# Expert Committee on the Formation of Kerala Co-operative Bank

**Final Report**

**Chapter 1: Introduction to the issues, discussion of the terms of reference and process.**

1.1 Kerala has historically had a strong co-operative structure, working in diverse fields. The financial co-operative structure in the state has also been strong, and has been performing much better than many other states in India. A large part of the success story of the Kerala co-operatives can be explained by the very strong base the co-operative structure has at the primary level. The Primary Agricultural Cooperative Societies (PACS) represent the most critical and foundation of the co-operative structure. These are called by different nomenclature – Farmers' Service Co-operative Societies; Primary Agricultural Credit Cooperative Societies; primary co-operative rural banks; multipurpose co-operative societies etc, but undertake the basic function of financial intermediation of collecting deposits from members and purveying agricultural credit. These co-operatives have federated at the district level to form the District Co-operative Banks (DCBs) and they in turn have federated at the state level to form the Kerala State Co-operative Bank (KSCB).

1.2 The three-tier structure of co-operatives is the model that we have adopted across the country, with some exceptions of states in the north east and other smaller regions. As per the records of the National Federation of State Co-operative Banks (NAFSCOB), 19 states in the country have a three-tier structure while the other 10 states have a two tier structure. Historically there have been valid reasons for the co-operatives to have a three-tier structure. However, in the changing circumstances, there have been significant structural changes in the rural co-operative banking structure worldwide, and it is an appropriate time for us to review the structure with a view to provide better services to the members of the primary co-operatives. The Kerala Government has decided in principle to merge/amalgamate the DCBs and the KSCB into a single entity and an Expert Committee has been appointed to draw up a roadmap. The order of constitution of the committee and its terms of reference are appended to this chapter.

Logic of the three-tier structure

1.3 There was logic in the three-tier structure from a pure banking perspective. The PACS operate in a limited area and have limited number of members. These members are typically the smaller customers and these customers are not found to be interesting to the mainstream banking system because of the type of documentation and transaction trail they could produce to make them bankable. In addition, these customers also traditionally deal in very small amounts, thereby making it difficult for the banks to cover the transaction costs and profit margins. As a result of the recommendations of the All India Rural Credit Survey Committee the country adopted a strategy of setting up co-operatives throughout the country with state partnership – to ensure that the poor and dispossessed came into the mainstream banking system.

1.4 The above description by definition makes the customers to be classified as risky. Moreover, since PACS work in a limited area of operation, it exposes itself to two types of risks – the geographic concentration risk and the portfolio concentration risk. Therefore, any adverse event is likely to have a big impact on the solvency of the primary. One way of dealing with these risks is for the primaries to diversify beyond financial activities and have trading activities which give margin buffers. Successful co-operatives such as Peringandoor, Mannarkad Rural, Kizhathadiyoor, Cheruthazham, Peroorkada Service Co-operative Banks have demonstrated that profitable non-financial activities help the co-operatives to grow over the years. While there is great merit in having the primary co-operatives as such and strengthen them, it is important to look at the functions of the two upper tier co-operatives.

1.5 The DCBs on the other hand were seen as an intermediate tier institutions. The banking logic of DCBs were that they would a balancing institution which absorbs surplus liquidity from primaries (where savings exceeds credit) and deploy credit to other primaries which need funds. Under a normal situation, this would be a classic banking function, except that in the agricultural sector, the need for credit gets concentrated seasonally where most of the primaries by virtue of a majority of their clients being in similar occupations need credit simultaneously. Therefore, this credit is to be funded from other sectors of the economy and a DCB was capable of sourcing deposits from other sectors and deploy it to the sectors in that the primaries are involved in. By the banking logic, while there was a strong case for DCBs to collect deposits in order to lend to primaries, there was no strong logic for DCBs to directly lend to individuals (who could have been members of the primaries). The logic of DCBs lending to other sectors should be seen as a purely balancing business act of deploying surplus resources generated at the district level after meeting the needs of the primaries. This gives the primaries a cushioning mechanism and helps to deal with the regional variations through an intermediary agency.

1.6 The function of the KSCB, therefore is similar to that of the DCBs, except that the KSCB is expected to do this function at the state level looking at the imbalances between the districts. Therefore, from a banking logic the functionality of the DCB and the KSCB is the same.

1.7 Historically, most of the co-operative sector across the country has been credit oriented, wherein the savings of the members at the primary level has been minimal and most of the members have leveraged themselves on significant multiples and that has moved upwards to the DCB and the KSCB. The co-operative sector thus survives on the basis of the refinance arrangements from the banking system, particularly the National Bank for Agriculture and Rural Development (NABARD). Since the primaries in other parts of the country were not (in general) raising local resources, the dependence on the district and state entities were much higher. The three-tier structure emerged with the logic of local connect that would help the DCBs to raise more deposits. That is the reason why we find that in general in a given state the DCBs together command much more resources than the SCBs.

1.8 Since the co-operative system evolved mostly on the basis of credit, there has been some concerns expressed by the regulators about their governance structure and governance logic. These concerns come from well tested banking principles. A set of borrowers being on the governance of a bank is seen as a conflict of interest. Worldwide, the banking governance ensures that the board members of banks do not borrow from the same bank and in case of India, if a board member has to borrow (irrespective of which bank she holds the position and which bank approves the loan), the case has to be ratified by the management committee of the board. Therefore, there have been questions about how solid the governance systems are in the co-operative banking system. The committee considered this issue in formulating its recommendations.

1.9 The Kerala co-operative system have evolved differently compared to the other parts of the country. The primaries in Kerala raise significant deposits and have a good connect with the members and a significant market share. The DCBs not only deal with the primaries, but have their own business, including loans to individuals who could potentially be members of the primary. The SCB is relatively weak in comparison to the collective power of the primaries and the DCBs.

1.10The idea of any reform or reorganization has to be driven by a sound logic of what the change is about, and why it is needed. However, the reform should not be at the cost of losing the basic co-operative and people oriented character. So, the approach of the committee has been to keep the soul of the movement in tact while examining how the objectives of the co-operatives could be enhanced more effectively. Therefore, we start by examining the co-operative principles and reiterating how the proposed reform is going to enhance and reinforce the co-operative principles (See Statement of Co-operative Identity appended to this chapter).

The importance of primaries

1.11Unlike other forms of financial intermediation – whether it is banks or non-bank finance companies, co-operatives are expected to deal only with members. The co-operative derives its identity as a co-operative from the member economic participation in the activities of the co-operatives. A bank by definition cannot be a co-operative because, by definition the bank deals with "public" deposits, which could be non-member deposits. However, there are co-operative banks across the world which continue to operate on co-operative principles by adding the customers as full members (using the principle of open and voluntary membership) or in some instances as non-voting members. However, this issue needs to be revisited. In order to be as near to the spirit of the co-operative principles as possible, it is important that the touch point of the members has to be based on the principle of mutuality and should be adhering to the co-operative principles and identity both in letter and spirit.

1.12 The PACS form the most important link in the banking chain. The PACS not only collect deposits from members, but also lend to members. Thus, the members are using both the financial services that appear on the assets as well as the liabilities side of the balance sheet of a primary. However, the primary co-operative will not be in a position to offer all the banking and financial services needed by the members on its own. That is because of the inherent nature of the structure of the financial services architecture, which in certain aspects expects significant amount of investment – both in terms of financial investment and technology. Typically, stand-alone primaries would find it difficult to offer interface based services to their members, services like remittance facilities; insurance and pension products; technology enabled – interoperable services like credit card, Automated Teller Machine (ATM) facilities and so on. For this, at present the co-operative network is accessing services of banking structures outside of the co-operative structure. While this is not so much of a problem, it would be much better if this is available in an institutional framework that is within the co-operative framework.

1.13 The committee firmly believes in not only retaining the member connect with the PACS, but also in strengthening the systems in order to ensure that the PACS are more transparent, accountable and responsive to the membership. There is also a general opinion that the co-operatives are not institutions that are well regulated and supervised, leading to a major issue with how these institutions are perceived by the people outside the co-operative sector, whether it is the regulator or the policy makers. In order to ensure that these financial institutions are robust, responsive member owned institutions but also safe and well-regulated institutions, the committee feels some proactive measures need to be taken to strengthen the primaries. The committee has some specific recommendations to this effect later in the report. However, the committee would like to state upfront that it believes that the current structure of the PACS – including all the activities that they are undertaking currently should not only be retained but also strengthened.

Process Adopted

1.14 The committee adopted a consultative and iterative process. The members of the committee met the elected boards of all the DCBs in their respective locations; it met with the board of directors of KSCB; the representatives of employees; the co-operative thought leaders; the planning board; members of the PACS association; representatives of the co-operative union; Directors of the co-operative training institutes; and with the representatives of the apex cooperative federations of non-credit societies. In all the meetings the committee tried to engage, listen and understand the concerns and considerations and got a ground level feel of the issues. While the committee did not present the blueprint in any of the meetings – as the blueprint was still evolving – it did present parts of the thinking process as questions and issues for discussion. Therefore, any of the steps presented in the report were discussed, not as specific proposals, but as postulates for which response was sought. (Details of the meetings held by the committee is given in Appendix 1.3)

1.15 The committee also invited representations and feedback from anybody who was interested in giving an input. A separate mail id eckcb@kerala.gov.in was specifically created to enable anybody to send in feedback. The secretariat classified the feedback into broad categories and placed it before the committee for its consideration. In addition to the other inputs, this was also a very significant input to the committee.

1.16 The committee met independently many times to look at technical issues – the financials, the situation of human resources and issues in technology.

1.17 The committee requested the State EGovernance Mission team to carry out a quick study on the assessment of the information technology issues, the level of adaption of technology, the readiness to switch to a common platform. The brief report of the State E Governance Mission team is appended to the report.

1.18 The committee considered all the inputs and went through multiple iterations in preparing the report. The final meeting of the committee was held in Hyderabad where the draft report was discussed threadbare and in great detail – the implications of the actions proposed were deliberated upon and the report was finalized in this meeting.

1.19While there was much debate on the approach of how the process of integration would happen, the committee evolved a common view and this report represents a considered and consensus view of all the committee members.

**Chapter 2: The emerging banking scenario, the situation in Kerala and the justification for reform and integration.**

2.1 The vision of providing modern banking facilities to the common people through easily accessible and locally acceptable cooperative banking system is possible only with extensive use of technology. The discussion paper prepared by Reserve Bank India (RBI) on Banking Structure in India-The Way Forward place considerable emphasis on the use of Technology in banks. It points out that the various expert committees on banking in India have favoured consolidation in the banking structure to create well capitalised, automated and technology oriented banks through mergers and acquisitions. The paper laments that in the absence of technology platform, the Urban Cooperative Banks (UCBs) have not been able to leverage the potential for financial inclusion. Surprisingly, and perhaps significantly, the discussion paper by RBI on the way forward for Indian banking structure do not include discussions on the way forward for the district cooperative banks and the State cooperative banks. Without going into the merits of the matter or attempting to evaluate the reasons for the conspicuous omission, it may be said without doubt that the cooperative banking system in Kerala plays an important role in serving the people and support the rural economy of the state. Apart from providing world class banking service and experience to direct customers of the DCBs and KSCB, millions of members of primary credit cooperatives in Kerala also deserve the access to modern banking facilities. KCB envisages fulfillment of this desire.

2.2 The district wise statistics of the commercial banks is given in the Table 2.1 below:

Table 2.1
District-wise details of Commercial Banks in Kerala as of March 2016

| DISTRICTS | No. of Branches | Deposits (Rs. Crore) | Loans (Rs.Crore) | CD Ratio (%) |
|---|---|---|---|---|
| Trivandrum | 655 | 50442.22 | 32217.07 | 63.87 |
| Kollam | 348 | 23276.16 | 13221.74 | 56.80 |
| Pathanamthitta | 361 | 29761.75 | 7710.49 | 25.91 |
| Alappuzha | 348 | 21677.91 | 9453.82 | 43.61 |
| Kottayam | 448 | 26531.58 | 13968.08 | 52.65 |
| Idukki | 166 | 3934.69 | 4808.64 | 122.21 |
| Ernakulam | 894 | 67518.43 | 57716.97 | 85.48 |
| Thrissur | 664 | 38176.21 | 21405.17 | 56.07 |
| Palakkad | 358 | 14849.47 | 9331.95 | 62.84 |
| Malappuram | 388 | 15295.65 | 8818.94 | 57.66 |
| Kozhikkode | 389 | 18462.51 | 13424.18 | 72.71 |
| Wayanad | 103 | 2065.46 | 2577.43 | 124.79 |
| Kannur | 352 | 18078.65 | 9602.27 | 53.11 |
| Kasaragod | 202 | 5207.98 | 4550.44 | 87.37 |
| TOTAL | 5676 | 335278.67 | 208807.21 | 62.28 |

2.3 The overall picture of Kerala shows that the banking in Kerala is well penetrated and better than the national average. In addition to the major state owned bank State Bank of Travancore (since merged with State Bank of India), Kerala is also home to many old generation private sector banks such as Dhanlaxmi Bank, Federal Bank, South Indian Bank, Catholic Syrian Bank etc. In addition, the new consolidated Kerala Gramin Bank (KGB) which has the best ATM network amongst all the Regional Rural Banks is also housed in Kerala with Malapuram as its headquarters. A new small finance bank – Esaf Small Finance Bank has also been licenced and is headquartered in Thrissur. Kerala is one of the best banked states in the country and amidst all this, the co-operatives have around 30% share in all parameters – bank branches, deposits and loans. However, one aspect is clear – the other banks in Kerala have adopted modern technology and are providing integrated services to their customers. While the co-operative sector in Kerala is strong, if it does not prepare well for the changed circumstances, it is most likely to lose its pre-eminent position to the other banks as it sees an intergenerational demographic shift.

