1982 is amended. **(Amended Acts notified and in force)**	Letter from the government indicating progress towards seeking Act amendment.
7. Based on the assessment under the earlier tranche, if required, Deposit Insurance and Credit Guarantee Corporation Act, 1961 is amended. **(Amended Acts notified and in force)**	Complied as per second tranche actions.
8. Bank Regulation Act, 1949, is amended. **(Amended Acts notified and in force)**	RBI executive order on fit and proper criteria RBI and NABARD circulars on enforcement of prudential regulations
9. Supervision and regulation of CCS classified as banks are undertaken in the participating states in accordance with the amended CSAs. **(Draft SCB and DCCB prudential norms)**	Approved and enforced prudential norms for DCCBs and SCBs.
10. Prudential norms for CCS (SCBs and DCCBs) and eligibility for board of directors and chief executive officers are developed based on amended Bank Regulation Act, 1949, and applied on the CCS (SCBs and DCCBs). **(Impact on net worth of SCBs and DCCBs)**	Net worth analysis provided in the independent assessment reports NABARD net worth estimates from supervisory audits
11. Participating states government nominees on PACSs boards withdrawn. **(Participating statewide notifications and numbers of nominees withdrawn)**	Letter from the government and data providing participating state-wise number of nominees withdrawn.
12. Participating states hold elections in the CCS and install new boards of directors and office bearers in all the SCBs and half of the number of DCCBs. **(Participating state-wise list of DCCBs and SCBs)**	Government letter providing participating state-wise list of DCCBs and SCBs where election held Amended CSA and gazette notification requiring elections.

Third Tranche Action	Documentation Received
13. Participating states complete reduction of equity to a maximum level of 25% of the capital at any level of the CCS and convert the equity over 25% to grants to the CCS. **(Participating state-wise list of DCCBs and SCBs)**	Government letter providing participating state-wise list of equity holding. Amended CSA and gazette notification requiring limiting of government equity to 25%.
14. Participating states government nominees on boards of SCBs and DCCBs limited to one. **(Participating states notifications)**	Government letter providing list of government nominees Amended CSA and gazette notification requiring limiting of government nominees to one.
15. Directors on boards of all CCS (SCBs and DCCBs) not meeting the approved criteria are to be identified by participating states. **(Participating states notifications)**	Government letter providing list of directors not meeting approved criteria Amended CSA and gazette notification requiring board members to meet approved criteria RBI circular on fit and proper criteria for board members and chief executive officers.
16. CCS (SCBs and DCCBs) terminate the tenure of directors on CCS boards representing defaulting PACSs. **(Participating states notifications)**	Amended CSA and gazette notifications requiring termination of directors representing defaulting PACS.
17. Rating of SCBs conducted by approved rating agency. **(Rating results of SCBs)**	Rating results of SCBs.
18. NABARD implements in all participating states the (i) accounting standards, (ii) management information system including internal control and audit systems, (iii) computerization plan, and (iv) human resources development plan for the CCS. **(Qualitative and quantitative progress)**	Letter from government providing qualitative and quantitative progress on adoption of accounting standards, etc.
19. Special audits (to assess the extent of accumulated losses as of 31 March 2004) of PACSs completed in all participating states. **(Participating state wise number of PACS audited)**	Letter from government providing participating state-wise list and number of audited PACS.
20. Participating states implement plans to phase out cadre-based secretaries in PACSs. **(Participating state wise implementation details)**	Letter from government providing participating-state implementation details.
21. Eligible PACSs adopt APRs and/or DAPs in all participating states. **(Participating state district-wise number of PACS adopting APRs/DAPs)**	Letter from government providing participating state-wise list of PACS adopting DAP and business development plans.
22. A plan for ineligible PACSs developed and implementation commenced in participating states that have ineligible PACSs. **(Participating state-wise Plan for ineligible PACS and status of PACSs brought under the Plan for Ineligible PACS)**	Letter from government providing participating state-wise list of identified ineligible PACS.
23. Support is provided by NABARD for cleaning accumulated losses of eligible PACSs in participating states that meet benchmark requirements of the MOUs. **(Participating state-wise number of PACS and amount)**	Letter from government providing audited amounts released by NABARD for cleaning accumulated losses.
24. Eligible DCCBs adopt APRs and/or DAPs. **(Participating state-wise APRs and/or DAPs**	Letter from government providing NABARD circular on adoption of APRs and/or DAPs by participating

Third Tranche Action	Documentation Received
adopted).	states Participating state-wise list of DCCBs adopting APRs and/or DAPs
25. Special audits (to assess the extent of accumulated losses as of 31 March 2004) of DCCBs completed in all participating states. **(Participating state-wise list of DCCBs audited)**	Letter from government providing participating state-wise list of DCCBs audited.
26. Support is provided by NABARD for cleaning accumulated losses of DCCBs in participating states that meet benchmarks requirements of the MOUs. **(Participating state-wise number of DCCBs and amount)**	Minutes of NIMC meeting providing details of participating states meeting benchmark requirements
27. SCBs adopt APRs and/or DAPs. **(APRs and/or DAPs adopted by SCBs)**	Letter from government providing NABARD circular on adoption of APRs and/or DAPs by participating states Participating state-wise list of SCBs adopting APRs and/or DAPs
28. Special audits (to assess the extent of accumulated losses as of 31 March 2004) of SCBs is completed in all participating states. **(Audit findings)**	Letter from government providing audit findings
29. Support is provided by NABARD for cleaning accumulated losses of SCBs in participating states to meet benchmark requirement of the MOUs. **(SCB wise amount)**	Minutes of NIMC meeting providing details of participating states meeting benchmark requirements.

ADB = Asian Development Bank, APRs = Action Plans for Revival, CCS = cooperative credit structure, CSAs = Cooperative Societies Acts, DAPs = Development Action Plans, DCCBs = district central cooperative banks, MOU = memorandum of understanding, NABARD = National Bank for Agriculture and Rural Development, NIMC = National Implementation and Monitoring Committee, PACSs = Primary Agricultural Credit Societies, SCBs = state cooperative banks.
Source: National Bank for Agriculture and Rural Development.