2.4 The commercial banks (including the KGB) have a network of branches and ATMs and have enabled themselves technologically to provide inter-operable services to their customers. The co-operative system is making its attempts and all the fourteen banks are computerized with modern CBS systems. However, there is a need for these co-operatives to come together – using the principle of co-operation amongst co-operatives to have a networked solution which shows the power of the collective. The solution of having a collective platform – firstly on information technology and branding will not only help customization and member responsiveness at the PACS level, but will also put the co-operative spirit and the power of the collective at the centerpiece when it comes to competing at the market place. The power of the collective will also help the co-operative network to offer services that are based on size and are capital and technology intensive (credit/debit cards, insurance services, pension services, remittance services etc.) on the strength of the co-operative branding. Kerala Co-operatives are eminently ready to meet this challenge because of their inherent strengths and numbers and the fact that they are healthy in comparison to the co-operatives in the other states.

2.5 The PACS in Kerala are strong and have a great member connect. On the whole PACS have significantly more deposits and loans than the other tiers. Overall when we examine the relative shares of various players in the financial services market, it is apparent that PACS have around 20% share both in deposits and loans in the state as a whole. While there are some districts where the share of PACS (Thirssur, Palakkad, Kozhikkode, Kannur and Kasargod) is substantially higher and some districts the share of PACS (Trivandrum, Ernakulam and Pathanamthitta) the relative share is lower, on the whole the share of PACS is worthy of taking note. The data given in the Table 2.2 below shows only the number of PACS, but some of the PACS also have branches which increases the number of touch points. The committee has not analysed the data of PACS in detail, but it is safe to assume that the PACS would be predominantly serving individual members in their area of operation.

2.6 At the district level, the DCBs are operating as bankers not only to PACS, but also other credit societies and to individuals. A closer examination of the numbers show that of the Rs.52,456 crore of deposits outstanding with the DCBs as of March 2016, and about half of the deposits of about Rs.26,066 crore came from PACS and about Rs.7,629 crore had come from other co-operatives. The rest of the deposits had come from individuals. Thus, it will be seen that the PACS and other cooperatives raise significant deposits and place them in the upper tier institution. However, the upper tier institution has not been able to deploy the resources very effectively – with a Credit-Deposit (CD) ratio of 54%. The commercial banks as a whole had a CD ratio of around 62% which is also not a great figure in terms of credit deployment. On the other hand a Kerala focused bank – with significant rural presence – the KGB (sponsored by Canara Bank) had a good credit deployment with a CD ratio of more than 80% throughout. While KGB is much smaller compared to the co-operative network, at a broad book size of Rs.10,000 crore in loan deployment, with around 600 branches, it clearly shows that a bank with a local focus could cater to the emerging needs of the state.

2.7 As of March 2016 the broad numbers pertaining to the PACS is given in the Table 2.2 below (Rs.Crore):

Table 2.2
District wise data on Primary Agricultural Co-operative Societies, March 2016

| District | Number of PACS | Number of branches | Deposits | Loans | CD Ratio |
|---|---|---|---|---|---|
| Trivandrum | 119 | 184 | 7014.29 | 5298.84 | 75.54 |
| Kollam | 130 | 172 | 6718.26 | 5181.72 | 77.13 |
| Pathanamthitta | 105 | 81 | 2294.19 | 1636.00 | 71.31 |
| Alappuzha | 189 | 66 | 2771.91 | 2328.58 | 84.01 |
| Kottayam | 143 | 360 | 6633.84 | 4760.68 | 71.76 |
| Idukki | 73 | 259 | 1680.08 | 1762.29 | 104.89 |
| Ernakulam | 177 | 138 | 9138.08 | 4288.80 | 46.93 |
| Thrissur | 161 | 284 | 15980.74 | 8243.62 | 51.58 |
| Palakkad | 96 | 183 | 5718.66 | 4053.63 | 70.88 |
| Mallapuram | 132 | 205 | 5305.47 | 3866.28 | 72.87 |
| Kozhikkode | 106 | 305 | 6916.2 | 5605.12 | 81.04 |
| Wayanad | 38 | 45 | 728.01 | 575.99 | 79.12 |
| Kannur | 137 | 501 | 10066.7 | 7085.4 | 70.38 |
| Kasargod | 64 | 146 | 2186.26 | 2018.96 | 92.35 |
| Total | 1670 | 2929 | 83,152.69 | 56,705.91 | 68.19 |
| Deposits placed in/Borrowings from DCBs | | | 26,066 | 5,492 | |

2.8 In addition, KGB also gets non-resident deposits which the co-operative network does not get. If that were to open up as well, there would be significantly more resources available at the hands of the co-operative sector. While the PACS themselves have a better CD ratio at around 68%, the need for managing the residual resources (after the local individual member needs are met) efficiently and professionally is clearly felt. An integrated structure helps in rationalization of costs, bring in seamless movement of resources across the state and better transaction efficiency both on the loan book as well as in treasury management.

2.9 This need for a sophisticated banking facility for the co-operative sector, is evident, where the credit and non-credit co-operatives can be served with efficient and proximate banking services. What is more interesting is that individual customers had put in almost Rs.18,748 crore of deposits with the DCBs. This indicates that there are significant number of individuals reposing faith in the co-operative banking system. It may be safe to assume that the deposits garnered from individuals at the DCB level is from individuals who would not be using the PACS. The data on DCBs as of March 2016 are given below.

| Table 2.3 Data of District Cooperative Banks as of March 2016 (Rs. Crore) | | | | |
|---|---|---|---|---|
| DISTRICTS | No. of Branches | Deposits | Loans | CD Ratio (%) |
| Trivandrum | 76 | 5748.64 | 2743.98 | 47.73 |
| Kollam | 63 | 3182.63 | 1724.71 | 54.19 |
| Pathanamthitta | 59 | 2051.88 | 1143.68 | 55.74 |
| Alappuzha | 55 | 2684.63 | 1455.89 | 54.23 |
| Kottayam | 58 | 3698.59 | 1626.41 | 43.97 |
| Idukki | 54 | 2049.44 | 1986.51 | 96.93 |
| Ernakulam | 62 | 8043.81 | 3716.08 | 46.20 |
| Thrissur | 58 | 5806.27 | 3298.32 | 56.81 |
| Palakkad | 44 | 4148.06 | 1760.19 | 42.43 |
| Malappuram | 53 | 3628.36 | 2188.2 | 60.31 |
| Kozhikkode | 60 | 3703.4 | 2546.4 | 68.76 |
| Wayanad | 31 | 763.69 | 652.37 | 85.42 |
| Kannur | 65 | 5419.03 | 2212.61 | 40.83 |
| Kasaragod | 45 | 1528.3 | 891.08 | 58.31 |
| TOTAL | 783 | 52456.73 | 27946.43 | 53.28 |

2.10 DCBs generally had around 10% of the banking business on an overall basis, with some districts like Idukki, Mallapuram and Wayanad having a greater share. On the deployment of loans we find that the co-operative structure in general deployed the resources locally as indicated by the CD ratios. Except in districts of Ernakulam and Thrissur , the deployment of the resources garnered within the district was significantly higher than the banking system in the case of PACS. However, the same cannot be said of DCBs. Only in the districts of Pathanamthitta, Alappuzha and Malapuram, the DCBs deployed proportionally greater credit than the commercial banks within the district. In general the CD ratios of the PACS were consistently higher in all districts except Thrissur and Wayanad compared to the DCBs and the commercial banks in majority of districts (10 out of 14). These numbers broadly indicate that while DCBs may be able to garner deposits, their ability to deploy credit directly to customers in the district is not very effective.

2.11 Of the total loans deployed, about 19% of the loans were deployed back to PACS, about 8.5% of the loans were deployed to other cooperatives and a good 71.5% of the total loans deployed were given to individuals. In summary what this seems to indicate is a somewhat loose financial linkage in terms of borrowing and lending between the PACS and the DCBs. The surplus funds deployed in DCBs by the PACS were around 50% of the DCB deposits and the funds given to PACS were around 20%. However, if we look at it from the PACS perspective, only about 30% of the deposits raised by the PACS were deployed at DCBs and 10% of the loans given by PACS represented borrowings from

DCBs. This only shows that DCBs are relatively more dependent on PACS for their business, while PACS could do well without much of DCB support.

2.12While this may be the case, we need to understand that the type of services that the PACS can provide to the members are severely restricted and they cannot provide any banking related services that may need the approval of the RBI. It is important that the PACS are able to retain the market share, the network and the business and therefore there is need for the upper tier to consolidate and provide value added services.

2.13In fact, when we look at the above figures, while the numbers might be for PACS as a category, there might be independent PACS who are only depositors and some PACS who might be predominantly borrowers. The upper tier could provide a dis-intermediated arrangement service for a fee by providing information on shortfalls and excesses of resources so that the PACS can lend to each other with only information, supervision and audit related intermediation by the upper tier , without necessarily resorting to financial intermediation. This will help in saving much of the costs that emanate from the requirements of SLR and CRR which do not fetch great returns.

2.14The PACS have a great network. In fact, in all, the PACS with their branches have more than 4,625 touch points and with the growth of technology and rolling out of ATMs, they could have more tech enabled touch points. These represent about 30% of the overall number of touch points provided by the co-operative and banking sector together. In most districts the PACS have the largest number of touch points. In Idukki and Kannur they have touch points more than all of the banking sector put together. About 39% The banking sector's branches are concentrated in three districts of Thiruvananthapuram, Ernakulam and Thirssur. With the consolidation of the State bank group into SBI there is bound to be rationalization of branches and the network of the SB Group will reduce in the immediate run. So the co-operative sector already has a footprint that is as proximate to the customer as it could be.

Logic of reform and re-organisation

2.15The proposed Kerala Cooperative Bank (KCB) is envisaged as a modern bank for the common people of Kerala including farmers, women, younger generation, small and micro entrepreneurs, non-resident Indians etc. The bank is envisioned as one that will provide all products and services of a modern, information technology enabled bank. It is also expected to bring the entire bouquet of banking products and services as well as other financial products to customers of the bank as well as to the members of the primary agricultural credit societies.

2.16The implications of the above analysis is evident. The proposed reform or reorganization of the co-operative banking structure is in keeping with the changes in the external ecosystem. As we have argued in the previous section, the banking logic of the function of DCBs and KSCB is similar. Both the institutions are federal institutions that are expected to manage the balances of the residual businesses of the lower tier institutions and also undertake such functions that the lower tier institutions are unable to take up due to their size.

2.17The DCBs across Kerala today cater to not only the needs of the PACS, but also to the needs of other primary non-credit co-operatives. Some DCBs have individuals as C class members and catering to them. In some areas, the DCBs are in direct competition with PACS through the branches.

2.18The DCCBs are also doing significant amount of standalone business, predominantly garnering deposits from individuals and other societies. They have an overall CD ratio of 53.28% indicating that they are unable to deploy credit locally, as effectively as the PACS or the commercial banks. Even in case of commercial banks, the CD ratio for the state is 62.28%, indicating that Kerala as a State is a net saver and the surplus resources from the state are possibly being deployed as investments elsewhere. A large part, 71.5%,of the deployment of credit of DCCBs is to individual customers. This is an interesting statistic and needs to be examined in detail. There are two possibilities that explains the story – that the individuals that the co-operative is serving are urban customers and are not overlapping customers with the PACS, in which case the market for loans is expanded by the DCBs. Alternatively, the DCB might be lending to the overlapping customers but for purposes that the PACS may not be lending. This aspect needs a more detailed examination. Irrespective of the detail of the portfolio of the PACS, the DCB basically seems to be doing a service that fills in the gaps left by PACS and may be covering the customers not served by PACS. However, it is also possible that the DCCB branches are in competition with PACS, at laest to a limited extent. In several districts that the committee visited, the DCB board – while opposing the consolidation indicated that the reason why they should continue to exist was largely driven by the logic of localization.

2.19This issue is less pronounced with KSCB. At one level, it is important for the system to work synergistically and at the other level there is also a need for the system to offer a range of financial services. The DCBs independently have been offering some value-added services like debit card facility and remittance facilities in association with other commercial banks. Not all the banks have a schedule status and each bank has differing credit deposit ratios – with some having significantly higher surplus funds that is not deployed. The compliance costs of each of these entities maintaining a decentralized Capital Risk weighted Assets Ratio (CRAR), Statutory Liquidity Ratio (SLR) and Cash Reserve Ratio (CRR) and compliance with the regulatory requirements is also present. In spite of these all the DCBs are not offering common banking services. In the process the co-operative sector may be in the process of losing out to the commercial banks on certain crucial facilities that the co-operative sector could offer. The arrival of the new set of banks- the Small Finance Banks and Payments banks- can only make matters worse for the cooperative banking and credit system, unless responded to.

2.20An examination of the data indicates that the percentage of customers of co-operative banks in Kerala below the age of 35 is only 23.5% and a significant 46% is above the age of 50 years as shown in Appendix 2.1. This is an important data point and shows that there is an imminent threat that the cooperative system may become irrelevant if the young generation are not coming to the cooperative system for their banking needs. The reasons for the younger generations keeping away from co-operatives could be due to (a) the inability of the cooperatives to offer value added services; (b) cooperatives not being visible as a young and "cool" brand; (c) non-availability of products that cater to the varying needs of the younger generation and (d) the look and feel of the cooperative banks, products and services are not attractive to them. While this is a threat to the survival of the cooperatives in days to come, it is also an opportunity for the cooperative system to prove the relevance going forward.

2.21 In this context, it makes immense sense to consolidate all the banking activities that do not have an interface with the individual member into a federal co-operative that can benefit from the size. This will also give the co-operative sector an opportunity to introspect and identify activities that are best done at the PACS level and activities that need to be carried out by the state level body. The focus of the activities of the entity would be to best serve the members of the PACS on aspects that the PACS themselves cannot undertake.

2.22 While it is envisaged that the PACS would be completely adhering to the principles of user-member controlled organisation, the state level entity is envisaged as a bank owned by the co-operatives, largely serving the co-operative sector, managed professionally and following all the prudential aspects of a modern bank. The issues pertaining to the control, governance and prudential management would be discussed in later chapters. The PACS have an existence of their own, are able to garner local resources and deploy them within their area of operation and are dependent on the upper tier only marginally for balancing their surpluses and borrowing in case of need. A more detailed study of the type of business the PACS are doing and where they could deepen their engagement with the members is to be undertaken to ensure that the PACS not only keep their members within their fold, but also garner additional business and be the port of first call for any individual residing within its area of operation. The committee suggests a much more detailed study of the status, products and services offered by PACS and the level of computerization. That has been beyond the TOR of the current committee.

2.23 In addition to the above another significant event is to be considered. The State Bank of Travancore, which is the only large public sector bank headquartered in Kerala has been merged with its parent State Bank of India. The implications of this move is that it will be a regional office of a large player and all the surplus savings of the state will get into the generalized pool of resources with the SBI. The focus of the bank on the region may suffer and Kerala would do well by having a large institution that is clearly focused on the state, but run professionally. While the consolidation of KGB is good news for the state of Kerala and it would indeed serve the purpose to an extent, the committee also sees that the co-operative sector as a whole has surplus resources that could be deployed. While these are currently being deployed in individual DCCBs according to the requirement locally and put into the treasury operations, pooling these resources would possibly yield better returns to the co-operative sector as a whole and cut down costs. While the regional nature of the development of the regions within the state should be kept in mind, there is merit in having a facility of professionally managing these resources, with prudence. This oversight and professional input is possible with a certain size.

2.24 It should be noted that the logic of consolidation is not at the cost of the local needs that are to be met. The logic of consolidation is only attributable to the residual resources that are available AFTER the local needs are met. Therefore the committee envisages that the PACS would take care of all the member needs in their area of operation at the individual level at the level of farm loans and micro and small enterprises and trade, the the upper tier will take care of all the needs of the customers who are in areas outside the area of operation of PACS; of the savings and credit needs of non-credit co-operatives; and pool the residual funds at a central repository both for treasury and loan book management to ensure a greater yield. At the first instance the committee is recommending a consolidation of the technological platform as well as a functional consolidation to bring in efficiency.

SWOT analysis

2.25 If we were to look at the logic of consolidation from a pure SWOT Framework, we classify the weaknesses and threats of the current structure and the strengths and opportunities of the new structure. Therefore, the committee changes the framework of analysis to look at Weakness and Threats first and Strengths and Opportunities later.

Weaknesses of the current structure

2.26 The State Co-operative Bank is in losses and its loss for the year 2015-16 is higher than the profits of all the DCBs together. While the provisional figures for 2016-17 seem to have a turnaround, the current structure at some levels is weakly capitalised. The DCBs are small by the reckoning of modern day banks and do not get to bear the competitive advantages of size. Two layers of co-operatives – the KSCB and the DCBs and multiple parallel systems with each DCB means that the overall co-operative structure would have significantly higher costs. Even on issues like information technology, while most of the co-operatives are on a similar platform, these just add to costs in the structure.

2.27 In most cases while the co-operatives are on a Core Banking Solution (CBS) platform, many are not generating system generated reports pertaining to NPA and other prudential norms. There could be some level of opacity in the data.

2.28 Even during the recent episode of demonetization, the RBI did not allow DCBs across the country to participate in the process of accepting old currency. One of the criticisms that was levelled against the co-operative system was that it was weakly governed and does not have the adequate technology to detect fake currency. In this background breaking away from the image of a three tier structure that suffers a reputational loss across the country would give a great fillip to the vibrant co-operative system in Kerala.

### Threats

2.29 There is a threat that the co-operatives will soon lose market share and will be rendered irrelevant. The committee has already discussed the age profile of the members of the co-operative structure. If some preventive action is not taken right away in quick time, the co-operative sector could soon lose market share.

2.30 It is also evident that all the existing and evolving value-added services of modern financial systems are to be offered by large well capitalized players. The current system dissipates and sprinkles around the capital that is readily available into small insignificant sized organisations and a consolidation would effortlessly make it possible for the co-operative structure to be able to compete with modern banks.

2.31 The current governance structure has the potential for interested parties grabbing the management and diverting loans. While this may not be happening in the instance of Kerala very widely, the potential cannot be downplayed and it is important to have a robust governance system so that the co-operative system is able to attract more people to repose faith and also their savings and investments with confidence.

### Strengths

2.32 Eventually when the completion of the structural change happens, it is expected that Kerala will have a people owned and people managed modern bank that has a significant market share in the entire banking operation. This bank will be non-exploitative, customer friendly, transparent and fair. As such the co-operative system has about 30% market share in the deposits and loans, but this may significantly increase and hopefully would add other sophisticated financial services to the benefit of the members. Currently the efforts are scattered. There are good primaries serving their members, they are affiliated to the DCBs, but the DCBs are also doing some independent business and sometimes there is little embedding between the PACS and DCBs, with the DCBs competing with the PACS in its area of operation. It is also clear that the DCBs are serving a larger set of individuals and other co-operative institutions. We therefore should consider the consolidated bank as the bank owned by co-operatives, and largely serving the needs of the co-operative sector.

2.33 Bringing all the banks together on a common platform, with modern systems of Information Technology (IT) and audit; governance with significant professional inputs will not only help the co-operative structure garner market shares in areas where it is not present, but also help in gaining significant amount of credibility.

2.34 The consolidation process cuts down costs of technology, administrative costs and financial costs significantly. Since this envisages delayering, there would be significant gains in terms of efficiency of managing a single large balance sheet and all these gains in the costs could eventually be passed on to the primaries so that they could serve their customer more effectively. It will also help the bank to effectively compete with the commercial banks and provide more ethical and friendly banking products at non-exploitative rates.

2.35 While there was a refrain that the members have access to the elected representatives of the DCBs and DCBs are local institutions, the committee has built in a system which would retain the local flavor while getting the benefits of the consolidation and thereby providing a robust system. The committee deliberated on this in details and recommended that the interface at the PACS level should be significantly strengthened.

Opportunities:

2.36 A large well capitalized bank clearly provides an opportunity for the sector to have a large and sophisticated institution which serves the interests of the co-operatives first. Such an institution would be able to offer products to the members of the PACS. The committee is aware that the co-operative system offers informed and aware members who have a great potential to use the services of a modern bank providing universal financial services. If the co-operative sector does not seize the opportunity quickly, it might lose out on market share to the commercial banks. The process of losing share would be functional and gradual, but almost irreparable. Probably it is already a bit late, but nevertheless the co-operative sector should see this as a golden opportunity and implement the reform and consolidation process.

2.37 If the merged entity adopts the recommended strategy of "managed integration" process than a "funded integration" process, it will gain both in terms of costs and profitability. In the "managed integration", the new integrated entity would largely manage the surpluses and deficits of the co-operative structure, by providing information and risk rating facilities for the co-operatives that are having excess funding without doing the financial intermediation. In such a case most of the portfolio would be off the balance sheet of the integrated entity and it would not have to provide for capital and the attendant costs in the form of liquidity deployment. The integrated entity would only manage the funded portion of the business to the extent that it raises its own resources from non-PACS sources, the surpluses of PACS that cannot be deployed among themselves and individual depositors. Then the overall assets under the management of the apex co-operative entity would be significant, but its own balance sheet would be much smaller.

2.38 The complexity of the consolidation is something that needs to be taken into account. Usual consolidation process in a normal merger or amalgamation would involve a consolidation of two entities. In this case we are talking of 15 different and unique entities and therefore the collaterals that the merger process would create is significant and not to be brushed away as trivial. Therefore, it is necessary that the process is done carefully and after considering all the difficulties. The fact that in spite of the technology being on the same platform, an entity like State Bank of India is taking time to merge and operationalize its seven entities should be considered carefully. However, the committee has suggested a phased and time-bound process of merger which should be implementable in a tight time frame.

**Chapter 3: A review of the past reports, their recommendations and the relevance to the current exercise**

3.1 The idea of collapsing a three-tier structure to two tiers is not new. In the past, the working group of the Fifth Five Year Plan (1974-1979) had recommended a two-tier structure for small states and had particularly mentioned Kerala, Haryana and Assam. A team appointed by the Reserve Bank of India to study the co-operative credit structure in Kerala (1972) has also indicated their preference for a two-tier structure. More recently, the Renjit Committee appointed by the Government of Kerala (1998) had also strongly recommended that the Kerala Co-operative Banking system should be moved to a two-tier structure.

3.2 While many other committees that looked into the reform of the co-operative structure (Vyas committee; Vaidyanathan committee) did not have significant mention of the layering of co-operatives, the recent Prakash Bakshi committee had recommended the functional delayering of the co-operatives, by recommending that the PACS should be converted as business correspondents of the DCBs. The Expert Committee considered the recommendations of the Bakshi committee and disagreed with its views and reiterated that the more appropriate approach that does not compromise the co-operative character is to strengthen institutions that have member connect and keep them as autonomous and democratic institutions while providing access to modern banking services through a large integrated banking establishment. To the extent that the primaries cannot offer certain services due to regulatory or size constraints, the suggestion of the Bakshi committee that they be agents of a larger bank should be welcomed, but only to the extent of the residual services that the primary cannot offer.

Rabobank

3.3 Rabobank restructured its banking structure into a single tier starting January 1, 2016. The bank operated on a two-tier structure, with primaries federating into a national structure. The group had 106 independent primary banks – all licenced by the central bank in Netherlands. The federal unit – Rabobank Nederland – worked as a service center for the independent banks being responsible for supervision and other support services. The need for Rabobank to restructure came from concerns of efficiency, profitability, regulatory compliance and the need to stay globally competitive in the emerging world, while providing the state of the art services to its members. Rabobank had 106 independent local Rabobanks each of which were having a banking licence and were operating under a single umbrella. However, the increasing compliance costs and multiple structures was adding significant costs and draining the efficiency. Starting March 2014, the bank went through multiple dialogues and finally decided to have a unitary structure of a single co-operative bank.

3.4 The challenge of this exercise was about maintaining the co-operative character of the structure while becoming a competitive bank. The path that Rabobank took was to retain the local councils, continue accounting for local profits – while integrating the overall results into single financial statements, and allow autonomy for the local councils to undertake social developmental activities based on the profits allocated. Similarly, the local democratic process continued to elect the local council, who would be responsible for supervision at the local level and the chair would be a delegate at the general council at the bank's general body. This general council would in turn elect the board. In integrating the financial functions, the bank did not lose out on the representativeness of the local, including hearing the voices as well as devolving financial powers to undertake local developmental activities.

Raiffeisen

3.5 In case of the German co-operative network which represents around 18.3 million members, the path adopted has been different. While the diversity of more than 1,000 local banks were maintained, the central banks consolidated over a period of time from about 52 central institutions in 1904, they were gradually reduced through consolidation to 4 in 1990, 2 in 2001 and to one central institution in 2016. The logic of consolidation was indicated as "pooling of strategic competence; pooling of operative strength; continuing development of processes and structures which are network oriented, transparent and efficient; realization of revenues and cost synergies; and more efficient allocation of available resources". The central institution provides financial services and products to the local banks with a strong brand. This is an alternative model of consolidation where the primaries were left in-tact both in the structural and legal form, but there was an increasing recognition of consolidating at the federal level.

Desjardins

3.6 In case of the Desjardins movement in Quebec, Canada the consolidation exercise has been slow and gradual. The movement had more than 1,200 caisse populaires (primary co-operatives) in 1998 and these have been through a process of amalgamation and restructuring reduced to a little over 300 cooperatives. The middle tier which had 11 regional federations at the turn of the century have all been disbanded and the movement is now operating as a two-tier structure. A large part of the restructuring was driven by the changes in the external environment, and cost structures that made the co-operative network expensive. At the same time, the explosion of technology helped the co-operatives to replace the intermediary function undertaken by the regional federations. While the membership in the movement remains at around 5 million, the structure has been able to maintain its market share and ratings and continue to operate as a formidable structure.

The relevance to the current exercise

3.7 The logic of doing away with a layer, and bringing in the principles of consolidation is evident not only from the older studies, but also from the exercises across the world from very strong co-operative movements. What is important to note is that each of the efforts have laid a very strong emphasis on the connect at the primary members' level. While Rabobank offers a model of a unitary structure for banking with a decentralized governance structure, the other two examples offer a decentralized structure of banking as well as governance. But in all the three examples, we find that the structure could carry on without the intervention of one layer – the middle layer. In the current situation, the committee does not envisage moving to a unitary structure of merging all the primary co-operatives, because these co-operatives not only provide the necessary elements of localization and decentralization regarding governance, but also they provide the same elements for the design and delivery of products and financial services to the members.

3.8 In essence, the recommendations of the other committees, prior studies and experiences elsewhere in the world suggest that it is indeed possible to consolidate the co-operative structure, without compromising on the co-operative nature of the structure. The co-operative nature is to be maintained by having a vibrant network of PACS that are governed locally and having a mechanism of representation in the governance of the federal structure that takes into account the regional concerns. This can be achieved by having an integrated structure at the higher level with a decentralized governance structure that builds into the governance of the federal structure. We discuss this in greater detail later in the report.

**Chapter 4: Designing a Futuristic Bank**

Vision:

*Safe and Reliable Banking for Everybody.*

Mission

*"To be the most accessible, friendly and safe banking service for the common citizen of Kerala providing a comprehensive end to end and enriching financial services for carrying out life and livelihoods with dignity"*

4.1 The new bank, being called as the Kerala Cooperative Bank will be a full-service bank – serving four distinct segments of the customers.

4.2 The core of its service would be to the PACS and its members. The way it is envisaged is that the KCB will provide financial, technical and support services to the PACS and its members in a manner that the members of PACS need not look elsewhere for any financial product and/or service.

4.3 In addition to serving the PACS, the bank will be the bank of first preference for all the banking needs of the cooperative sector including milk, rubber, coir, consumer, labour and a range of other cooperatives existing in the state of Kerala.

4.4 It will be open to all individuals who are not members of PACS or cannot use the service of PACS. These individuals would be customers rather than members of the bank and

4.5 It will offer banking service to institutions and body corporates. These services would be offered like any mainstream bank.

4.6 The new bank would be at the core serving co-operatives and their members, but will also function as a modern banking institution participating in the economic growth and prosperity of Kerala.

4.7 In keeping with the fact that Kerala has one of the best decentralized public management systems through the Panchayati Raj institutions; the seamlessness between rural and urban areas and the integration of the Keralites with the global economy, the new bank will strive to serve all segments of the society and would be an institution that instills the pride of Kerala and all that Kerala represents.

4.8 The institution will participate in the economic development of Kerala by providing financial services to developmental projects of the state, particularly promoted by the local self governments without compromising on the commercials.

4.9 The bank will be friendly to the customers, particularly the savers. It will strive to constantly improve internal efficiency and cut costs so that the customers are not imposed any fees for use of the services – like ATM withdrawal charges, cheque book charges, cash transaction charges etc. It will strive to serve all the customers by pricing the products and not pricing the services.

Why?

4.10 In our interactions, there have been several questions asked of us as to why this change was necessitated. Particularly if the current system is not broke, is there a reason to fix it. These are valid questions and need to be addressed. The modern-day banking has undergone significant changes. The

PACS are the immediate connect with the members. The question is how could the PACS serve the members better than a full-service bank branch. PACS have several advantages of being local with the direct touch with the members. In addition, PACS have the tremendous capability of localizing any product or requirement and servicing the needs of the members. Therefore, institutions like PACS that are autonomous need not be boxed in by the constraints of the central office. While the critics of the proposed integration of the upper tiers are indicating that this is centralizing the power, it is in fact strengthening the decentralization process at the cutting edge and reinforcing the concept. The beauty of the co-operative system is in the diversity of services – including non-financial services that the primaries can provide. In fact, through efficiencies and rationalized investments brought in, the PACS will be supported by a modern day bank at the cutting edge of banking today, updated continuously and shall offer every possible banking product and service to millions of its members who shall not have to look elsewhere.

4.11 If most of the financial business was located in PACS that are running on the principle of mutuality and adhering to the co-operative principles and identity, there is not only localization of resources, but also most of the resources could be locally deployed. While resources raised by a bank branch would get counted into the overall resources of the bank and would go through all the statutory requirements of liquidity, PACS can effectively deploy its resources locally and put in only the residual amounts into the banking system. However, the committee recognizes that the PACS would be unable to offer some of the modern banking services that come only with the advantage of having a large organisation. For a modern day customer, not only the existing members, but the members from the new generation, it is necessary to recognize the diverse range of services that the co-operative banking system could deliver with a superior member connect.

4.12 Such services, are heavily regulated and offered only by large and financially sound institutions. If all modern banking facilities are to be offered, consolidation makes immense sense to ensure that the institution has adequate capital, it is well governed and has adequate size and systems. Consolidation provides an identity and credibility. In the light of how co-operatives – particularly the DCBs were treated and seen by the regulator in the recent episode of withdrawal of specified bank notes (demonetization), it is important to re-build the image of a strong and well governed bank with adequate systems and adequate permissions to carry out mainstream banking. The need for consolidation therefore is now.

What?

4.13 At the PACS level, it is possible to offer a range of savings and loan services. However, given the size of the PACS it would be difficult for the PACS to manage aspects pertaining to asset liability mismatch, liquidity management and treasury, which is essential to ensure that the society is run profitably and the benefits of efficiency are passed on to the members. These services can be offered by an institution at the upper tier both as a fund manager managing off-balance sheet products on behalf of PACS or as an entity that accepts the funds and manages it on-balance sheet. This is particularly important (as we see from the figures) that the members of the PACS are net savers and are possibly looking for deploying their surpluses in profitable avenues.

4.14 Similarly given that PACS are small autonomous organisations, and the current regulation, it would be impossible for them to be a part of the payments systems. Given the mobility of people and the need for interoperable transactions, it becomes absolutely necessary for the members of PACS to have access to modern products. As of now such products are not widely available with the members of the PACS, but many DCBs have started offering debit cards co-branded with Ru-Pay and offering other tech enabled products in association with the commercial banks. However, if the co-operative sector had a large – systemically important – co-operative bank, these products could be offered within the system which will help the members to retain the profits within the system.

How?

4.15 Basing on the past reports, the consultations, the international experiences there is a strong case for the new structure to be two tier rather than three tier. From the data discussed in the last chapter, the important function being done by the DCBs of raising local resources and purveying loans beyond the area of PACS could be best achieved through a process of centralization wherein there is seamless movement of excess funds into a central pool for effective deployment either in a treasury function or in portfolio function. As the committee envisages, the integrated structure would and the relationship with the members would be as described below.

4.16 The integration of the services that a full-service bank and a PACS can provide seamlessly can happen through adoption of technology. In the case of services that are to be provided by the bank, say for use of debit card against an account held with the PACS, the bank will have to create a mirror account with a sweep facility. Given that the new payment banks are having such arrangements with correspondent banks and with the use of technology, it is possible for members to have basic services directly in the books of PACS and other add on services through the integration of technology. There has to be a significant investment in technology at the bank level to start with, and the PACS will have to be encouraged to integrate themselves with the central technology. With the overall size of the entire co-operative system, it is possible to negotiate a centralized terms of engagement to be optionally used by PACS as and when they are ready.

4.17 Individual members will solely be dealing with PACS in the area of operation of PACS. They will open their savings accounts, park their deposits, access their loans and all other financial services only through the PACS.

4.18 PACS will do all the business that it is permitted to do on its own books, including non-financial services. Any business beyond what is authorized to be done by PACS directly, the PACS will be an agent of the Kerala Co-operative Bank, which is envisioned as a full service universal bank under the co-operative structure.

4.19 PACS will collect savings, term deposits, and other deposits from its members. PACS will also make loans available to the members on its books. Any business that a PACS cannot do on its own will be done in association with the KCB. Let us take for instance, a possibility of issuing a debit card for all the members of the PACS against their respective savings accounts in the PACS. Obviously PACS because of not being a bank cannot be a part of the payments system.

- The debit card issued to the member of the PACS has to be a card issued in association with KCB. If a member of the PACS were to use the debit card interoperably, then the back end system should be capable of the following:
- Trace the transaction to every member of the PACS – ensuring that each of these members are complete KYC compliant as per the regulatory requirements of banks and have a shadow (zero balance) account with the KCB.
- PACS will have adequate liquidity parked with the KCB on which norms can be evolved on the average liquidity to be maintained, and limits of credit where there would be triggers of top up.
- Every time a member uses the debit card for withdrawal, the system will reduce an equivalent amount from the PACS escrow account and pay the member. The PACS accounts will automatically be adjusted to show that the deposit in the KCB account is reduced by the amount withdrawn by the member.
- KCB may charge an annual maintenance charge per account to the PACS or the individual members for offering this facility.
- This facility could then extend to any outlet that is interoperable on the banking system with appropriate interchange charges.

4.20 In essence the committee is proposing that the PACS – though autonomous institutions should have adequate state of the art technology to satisfy the regulator that there is no systemic risk involved in having such an arrangement.

4.21 Similarly, members of the PACS would get all the other services that the PACS is authorized to provide – credit limits for a range of purposes, and all other facilities that is currently made available by PACS. All value added services would be provided by the KCB.

4.22 The role of the KCB would be restricted to serving

- Customers who cannot become members of any PACS – either because they are a body corporate; reside outside the area of operation of a PACS.
- Purposes that the PACS cannot service.

4.23 For instance, if the PACS is not offering vehicle loans to its members – either because of its resource position or because it does not want to handle the product, then members of PACS could be given a loan for that purpose by the KCB. KCB can certainly service all the customers outside the area of operation of the PACS. Any business that comes the KCBs way, and can be done by PACS has to be necessarily directed back to the PACS. This means that there should be absolutely no conflict and poaching of clients, and in case of any conflict, the right of the PACS to service its customer should prevail. The committee provides a list of illustrative services that could be provided at both the levels in the discussion below. However, the committee do not restrict the choice of customers, but recommend that the service levels at the PACS and the credibility thereof need to be strenghthened such that the ease of access, the level of service and the local flavor will compel the customer to approach the PACS as her first option. If the PACS is unable to offer a product or service by itself, then, it should be encouraged to do so on behalf of the KCB and facilitate and deliver those services and products through appropriate arrangements such that the necessity of a customer approaching the KCB or any other bank is made redundant.

Services envisaged as sole products of PACS:

4.24As a society operating on the principle of mutuality, the PACS have been offering several services and should continue to offer these services

- Savings accounts and checking accounts
- Deposit services, including recurring, term and other types of savings products
- Loans of all types – agricultural loans under the refinance scheme, other loan products (including gold loans, housing loans, vehicle loans and other term loans) for individual members.
- Any non financial fee based service that the local co-operative envisages, including hiving off of current non-financial asset/service being offered by the DCBs based on a fair valuation.
- Services envisaged basically as products of PACS with the use of KCB network
- Debit cards that could be inter-operable on the entire banking network across the world. This cannot be offered by individual PACs, but they could be offered as a common co-op branded card. This could use the payment infrastructure created by NPCI and could be Ru-Pay branded.
- Net banking and app based banking services including UPI, BHIM and USSD.
- Universally accepted Credit cards linked to the history of transactions in PACS with auto debit facility for dues.
- Electronic transfers, mobile transfers, remittances (including forex) – both inward and outward, using the IFSC and SWIFT code of the KCB.
- Schematic accounts like Kisan Credit Cards, Mudra Cards and Aritsan Cards
- Routing agency for Direct benefit transfer facilities for LPG and other subsidies.
- Cross selling of insurance, mutual funds including money market mutual funds, pension products as an agent/sub-agent of KCB

Services envisaged to be offered by KCB

- Currency management (including currency chests)
- Treasury

- Loans to bodies corporate
- Bulk agency for insurance/pension/mutual fund products
- Depository services
- International deposits
- Business of individuals who cannot become members of either PACS or other societies that do not offer financial services
- Urban banking
- SME financing
- Trading of priority sector lending certificates(when permitted),
- Portfolio sale as derivatives
- Exchange traded funds
- Consortium finance.

4.25Basically, KCB will undertake any function that a modern universal bank is authorized to undertake with adequate permissions.

Size and Network

4.26Given that it is envisaged that the current PACS network would be completely strengthened and leveraged, the new bank should be a technology enabled slim bank. Since the last mile member touch point is already with the PACS – which collectively have nearly 4,625 touch points in Kerala (as against a total of 6,000 branches of the banking system) the physical outreach should be seen from the perspective as an integrated large co-operative network. In this regard, the PACS could also undertake offering services to the customers of the KCB on the basis of a small fee. Therefore, it is envisaged that the new KCB would be headquartered in Thiruvananthapuram, with three other significant regional offices – in Thiruvananthapuram, Kochi/Ernakulam and in Kozhikode. All the administrative, compliance and supervisory departments will be housed in the headquarters in Thiruvananthapuram. In addition to managing the central region, the Kochi/Ernakulam regional office will also handle forex and other corporate commercial operations. The Kozhikode office will cater to the northern regions of Kerala while Thiruvananthapuram will cater to southern region.

4.27It is envisaged that the new bank will have significant technology enabled touch points like ATMs but eventually – over a period of 5 years - will have only about 15-20 branches per district – basically working in larger towns and district headquarters that are not covered by PACS. The criteria for the branch to exist should be purely determined by the existence of non-PACS business and the committee envisages that a potential deposit base Rs. 20 crore should become the criteria for justification of a branch. The committee also recognizes that this criterion is stringent at this time and may result in a need to close down many existing DCB branches. The committee recommends a slow and gradual path in rationalization of the branches, using the following strategy:

- In areas where the existing branch is competing with the PACS, hand over the business to the PACS depending on the coverage;
- In areas where the branch cannot garner a deposit base of Rs.20 crore, steps would be taken to convert the location to a bank owned and bank operated touch-point – more like an extension counter and the staff be transferred to a nearby branch.
- In case the costs cannot be covered, close down the branch and transfer the portfolio and employees to the proximate branch.
- The possibility of expanding PACS barch network by taking over the existing branch may also be considered on a viability cum feasibility basis and subject to jurisdiction constraints.

4.28 Since the committee envisages that all the business in the service area of the PACS will be undertaken by the PACS themselves, it is envisaged that the co-operative network will have the largest number of touch points and points of presence. In all with PACS being present in every nook and corner, and the network being leveraged to provide all the modern facilities, the total number of touch points where the members could transact would be in the range of 3,500 and growing. It is recommended that in addition to each of these touch points having an ATM the bank should strive to have many more off-site ATMS.

4.29Thus the committee does not envisage a large physical presence for the KCB through its branches. KCB would be doing business in the urban and moffusil areas not covered by the PACS, and as and when the PACS expand and grow, the KCB will strive to hand over the business in the respective area to the PACS to the extent that it falls within the mandate of PACS. Much of KCB operations would be in managing treasury, technology, supervision and wholesale business.

## Chapter 5: Integration process

5.1 The committee has examined multiple paths for the integration of the co-operative structure, based on the consultations held with a wide variety of people. The preferred path is a gradual path in which the integration will happen in a de-centralised manner, starting with the integration of IT systems, followed by functional integration which will be followed by legal integration involving integration of financials as well as HR systems.

5.2 This is a slow, consultative and incremental process. This will have milestones, the investments into the system would be spread over multiple financial years, has adequate scope for mid-course correction. The committee recommends that this must be participative and voluntary in nature. This is the style adopted by Desjardins where the consolidation process is continuous, and gains are small and incremental. This approach is expected to reduce the potential impact of largescale collaterals that are likely in a massive merger operation involving 15 independent entities, even though strung together through the overarching administrative powers of the Registrar of Cooperative Societies and State control.

What does this path entail?

5.3 It is important to note that in this path, there is no centralized entity but still the idea of consolidation has to be carried out by a centralized co-ordinating mechanism. The committee recommends setting up of a project management unit, which will house the best of the thinkers and managers which will also become the core management team of the consolidated bank. It is envisaged that this project management team gradually expands with select members from within the co-operative – mostly DCB system – co-opted on a pure merit basis.

5.4 The government may choose to also have an interim Project Advisory Committee till the new KCB appoints a board as per the recommendations given in the governance section. The advisory committee should be headed by an eminent person to ensure that all the issues of conflict of interest are taken care of and the project is able to provide a comfort to the regulators on the merits of the consolidation and the integrity of the process.

5.5 Since the KSCB currently is scheduled and is small enough, the committee recommends KSCB as the project office cum integration core. There should be a small project management and implementation team working out of the KSCB, gradually taking under its fold the management functions of all the new initiatives and modernizing the bank. Since the extant licences are already with the KSCB it makes great sense to continue with those licences add the newer licences to the apex bank.

5.6 While, there was much concern expressed about entities that are profitable merging into a (currently) loss making KSCB, this should be seen as a part of the process of creating a merged entity, while leveraging on the benefits and licences that the current entity has. The process could possibly start with the change of name from KSCB to KCB. The process of changing the name should be simple and would possibly require a resolution to be passed in the general body of the KSCB. This should happen without much difficulty.

5.7 In the run up to the merger, the KSCB should be adequately capitalized, preferably with the incremental contributions coming from the co-operative sector from a range of co-operative institutions. While there is much debate on whether the new Kerala Co-operative Bank should be a bank only of the PACS or of the entire co-operative structure, not only in terms of client servicing, but also in terms of governance the committee believes that the KCB should eventually become a bank of the co-operatives rather than of just the PACS, with PACS being the most important stakeholder.

5.8 We will discuss the issues pertaining to governance and its signaling in a later chapter. As a matter of incentive to encourage co-operatives to invest upfront in the emerging KCB, the KCB could offer shares at par to the institutions joining in the first twelve months of the process. After which any entry of any co-operative to the membership of KCB should be based on a share premium. Since there is no mechanism for discovery of the price of the share through market mechanisms, the committee suggests that the premium should be the difference between the face value of the share and the book value of the share, with the proviso that in case the book value of the share at any point in future happens below the face value, then the floor price will be the face value of the share.

5.9 In keeping the spirit of co-operation and the autonomous nature of the co-operative institutions, it may be good for the state government to contribute to KCB as a one-time grant. This grant is for a larger public purpose of strengthening the peoples' movement and not to take control of the structure. An estimate of the resources required is given later in the report. If the state so desires, the amount needed for the integration process could even be given as a soft subordinated debt, so that as the co-operative system grows and gains market share, it should be in a position to return the amounts to the State.

5.10 So, in the process, the first task of the KCB would be to ensure that it is well capitalized and does not have the risk of any adverse action from the RBI. The systems should be modernized and the KCB should be in a position to centrally manage a treasury and portfolio management division. Alternately the Government might think of proposing that the project management unit may also have another division of fund management, quite autonomous from the day to day operations of the KCB.

5.11 The core team to be appointed in the KCB – which is different from the project management team – will start working on the value added services to be provided by KCB – starting with funds and treasury management. This core team will be trained and may eventually become the top management – the cadre of General Managers with functional specialisation- of the new integrated bank.

Timelines

5.12 The broad timeline for rolling this out is given quarter wise in the chart below and we envisage about 6 quarters to get the work going through a process of dialogue and consensus. The seventh quarter is indicated for winding down processes.

Table: 5.1 Timeline for the process of Integration

| Q 1 | Q 2 | Q3 | Q4 | Q5 | Q6 | Q7 |
|---|---|---|---|---|---|---|
| Establishment of Project Management Office | | | | | | Disbanding of the team and complete integration into KCB |
| | Integration of two DCBs into the state unit | Review | | | | |
| IT audit | Complete system audit of DCBs proposed to be merged. Provision of capital if required | | | Roll out of software to all locations | | |
| RFP for common software | Selection of Vendors | Customisation of software as per the requirements of the system | Installation and testing of Software in 2 locations | Complete system audit of all other DCBs. Branch rationalization/closure on the basis of profitability, study of overlaps and functional details. | | |
| Study of financial products of different DCBs | Mapping of HR competencies of DCBs | Start process of allocation of HR to specialised functions and retraining | | | | |
| Standardisation of Products and Incorporation of the products into the software | | | Integration of seven DCBs into the state unit | Integration of five DCBs into the state unit | Consolidation | |
| Common terms, synthesis of different product | | | Introduce debit cards first on a pilot to customer of SCBs | Start process for getting licences for other services like NRI accounts, Forex dealership. | Introduce cards for the customers of PACS-pilot test | |
| | Assessment of PACS software | Selection of PACS for 1st Phase of computer readiness for plug and play with DCB platform | Design Rationalisation of products | Plug and play PACS in KCB software Phase I | Plug and play PACS in KCB Software Phase II | Plug and play PACS in KCB Software Phase III |
| Establishment of Fund management system and a team.[1] | Working arrangements with DCBs on management of excess Funds | Stabilisation of the arrangements | Management of DCB Funds, and as integration happens, management of the funds on the balance sheet. | | | |

[1] It is envisaged that the KCB will manage the excess funds of the DCBs and PACS. These funds could be deployed in portfolio of loans or in treasury operations. Pending the full operations of the KCB with all the loan processing

5.13The project management unit on the other hand will, address the following issues:

- Integration of IT platform to bring all the DCBs and the SCB on to a common platform. The entire IT function of the co-operative banking system would be managed by this team. We shall discuss the steps involved in this in the following section.
- As the co-operatives are getting to be on a common IT platform, clean up the critical entity that already has the licence and scheduling arrangements to make that a strong organisation and regularly add centralized services and facilities and licences to that entity. While this is not a natural process as permissions from the regulator has to be sought, we assume that if the regulator agrees in-principle to the scheme and timeline of merger and the KCB achieves the milestones indicated by the RBI, it should be possible.
- The resources provided by the State government in the form of grant or loan should be on the basis of a memorandum of understanding and performance parameters.
- All the new functions of the KCB will be managed by the core team. Anybody from within the system should be free to apply to join the core team at KCB. All the old functions as and when they are reviewed and redesigned will be handed over to the core team.
- The core team will start expanding as and when new functions are added to it. For all this preferably existing staff of DCBs may be co-opted and thoroughly trained. Recruitments from outside will be made on very exceptional basis. In general, it is preferred that managers who have more than 10 years of residual service should be given preference for training and redeployment.
- There should be another team recruited in the KCB from within the DCB system to be redeployed to the DCBs. They would go there with a specific purpose of preparing the DCBs for the merger, examining standardization issues, fitment issues, accounting matters, recognition of NPAs and technology alignment.
- The process of merger with DCBs that pass a resolution to merge with KCB as per law can simultaneously start. The committee expects at least two DCBs would start the process and pass the resolutions within the first quarter of getting an in-principle go ahead from the regulator.
- In the second phase, ensure that all the DCBs offer common financial products to their members. Any specialised product developed by a DCB should be easily replicable in any other DCB. This means that the co-operative system has a common pool of financial products, with each DCB

---

systems in place, the committee suggests that this be just a treasury and fund management system. The committee does not envisage any of the current staff undertaking this task independently. It therefore recommends that a separate team of experts be recruited to manage these funds. The task could even be outsourced pending the development of capabilities within the team. However, the committee also strongly recommends that a small team of hand-picked officers from KCB/DCBs be involved in the department from the beginning so that they eventually can take over the treasury function.

offering all or a part of the pool. Theoretically all the DCBs should be able to offer this pool. Clean up the balance sheets of DCBs.

- In the process of getting common heads of accounts, common accounting systems and common software, the process of accounting, finalization of accounts, recognition of NPAs etc. would have to be standardized. This means that the best of the accounting practices would be adopted by each of the DCBs and all of them will be compliant with all the banking norms as applicable to a universal bank. The developments on this front should be good enough to satisfy the Reserve Bank of India.
- Make an inventory of all non-banking assets of the DCBs – these could include facilities like libraries, marriage halls or other assets which have the potential of earning revenue, but are not permitted under the current banking laws. Since the idea is to make a strong Kerala Co-operative bank, all such non-banking revenue generating assets should be hived off into a special purpose vehicle or a strategic sale to be undertaken. Preference may be given to PACS in such transactions. The assets will be marked to market and sold off. Thus, the co-operative system would also realise some capital gains and contribute to the capitalization of the structure without thus reducing the requirements of further financial investment.
- Care is to be taken to ensure that all the staff managing these facilities are also transferred to the Special Purpose Vehicle (SPV) or the acquiring entity. The committee recommends that the merger with the merged entity should happen only after these assets are hived off to the SPV or encashed.
- During the period, the excess funds of the co-operative system to be managed at a central level – either by establishing a special fund managed by professionals or with a well-capitalized, professionally managed KCB The fund will have two functions – managing liquidity – this would be done through treasury operations and managing yield on excess funds, which will be done through portfolio management.
- The DCB branch network should be constantly supervised and loss making and unviable branches should be closed down. All overlapping products with PACS and all branches directly competing with PACS should be closed down and some rationalization and redeployment of staff can happen.
- A detailed review of the level of computerization of PACS to be undertaken by the project management team, and adequate steps to be undertaken to bring the PACS ready on the IT platform to integrate with the financial infrastructure of the KSCB and the eventual KCB. Upgradation of PACS software and making it ready to plug into a large banking system to be done. Leveraging the NABARD's computerization plans is absolutely critical to manage costs.
- Make amendments in the Kerala Law to smoothen the process of merger of the upper tier co-operatives. The law to be thoroughly studied to ensure that the operational hurdles in mergers could be smoothened. The law should be reviewed to ensure that DCBs passing resolutions to merge with the new KCB happens seamlessly; it should be amended to allow PACS that have members of DCBs and are delaying the process of passing the resolution to voluntarily withdraw

from the membership of the DCB and seek a direct membership with KCB; To ensure that at a given time a PACS could only have a membership of either the DCB or the KCB; and once the PACS joins the KCB, it cannot withdraw its membership for a period of five years.

- The change in law should also ensure that at withdrawal of membership, the PACS gets a refund of its share capital as well as the pro-rata share in the free reserves of the DCB. The PACS thus withdrawing should invest the entire proceeds in the share capital of the KCB. This may be effected through book transfer and supported with legislation.
- Once these two are achieved, start the integration process. Even if all the DCBs pass a resolution for the merger immediately, the merger should happen through a phased process starting with the merger of two DCBs in the first instance, three in the second and then about six in the third instance and the rest in the fourth instance. In the process these DCBs would be thoroughly audited, all their losses and NPAs provided for and should be able to join the integrated structure with the click of a button.
- The HR would also be integrated in a gradual manner, but the integration of HR need not wait for the complete merger to happen. The integrated system could optionally draw resources from the DCBs through an open offer of appointment either on deputation or on a full-time basis. Staff of DCBs could apply to join the KCB ahead of the process of merger of a particular DCB by way of mutual understanding, even if the DCB is joining the KCB later. The HR acquisition may not be related to the size of the KCB during the process and any existing employee wanting to join may be allowed to join KCB without any ceiling on staff strength of KCB.
- In case the DCB does not pass a resolution for a merger within a reasonable timeframe, the State could review the situation at that point and take a call on how it wants to proceed with the residual integration process and pass appropriate legislations if needed.
- There should be assurances of parity in pay and seniority for DCBs that join the integrative structure later as and when the HR integration of DCBs happen. A detailed exercise for fixation of pay and fitment into cadres of KCB is suggested.

**Chapter 6: Issues in financial integration.**

6.1 At the level of DCBs the resources for the entities have come largely from PACS, other co-operatives, individuals and government. At the level of the KCB as well the investments have come in from DCBs and other co-operatives. In addition to the resources that are clearly identifiable by the parties who have contributed, there are also other resources held at both these tiers. These are in the form of past profits which manifests as free reserves. In general, we find that the total investments and the capital available at the level of the DCBs is significantly higher than the investments that the DCBs have made in KCB. However, when we are looking at the integrated picture, a careful exercise of cancelling out contra transactions has to be made. Otherwise we would end up assuming a larger resource base than available.

6.2 From the figures supplied by the RCS we find that the DCBs together has around Rs.1,092 crore of capital. This consists of capital contributed by the PACS to the extent of Rs. 649 crore; other cooperatives Rs. 180 crore; individuals Rs. 75 crore; and the government Rs. 185 crore. At the KCB level the share capital is around Rs. 679 crore, with two significant inputs. The A class capital of DCBs is around Rs. 385 crore. Since we are talking of the merger of the two systems, this amount will vanish from the liabilities side of the balance sheet as well as the assets side of the DCB Balance Sheet, leaving the net contribution to the integrated banking system of Rs. 294 crore – which are the B Class shares held. The System has made a loss of Rs. 341 crore which essentially means that in the integration process the contribution of the State co-operative bank to the kitty would be a negative amount of around Rs.50 crore. (The committee was informed that the provisional profit figures for the financial year ending 2017 is positive and could potentially contribute to capital).

6.3 Since the integrated entity will have no individual members, all the capital of the individual members in the DCBs will have to be returned. The committee recommends that this be done before the process of merger at the DCB level itself. The process of returning the share capital of individuals could happen even without the resolution for the merger with a directive from the Registrar of Cooperative Societies (RCS).

6.4 The KCB and the DCCB should wind down any individual loans that fall into the area of operation and into the category of the regular portfolio of PACS and transfer it to the respective PACS without prejudice to the loan terms and with mutual consent.

6.5 The capital of the KCB will have to be augmented to get it to adequate levels of capitalization as accepted by the RBI under its prudential norms. This augmentation of capital can happen in four ways:

- When the DCCBs pass resolutions and merge with the KCB, encourage PACS to contribute an enhanced amount of capital to the KCB;
- Encourage all other co-operatives to contribute to the capital of the KCB on par during the process of consolidation. Due to the recent ordinance, the non-credit co-operatives are no longer the voting members of the DCCBs and these co-operatives could be encouraged to withdraw their capital and invest it in KCB;

- Encourage PACS that are withdrawing their membership and capital from DCBs to contribute enhanced amount of equity to KCB;
- In addition, the State government should contribute to an offering of subordinated debt at very low interest rate to the KCB – signaling the independence of KCB as an autonomous co-operative and seeking the debt to be repaid as and when the integrated system starts earning handsome profits. This debt could be a long-term debt and structured in a way that it can be reckoned for capital adequacy purposes. The committee prefers the sub-debt route, but in case the State chooses, it could also provide a grant in aid to see the transition process. The committee would discourage the state government from taking an equity position in co-operatives.

6.6 In our interactions with various stakeholders, representations were made to the committee that that the share capital in the DCBs were recently augmented to achieve capital adequacy as per the requirements of RBI to ensure that the DCBs met the licensing and other prudential and regulatory requirements as specified by the RBI. It was indicated that most of the share capital had come in from PACS on the informal promise of a certain level of dividend. The stakeholders warned that if the merger plan was not acceptable to the lower chain, these share capital amounts may be withdrawn and there would be lack of resources due to the withdrawal of capital. The committee deliberated on this issue and found a way to address the issue. The PACS get a dividend on the nominal value of the share-holding in the DCBs. Co-operatives across the world operate on the principle of open membership and theoretically it is possible for a PAC to withdraw its share capital from a federal entity anytime. However, the PACS would have no claims on the funds and reserves created by the DCB over the years. Under normal circumstances in a merger, these reserves would be transferred to the eventual KCB as free reserves or as the identifiable stake of the current shareholders of the DCBs. The spirit of the co-operative principles would indicate that all free and non-identifiable funds should remain as such. These reserves would not be eligible for calculation of dividend and not available for further distribution, unlike undistributed profits. The committee feels that since each of the DCCBs are at different stages of evolution and their performance has been based on the past forgone profits of the PACS, the undivided reserves should be allocated as pro-rata share capital in the KCB for all A class members of DCB. The arguments for this are as follows:

- The membership of the DCBs though have been voluntary and open have in essence been stable over long periods, with largely additions to the DCB rather than PACS and other societies. A well performing DCB thus would have a larger share of undivided reserves in the merged entity and all PACS might just have a nominal capital. Some DCBs that have not been particularly profitable might have raised additional capital for the purposes of capital adequacy from the PACS. In such a scenario, the members DCB that has healthy undivided reserves should get a relatively lesser share in the merged entity while the weaker DCB with newly contributed identifiable share capital will get a disproportionately higher share capital.

- Since the merged entity will almost start as a merged entity with fresh capital coming in, its undivided reserves should be created over a period of time based on the performance of the merged entity.

6.7 In keeping with the spirit of licencing of universal banks by the RBI, the committee suggests that the shareholding of the merged entity be as broad-based as possible, not involving the State government in the equity structure, but opening up membership to all types of co-operative entities. In essence, KCB should be a bank that represents the stake of as many cooperative institutions as possible and provides on priority services to the co-operative sector. The committee also recommends removing the category of individual shareholders and redeeming their share capital at each stage of the merger process.

Table 6.1 Share Capital available in the Co-operative System (Rs. Crore)

| | Class A | Government (to be converted into sub-debt) | Individuals (to be redeemed at merger) |
|---|---|---|---|
| a.Capital of DCB | 825 | 182 | 75 |
| b.Capital of KSCB | 385 | 294 | |
| c.Reserves of KSCB | 431 | | |
| d.Losses of KSCB | 341 | | |
| e.Free Reserves of DCB | 704 | | |
| f.Undistributed profit DCB | 118 | | |
| g.Total Capital of KCB | (a+c-d+e+f) 1,737 | (a+b) 476 | 75 |
| Total Equity | 2,213 | | |

Deposits

6.8 Overall there is around Rs.53,000 crore deposits in the system if we negate all the deposits made by the DCBs in other DCBs and the KSCB. The challenge for the merged entity would be to retain these deposits. However, the fact to be highlighted is the following:

Table 6.2: Deposits in the co-operative system

| | Total (Rs.Crore) |
|---|---|
| a.Deposits in DCB – Other Societies | 7,629 |
| b.Deposits in DCB – Individuals | 18,748 |
| c.Deposits in DCB - PACS | 26,066 |
| d.Deposits in KSCB - DCCBS | 5,351 |
| e. Deposits in KSCB - individuals | 447 |
| f. Depoosits in KSCB - other societies | 314 |
| Total Deposits | 58,555 |
| Total Deposits for KCB a+b+c+e+f | 53,204 |

6.9 The primary co-operatives being societies and not banking institutions operating on the principle of mutuality can collect deposits from their members and use those resources to lend to the members. The primaries are not liable to the prudential regulation of maintaining liquidity both in terms of cash reserve ratios and statutory liquidity ratios. Given that the primaries have garnered around Rs.83,000 crore as deposits and have put in only around Rs.26,000 as deposits in the DCBs, it is clear that the monies are being managed fairly well at the primary level. However, given that DCCB/KSCB and later KCB would be subject to these prudential requirements where the funds earn a low interest rate and essentially are invested in government securities, it makes immense sense to route transfer as much of the loan business to the primaries. They would be able to deploy the resources more effectively and the apex institution should be managing only the residual liquidity of the primaries, making the sector as a whole more profitable. As of now the primaries as a whole had a CD ratio of about 68%, with some PACS, particularly in Idukki district having more than 100% CD ratio.

6.10 A major part of the deposits both in DCCBs and KSCB are in the form of expensive fixed deposits. The current and savings account represent only about 20% of the deposit base. Given that most of these deposits come from wholesale customers – like societies and institutions, there would be a case for financial disintermediation – particularly if the integrated entity is unable to deploy the funds effectively. The integrated institution will have to have a very strong treasury operation which would help the primaries to manage their surpluses through a pooling system.

6.11 The strategy for the merged institution would be to use a networked software and common protocols to deploy the surplus funds of the primaries to other primaries that are in shortfall. This can be an optimized automated software operating a the KCB level which decides on the basis of surplus-shortfall and a risk matrix to allocate funds from one PACS to the other, subject to a consent based on a risk score. KCB could get a fee for the information and risk grading matrix and do these transactions completely off the books thereby making it a win-win situation for both the PACS. In essence, the federal organisation and the primaries will operate in completely non-overlapping spaces. In fact the federal could also manage the rest of the surplus funds as a pure fund manager for the primaries, while doing banking entirely on the basis of the deposits – both institutional and individual – raised by the KCB directly. Thus the federation would have a fairly healthy fee based income, while the risk will be diversified across PACS who would be able to absorb that risk because of the premium pricing they would get and the higher yield on not having the SLR-CRR obligation. Going forward, given that the portfolios of the primaries could be available to be classified as priority sector loans there might be opportunities for securitization deals and offering derivative products.

6.12 The capital requirement of the KCB may be significantly moderated if the above business model is adopted.

Loans

6.13 Unlike the other states where the co-operative system is highly leveraged and predominantly a lending institution, in case of Kerala we find that the co-operative system, at all levels is an institution where people have saved significantly and the system in itself has not been able to adequately deploy the resources. The CD Ratio at the PACS level as a whole is about 68%, at the DCCB level the ratio is

53% and at the KSCB level it is less than 50%. Therefore, it is evident that the PACS are the most efficient in deploying the resources, and most of the resources at the PACS level are deployed in the retail.

Table 6.3 Loans of the Cooperative System

| | Rs. Crore |
|---|---|
| a.Loans to PACS | 5,491 |
| b.Loans to individuals | 18,359 |
| c.Loans to other societies | 2,349 |
| d.Loans to other institutions | 457 |
| e.Loans from KSCB to DCCBS | 1,746 |
| f. Loans from KSCB individuals | 734 |
| g. Loans from KSCB other societies | 172 |
| h.Loans to other institutions | 760 |
| Total Loans | 30,068 |
| Total loans for KCB a+b+c+d+f+g+h | 28,322 |

6.14If we were to find the co-operative system to be very savings oriented, then it is clear that the customers – the savers at the PACS and other levels would need significant value added products to continue as customers. The second aspect that is very clear – particularly looking at the amount of institutional lending that the system is undertaking, it is clear that the system does not have the skill sets to manage a wholesale, corporate, large institutions loan book. This aspect has to be kept in mind and a significant amount of HR interventions – recruitment of specialists as well as training of selected people will have to be made. In addition to the above significant issues, the structure will have to have a clear strategy on fund management particularly have a very active treasury and portfolio management division.

6.15As of now, the system needs a capital infusion of Rs.800 crore to be adequately capitalized. The provisional figures of profits of the KCB and DCBs indicate that this might get modified downwards. This is largely because the co-operative system is operating on a rather low CD ratio and therefore the resources are deployed in risk-free assets such as investments in financial instruments that are safe, carrying a lower risk weight. However, depending on the growth trajectory of the integrated institution and depending on the strategy chosen for integration the requirements of capital would change. Even without any growth in deposits, just with the better deployment of credit will require the provisioning of more capital. Given that as KCB they would have an aggressive plan of taking the CD ratio to 75% and also investing in market based instruments, the capital requirements at the current level of deposits would be an additional Rs.800 crore. If the status quo on the CD ratio continues, but the bank itself grows at a compounded annual growth rate of around 15% per annum, the structure would need an infusion of capital of around Rs.1,000 crore by 2019 (based on March 2016 figures). Therefore, if we are considering a moderate growth rate, we are looking at a capital infusion of around Rs.400 crore per annum.

6.16The committee recommends a process of integration that tilts towards managing the resources off the balance sheet, rather than scoop the funds and redeploy them. For instance, in the above equation of the total deposits of Rs.53,000 crore mobilized by the upper tier co-operatives, about Rs. 34,000 crore are raised from other co-operatives at the primary level. The rest of the deposits have been directly raised by the federal system. Similarly of the loans deployed, around Rs.8,000 crore are redeployed to PACS and other societies, while Rs.20,000 crore have been deployed to individuals and other institutions. In a managed integration model, the integrated entity would have only Rs.19,000 crore of deposits and 20,000 crore of loan portfolio that it has to manage on its books. The amount of Rs.8,000 crore given as loans to PACS and other societies could be done by arranging the amounts to deficit PACS from surplus PACS through information intermediation. The integrated entity can draw down only Rs, 11,000 crore (of the Rs. 34,000 crore surplus with the co-operative system) and keep the rest of the amount as managed portfolio on behalf of the primary co-operatives, thereby managing risks and returns in an efficient way. In this situation, the capital requirements of the integrated structure would be minimal and it is possible to manage at the current levels of capitalization. The pre-requisite for this is an integration of the IT systems and building of a very strong IT backbone.

6.17The above proposals would significantly change the sources of revenue to the KCB as well as change the nature of exchanges with the PACS. Given the substantial nature of changes, there is a need for thoroughly examining the accounting practices at each of the levels and bring it on par and comparable with modern banking corporations. It may be a good idea for the KCB to adopt mainstream corporate accounting practices and also voluntarily move towards following the new Indian Accounting Standards as well as prudential requirements under the Basel framework that is applicable to the universal banks. This would mean equipping the management team with computational abilities to assess risk and develop a risk evaluation framework. The committee would like add that such progressive, proactive decisions aligning with higher level of prudential banking and voluntary adherence to higher level of regulatory comfort will find favour with the regulators.

**Chapter 7 Issues in IT Integration**

Technology in DCCBs and KSCB

7.1 Thanks to facilitation by NABARD, all the DCBs and KSCB are on Core Banking Solution (CBS) platform. While nine banks used, the opportunity provided by NABARD to adopt the CBS and got on to Finacle of Infosys, one bank (Ernakulam DCB) had on its own acquired Finacle earlier. The remaining five banks use various other software solutions for their core banking. An assessment report was prepared by the State E-Governance Mission Team-Kerala at the request of the expert committee which is appended (Appendix 7.1). As seen therein, there is wide variation in both the deployment of technology and the use of technology among the banks. The latest acquisition facilitated by NABARD is also an older generation of Finacle 7.0.29. (The latest version of Finance currently in use is version 11E). As generally solution providers support the software versions on a V-1 basis (i.e. latest version minus one), it will be necessary to ensure support on an ongoing basis to ensure that there are no emergencies that may befall the system in case of major support requirements on an ongoing basis. This is also important because Ernakulam DCB which acquired the solution directly also has a Data Centre of their own, the KCB can utilize the same.

7.2 In fact, the status of adoption of technology in the three-tier cooperative banking structure is inadequate to meet the requirements of a modern bank. It will also be extremely costly for each DCB to acquire, continuously update, upgrade and maintain the technology solution on standalone basis. The modern banking which includes multiple channels, services, products and analytics require several enterprise applications to be plugged into the core banking solution as discussed later. It also requires a large number of approvals to be obtained. A list of these approvals and the present status is appended. (Appendix 7.2). As can be seen, several approvals are not obtained by most of the DCBs. It may also be kept in view that these approvals will require updating the technology solutions deployed on a continuous basis.

7.3 The Expert Committee note that the annual report of the Kozikode DCB has reported that already a committee has been formed for the purpose of introducing common accounting software in cooperative banks and a common banking software for integrating bank branches and that they have held detailed discussions with experts from the IT field. The Annual report adds that on the basis of the discussions so held a detailed roadmap has been submitted to higher authorities for approval. The committee recommends that this study be a taken into account for considering the integration of IT.

Skill sets and technology competency

7.4 The interactions with various stakeholders in the banks visited, as well as with employees' associations reveals that the skill sets and technology competencies of staff are inadequate. It was also found that there was a requirement for intensive training of staff on technology based banking. Several banks also do not follow essential practices like backing up data, appropriate security for access and transactions, access to servers etc. The disaster recovery and business continuity arrangements are not available in most of the banks.

Benefits of system integration and IT Upgradation

- Improved efficiency of operations
- Ability to provide more modern banking facilities
- Effective financial inclusion
- Provide banking facilities to all PACS members of the society level.
- Significant reduction in cost of IT infrastructure and maintenance.
- Improved risk management.
- Ability to develop meaningful management information from the system
- Ability to ensure appropriate and high level of regulatory compliance
- Possibility to expand business opportunities to hitherto untapped areas like credit cards, foreign exchange, NRI deposits, export credit, trade finance, cross selling products, strategic alliance etc.
- Leverage economies of scale on IT investments.
- Utilise existing software solutions, data centre with suitable upgradation, hardware.
- Availability of analytics facilitating improvements in customer experience, product and hence men's, product designing, process improvement, staff efficiency improvement etc.
- Greater ability and preparedness to meet competition
- Transformation into a world-class bank, first of its kind in India

System integration

7.5 The formation of Kerala cooperative bank will entail the integration of the books, database etc., of all the 15 entities involved. Some of the main challenges in this regard are discussed below.

- Multiple technology platforms: As mentioned above, there are 9 banks using Finacle 7.0.29 and one bank has deployed Finacle 7.0.18. Five banks use different other software solutions. This pose a challenge in preparing these five banks for data migration and system integration into one common platform.
- The banks do not have common account heads and uniformity of processes etc. This will have to be addressed, preferably by developing common account codes, processes, procedures etc., and deploying it in all banks through the directions of the RCS.
- Nine banks which Finacle 7.029 operate on Software as a Service model. The Ernakulam DCB has its own data centre and has bought a licence for Finacle 7.0.18. Thus 10 banks use Infosys provided Finacle. Two banks use Datamate version 3.28 provided by Datavision headquartered at Pune. One bank use C-Edge which is the solution provided by TCS-SBI joint-venture. One bank use Virmati 2.5 provided by the Virmati group from Ahmedabad. The remaining banks use

Intellect which is a product of Polaris. Discussions with the State E-Governance Mission Team-Kerala who studied the core banking system of 11 DCCBs/KSCB for the expert committee has indicated that the required data can be migrated/integrated into a common software solution.

- As different IT solutions are being deployed, there is significant differences in the process and procedures followed in different banks. The integrated solution will have uniform processes that may need intensive training of staff.
- The status of the accounts, particularly in NPA status of loans, computation of accrued interest, instalment dues, etc. have to be made up to date by each bank. Extensive study may have to be mounted to understand the variations in accounting, practices, processes and procedures. A time bound action plan will have to be put in place to prepare each entity for the migration process
- Culture differences are perceived between different amalgamating/merging entities. This may raise difficulties during the integration process and post integration period, as well as to maintain business as usual during the process till full integration, User Acceptance Tests, field tests and final roll out. Significant level of training/retraining is envisaged immediately and on an ongoing basis for the staff is envisaged.

7.6 Considering the challenges and complexities involved, the following system integration plan is proposed. The integration process shall include several stages. The proposed stages can be in alignment with the roll out plan envisaged elsewhere in the report. Even before the process is started, an expert team will have to selected and a Project Management Unit with a Project Management Head will have to be set up. One approach is to set up a qualified technical Special Purpose Organisation for IT integration. The EC would like to re-emphasise the importance of the project management unit and the high quality of the personnel in the unit both to head and man the operations is required to ensure successful, timely and effective roll out of the Technology enabled, modern, universally customer friendly Kerala Cooperative Bank.

Stage 1: preparatory stage

7.7 All banks may be brought under a common accounting system, product codes accounting treatment, NPA computation, etc. A task force with experts in banking, accounting, IT, audit and regulatory aspects may be constituted under the RCS to achieve this objective. Necessary administrative orders maybe passed by the RCS in this regard.

7.8 All banks may continue to function under Business as Usual basis using the uniform accounting process and procedures laid down by the committee once the same is implemented on a prospective basis.

7.9 The historical transactions may be migrated into the uniform pattern up to the date of the prospective switch over in each bank.

7.10 Once the historical transactions, data, accounts are migrated on bank by bank basis, the same may be subjected to audit for accuracy and necessary adjustments that may be required due to possible realignment of accounts, sub heads etc. may be carried out.

7.11 Thereafter, the accounts up to the date of switch over shall be migrated to a single database and integration process shall be taken up.

Stage 2: System integration

7.12 To begin with, one of the existing software platforms maybe used for integration. The Software as Service terms maybe re-negotiated, if necessary, with the service providers for use in a single large bank with branch network across the State instead of multiple banks as of now. All existing service arrangements like switches, sub-memberships, Special General Ledger accounts etc. maybe consolidated with single service provider under each/multiple categories as necessary to continue business as usual. (CBS, internet banking, ATM, card, mobile banking, treasury, alerts, Cheque Truncation System etc).

7.13 Technological feasibility of each DCB and KSCB be continuing its activities under the extant software may be negotiated. Banks on a different platform may be brought under a similar version. This will require acquiring the new software and migration to a common platform. Alternately, these banks may modify, as and if necessary, their oprations in such a way that they are ready for integration into a common platform when the final integration takes place. This may be cost effective. In such a case, it may be first integrated one by one into the common platform before they are integrated into the single entity. Once all banks are brought under common CBS platform, the master integration into one entity may be attempted. The arrangements shall necessarily involve business continuity at all existing branches. All existing branches will continue to function at stages one and two - in other words no branch rationalisation shall be attempted at these stages.

Stage 3: Disaster Recovery, Business Continuity

7.14 A single consolidated Disaster Recovery System and business continuity arrangement may be put in place. The entire historical/archive data required in this regard may be backed up into the disaster recovery/business continuity arrangement. Special care may be taken in case of the five non-finacle driven banks in this regard. Arrangements for real time back up into the Disaster Recovery System maybe done.

Stage 4: system upgradation

7.15 The KCB envisions high end technology adoption. Thus, the KCB's design principles include the provision of multiple channels of delivery, products, services etc. provided by any modern, automated, technology driven bank. Several enterprise applications will have to be plugged into the CBS for fulfilment. It is, therefore, suggested that an appropriate CBS may be acquired. It is understood that the current software in use is capable of rolling out all the services generally catered by all banks in India. However, the continuity of support must be ensured as discussed earlier in this chapter. This can be achieved either by using/upgrading the existing CBS platform to an appropriate level or going to the process of acquiring fresh solution. Subject to feasibility under technology acquisition/expenditure norms of the Government, the using/upgradation of the existing CBS platform maybe a more practical option as the overall preparedness will be higher and the transition faster.

7.16 The upgraded solution shall support products and services, regulatory compliance, security features etc. The solution must be India and international ready in terms of compliance to all national regulatory, statutory, mandatory prescriptions, directions, conventions etc. as well as capable of forex transactions, cross-border business etc. The continuity of support is another key aspect. The Committee would like to emphasise that it is advisable that the solution used may be acquired from a large, experienced banking software solution provider in India who have multiple banks as clients to ensure that they are constantly updated on regulations, market intelligence in terms of products, services, processes etc., Government policies etc. It is also essential to appoint a system integrator to ensure that all the enterprise applications are plugged into the core banking solution. This can be achieved on a phased manner depending on management comfort and institution readiness.

Stage 5: Enterprise Applications

7.17 It is suggested that the proposed bank may provide multiple channels, services, products, features etc. some of which are listed below*.

i. Any branch banking
ii. Anywhere anytime Banking
    - Automated Teller Machines (ATM)
        - Brown Label (own)
        - White Label
        - Other Bank ATMs
    - Point of Sale Terminals (PoS)
    - Internet banking
    - Mobile Banking
    - Phone Banking
    - Micro-ATM
    - Mobile Wallet
iii. Card Payment System
    - Credit Card
    - Debit Card
    - Pre paid card
    - Co-Branded Card
iv. MICR Clearing
v. Cheque Truncation System (CTS)

vi. Instant Funds Transfer
    - National Electronics Funds Transfer (NEFT)
    - Real Time Gross Settlement (RTGS)
    - Immediate Payment Service (IMPS)

vii. Electronic Clearing Service (ECS)

viii. National Automatic Clearing House

ix. Online payment for e-commerce transactions

x. Online settlement of stock market transactions

xi. Aadhaar enabled services
    - Aadhaar payment bridge system
    - Aadhaar enabled payment system
    - Aadhaar-based account opening

xii. Auto sweep in/out and Flexi Fixed deposit facilities

xiii. Wealth management service

xiv. Online services for international trade and payments

xv. Cash management service (CMS)

xvi. Customer relationship management (CRM)

xvii. Asset liability management (ALM)

xviii. Anti-money laundering (AML)

xix. Treasury Systems

xx. International electronic financial communication network

xxi. Structured financial management system (SFMS)

xxii. Online Bill payments

xxiii. E-statements

xxiv. Balance enquiry on mobile/ missed calls

xxv. Use of Banking Correspondents

Stage 6: Information Technology in Primary Cooperative Societies

7.18 The success of KCB will remain limited if the PACS are not included in the technology upgradation process. As the PACS are not banks, they will be able to provide modern banking and financial Services only by adopting technological solutions and linking to the KCB in such a way that it will be acceptable to the regulators. This linking up will require the services of a technology interphase between the PACS and the KCB with high degree of safety and security features. A major advantage in this context is that almost all the PACS in Kerala are on one or the other technology solution. A challenge in this context is that there are about 70 Technology Solutions that are used by PACS. It is, therefore, important to ensure that software solutions in each PACS is appropriately readied to link with the KCB through the interface. It is also necessary to ensure that the members of PACS who wish to use the various banking products and services of KCB are also made customers of KCB. For this, there might be a solution that could be sought from NABARD. There are also service providers with necessary solutions. It is also understood that most of the technology solutions in PACS can be linked up as envisaged with different degree of effort, but without any major overhauling. In fact, some of the PACS are already attempting this linkage. Such an integration will enable the PACS to render all channels of services, products etc., to their members who shall also be fully KYC compliant customers of KCB. With appropriate non-compete agreements, interests of PACS may be protected. Such an arrangement is recommended elsewhere in the report.

7.19 There is a need for the assessment of PACS and their IT preparedness to plug in to the integrated system to move towards an eventual roadmap of PACS having their own customized loan and deposit products. However, for products that are interoperable – like savings accounts that could be interoperable in case of customers, or excess funds that could be scooped into a central pool, or for treasury management for PACS on a fee basis etc, certain degree of standardization is recommended at the pan PACS level. In the long run, a single software solution for all PACS is recommended to reduce costs, ensure ongoing support and maintenance, uniform upgradations, greater efficiency, interoperability etc.

7.20 The KCB ecosystem may have to create some facility for PACS members to have a mirror account with the federal structure. Say a member from PACS – "A" wants to withdraw from an KCB ATM, the system should be able to transfer that amount from the PACS SB account to a mirror KCB account and pay the member through an automatic debit and credit. Details of systems and KYC requirements etc., need to be examined. The methodology for PACS to issue Ru-Pay Debit cards is detailed in Appendix 7.3.

7.21 The committee recommends that base technology must be carefully selected to ensure that appropriate technology with which the organisation can grow is selected. As of now the negotiations with the firm Indian Financial Technology and Allied Services (IFTAS) – which is a Section 8 company promoted by Institute for Development of Research in Banking Technology, which in turn is promoted by RBI may continue. The technical inputs provided by them must be considered to be rolled out at the PACS level. The information technology architecture must be scalable. While implementing the solutions there is need to undertake intensive due diligence on each entity involved in spite of the fact that they may be familiar organisations. The due diligence should look at systems, processes, hardware, software, people skills, management commitment etc,. The outcome of the due diligence exercise shall be used to plan the system integration process by identifying difficulties, technical show stoppers, synergies, positive factors etc.

7.22 The cultural differences in the involved entities must be examined. The study shall result in identifying attitudes, training needs, skill building requirements et cetera. It is possible that different timelines, training content, methodology etc. may be required for different entities. Serious marketing of the idea of big, modern, tech-enabled, multichannel bank must be attempted to motivate staff and to bring everyone on board and the system integration process must be carried out as quickly and seamlessly as possible. A largescale awareness campaign among PACS management and members may be mounted to allay fears and encourage full utilization of the services, products and facilities offered by a modern bank largely owned by them.

7.23The committee recommends that the integration of IT to a common platform, in order to ensure that there is security, stability, disaster recovery mechanism and power of bargaining. This will also lead to standardization of the formats and will create a base for integrating the IT with one click of a button eventually when the legal integration should happen. It may be a good idea for the tech team/ project management unit to interact with the technology team of State Bank of India to understand the issues they faced in merging with the associate banks and in particular with Bharatiya Mahila Bank – which was on a different platform. While the scale of the merger exercise of the State Bank group is of a different magnitude, is still would have very interesting insights. Investments could be made by the state government and it will give some assurances to the RBI and other regulators.

7.24The last and the most significant recommendation regarding the vendors of CBS services is in the opinion of the committee very critical. The centerpiece of the entire consolidation exercise depends on having a very strong and robust information technology architecture. If that were to happen, to the satisfaction of the regulator, with no risks to the customers, then the provider of the solution should have had an experience of handling a banking operation of the size of more than Rs.100,000 crore of total business. The request for proposal statement should therefore necessarily consider the clause on experience on handling large and complex banking operations.

Ref:

*Smart Banking, an Introduction by Sunil Aggarwal and Vinay K Nangia

## Chapter 8: Issues in HR Integration

8.1 HR integration is going to be the most daunting task in the exercise. As we envisage that the integrated bank would be technology driven slim bank, the number of employees it could absorb in the mainstream functions is limited. However, the committee realizes that neither retrenchment nor a voluntary retirement scheme is a viable option. The committee has consciously taken a no-pain approach and recommends a caliberated approach. Therefore, any action with regard to the HR is to be done in consultation with not only the employees' unions, but also with the employees themselves.

8.2 In the interaction with the employees' representatives, the committee found that they as a class had extended a widespread support for the integration exercise. The employees as a whole see stability of job and growth possibilities in the new integrated structure. The fact that the new bank is going to be a lean organisation would immediately raise some doubts and insecurity in the minds of the employees.

8.3 The intent of this exercise is not to retrench nor compulsorily retire employees. However, there has to be some way of rationalizing the employee strength. If it were to be a win-win situation, we need to ensure that adequate inputs are given to the employees so that there is a significant skill enhancement. Employees who are showing exemplary skills should be a part of the core team that is rolling out the integration process. Each employee would get an opportunity to be counselled and choose a redefined role in the integrated structure.

8.4 An age analysis would indicate that while most of the workforce is on an average above 40 years of age, indicating the challenges of re-training, there is little that is going to happen by way of natural attrition due to retirement in the next few years. It is important to look at these issues carefully to ensure that the transition to the new integrated structure happens without any loss of livelihoods to anybody.

8.5 If we were to look at the staffing of the new integrated bank, it is expected that the current branch network of all the DCBs put together – of around 800 branches will be rationalized. The committee envisages a substantially lower number of branches based on a new assessment of existing and potential business parameters. This would certainly mean that the employee strength would be not only in excess, but also in some levels with inappropriate skill sets given that many more specialised functions would be incorporated. The idea is that with a robust network of PACS at the village level, the integrated new bank will be doing only the business that is left over by the PACS and also providing fee based support services to the primaries. While in districts like Idukki, Kannur, Wayanad, Kasargod and Kozhikode, where the presence of the PACS is as good or better than the banking network, places like Ernakulam, Thrissur and Thiruvananthapuram might need a strong branch network of the co-operatives. Keeping in view the overall strength of the PACS and their ability to reach out to the customers, the committee envisages somewhere between 15 to 20 branches per district at the end of a five-year branch rationalization exercise. During this period there would be a freeze on general recruitment, with specific, skilled and justified recruitments will happen.

Table 8.1 Details of Employees in DCBs

| fSl.No. | Designation | Cadre | No. of Staff | Ave. Age | Ave. Year of Service | Academic Qualification | | | Ave. Gross Salary (Rs.) |
|---|---|---|---|---|---|---|---|---|---|
| | | | | | | PG | Graduate | UG | |
| 1 | General Manager | I | 12 | 44 | 11 | 11 | 1 | 0 | 89761 |
| 2 | Dy General Manager | II | 41 | 52 | 27 | 11 | 26 | 4 | 118176 |
| 3 | Executive Officer | III | 247 | 54 | 28 | 42 | 186 | 19 | 99494 |
| 4 | Inspector of Branches | III | 18 | 55 | 30 | 0 | 15 | 3 | 106594 |
| 5 | Senior Branch Manager | III | 147 | 54 | 28 | 21 | 108 | 18 | 100519 |
| 6 | Agricultural Officer | III | 9 | 40 | 9 | 5 | 4 | 0 | 66673 |
| 7 | Branch Manager | IV | 791 | 49 | 18 | 149 | 582 | 60 | 66764 |
| 8 | Superintendent | IV | 9 | 47 | 18 | 1 | 7 | 1 | 67631 |
| 9 | Chief Accountant | IV | 1 | 42 | 14 | 1 | 0 | 0 | 60627 |
| 11 | Public Relations Officer | IV | 3 | 40 | 12 | 2 | 1 | 0 | 60169 |
| 13 | Senior Accountant | V | 738 | 48 | 15 | 76 | 560 | 102 | 54481 |
| 16 | Accountant | VI | 745 | 45 | 11 | 117 | 485 | 143 | 42088 |
| 19 | Clerk | VI | 598 | 43 | 6 | 69 | 451 | 78 | 34598 |
| 20 | Clerk/Cashier | VII | 904 | 42 | 5 | 109 | 677 | 118 | 32962 |
| 21 | Cashier | VII | 23 | 48 | 13 | 3 | 16 | 4 | 43416 |
| 22 | Steno Typist | VII | 9 | 46 | 14 | 0 | 3 | 6 | 52857 |
| 23 | Typist | VII | 15 | 49 | 17 | 1 | 4 | 10 | 47848 |
| 24 | Typist cum Clerk | VII | 4 | 46 | 17 | 0 | 1 | 3 | 58155 |
| 25 | Telephone Operator | VII | 4 | 50 | 7 | 1 | 2 | 1 | 37487 |
| 26 | Data Entry Operator | VII | 12 | 44 | 8 | 1 | 8 | 3 | 38796 |
| 27 | Record Keeper | VIII | 18 | 50 | 22 | 0 | 0 | 18 | 60920 |
| 28 | Bill Collector | VIII | 169 | 52 | 21 | 0 | 3 | 166 | 50348 |
| 29 | Deffedar | VIII | 2 | 52 | 20 | 0 | 0 | 2 | 57117 |
| 30 | Shoroff | VIII | 52 | 50 | 25 | 0 | 0 | 52 | 59847 |
| 31 | Driver | VIII | 42 | 47 | 17 | 0 | 1 | 41 | 51645 |
| 32 | Caretaker | VIII | 4 | 48 | 24 | 0 | 0 | 4 | 67576 |
| 33 | Peon | IX | 646 | 43 | 7 | 12 | 120 | 514 | 26127 |
| 34 | Watchman | IX | 3 | 48 | 1 | 0 | 0 | 3 | 23394 |
| 35 | Lift Operator | IX | 1 | 48 | 13 | 0 | 0 | 1 | 23644 |
| 36 | Part - Time Sweeper | X | 828 | 44 | 11 | 0 | 13 | 815 | 15754 |
| 37 | Gold Appraisar | | 2 | 56 | 35 | 0 | 0 | 2 | 94614 |
| 38 | Electrical supervisor | | 1 | 36 | 1 | 0 | 1 | 0 | 82766 |
| | Total | | 6098 | | | 632 | 3274 | 2191 | 49812 |

Table 8.2 Details of Employees in KSCB

| | | | |
|---|---|---|---|
| CGM | 1 | | |
| DGM | 7 | Clerk Gr 2 | 12 |
| Senior Manager | 34 | Fair Copy Supt. | 1 |
| Law officer | 1 | Typist Gr I | 4 |
| Manager | 29 | Typist Gr II | 5 |
| Project Specialist | 1 | Steno Typist II | 5 |
| Asst Engineer | 1 | Driver | 1 |
| Overseer | 1 | Record Keeper | 1 |
| Accounts Officer | 12 | Care Taker | 1 |
| Senior Acct | 32 | Daffadar | 1 |
| Acct | 26 | Gold Appraiser/Cash Asst. | 17 |
| Elect | 3 | Bill Collector | 20 |
| Plumber | 1 | Peon / Peon Attender | 12 |
| Clerk Gr 1 | 26 | Guest House Attender | 9 |
| Reception | 1 | Part Time Contingent | 28 |
| Total | | | 293 |

8.6 The process envisaged was described earlier where if the branch does not meet certain business criteria it would be closed or if is in the area of operation of the PACS the business would be handed over to the respective PACS. This would have an implication on the people staffed in those branches and the employees are free to exercise one of the following choices:

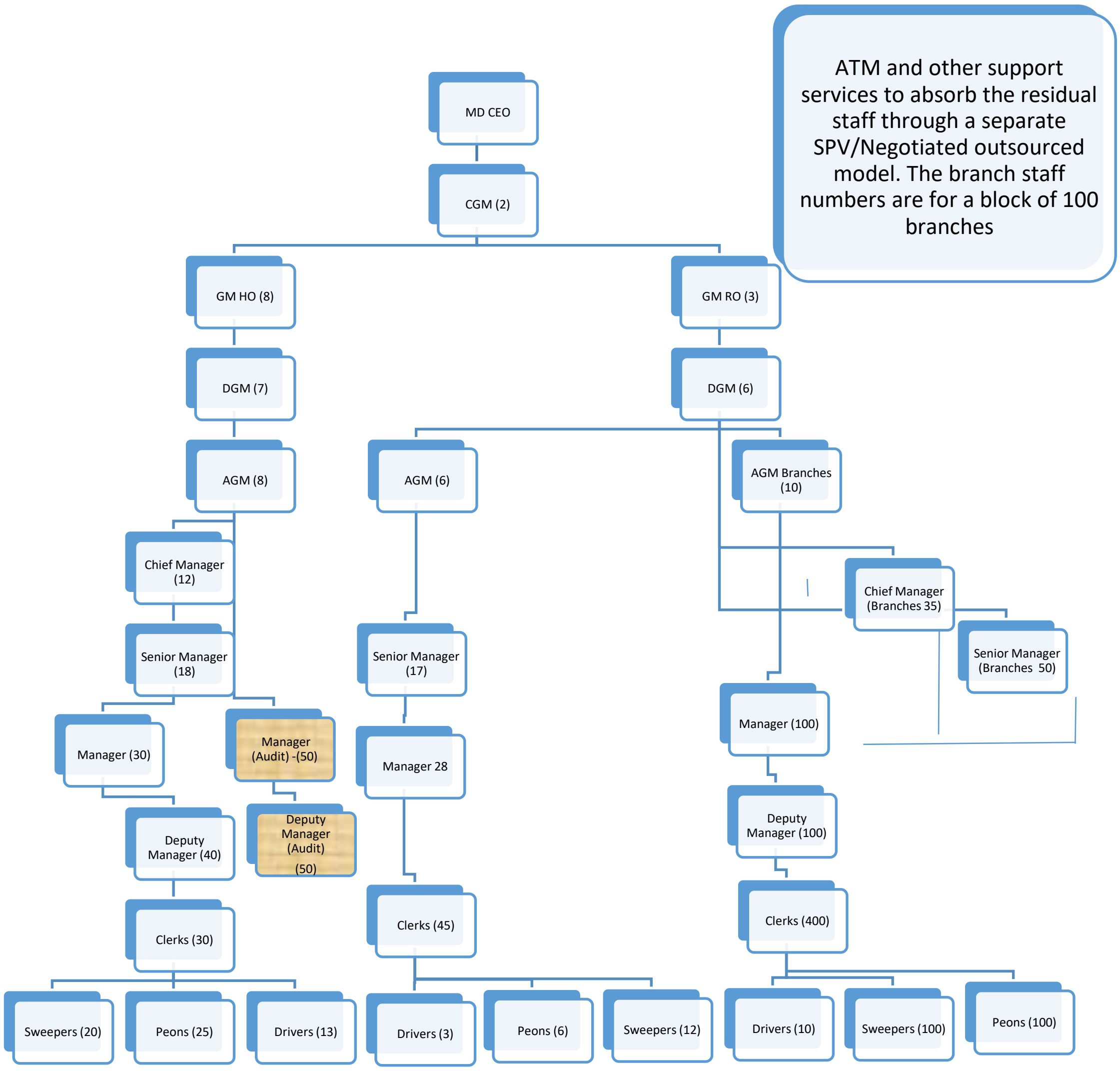
- If they have less than 10 years of residual service, seek voluntary severance package. The severance package should be employee friendly and should adequately compensate the employee wanting to move out;
- If they do not want to seek the severance package or they have more than 10 years of residual service, then seek a transfer to a proximate branch or the regional office. Given that under the new dispensation a significant amount of business would be pushed towards the PACS, it is envisaged that the KCB will manage a pool of resources who could be deputed to the PACS on a need and payment basis. The employees could seek to be a part of the pool and would be in regular employment with KCB.
- Alternately if the employee wants to move into specialised functions within the bank, subject to due diligence on qualifications, experience and aptitude, KCB would invest in reskilling of the employee and redeploy him or her in the preferred function.
- There would be natural attrition due to retirements. These positions will not be filled again unless there is a business justification.

Table 8.3 Staff requirements for the new KCB and the current staff position

| Projected staff requirements for KCB for every block of 100 branches | | | | Current staff strength in KSCB and DCBs | | | |
|---|---|---|---|---|---|---|---|
| Designation | HO | RO | Branches (100) | Equivalent cadre in SCB | Nos | Equivalent Cadre in DCB | Nos |
| CGM | 2 | | | CGM | 1 | Not Existing | 0 |
| GM | 8 | 3 | | DGM | 7 | GM | 12 |
| DGM | 7 | 6 | | Senior Manager/ | 34 | | |
| AGM | 5 | 6 | 10 | | | DGM | 41 |
| CM | 12 | | 35 | Manager/ Law officer/Asst Engineer/ Project Specialist | 32 | Ex Officer/ Inspector of branches/ Sr. Branch Manager/Ag. Officer | 421 |
| SeniorManager | 18 | 17 | 50 | Accounts Officer | 12 | Superintendent/Chief Accountant/ PRO | 804 |
| Manager | 30 | | | Senior Accountant/Overseer | 33 | Senior Accountant | 738 |
| Manager Audit | 50 | 28 | 100 | | | | |
| Deputy Manager | 40 | | | Accountant | 26 | Accountant/Clerk | 1343 |
| D M Audit | 50 | | 100 | | | | |
| Clerks | 30 | 45 | 400 | Clerk Gr1 Receptionist, Electrical Sup | 73 | Clerk/Cashier/Typist/Telephone Operator/Data Entry, Appraiser, Electrical Supervisor | 974 |
| | | | | Clerk Gr 2 | 22 | Record Keeper, Bill Collector, Dafedar, Shroff | 241 |
| Drivers | 13 | 3 | 10 | | 4 | Driver/Caretaker | 46 |
| Peons | 25 | 6 | 100 | | 49 | Peon/Watchman/Lift operator | 650 |
| Part time Sweepers | 20 | 12 | 100 | | | | 828 |
| | 310 | 126 | 905 | | 293 | | 6098 |

The above calculations for KCB are made on the assumption that each branch would fetch a deposit base of at least Rs.20 crore and will have a matching loan book. The Head Office and Regional Office staff would be fixed up to 300 branches and move proportionately after that. While the situation on just looking at the branch network appears that the system may be understaffed, that would not be true if we apply a deposit base of Rs. 20 crore as the criteria. As the rationalization process proceeds, the staff would be appropriately redeployed. The committee recommends that no action be taken which is detrimental to the interest of the employees and no action be taken without the explicit and willing consent of the employee.

A hierarchical depiction of the staff pattern detailed above is given in the flow chart below:




8.7 There is diversity in salary scales between DCCBs. The KSCB has a different and higher salary scale. There are also a large number of scales/ grades of employees which has to be rationalised to 14 grades. It is suggested that the existing grades may be regrouped based on functionality/ job description and made into 14 grades. The scales of KSCB may be taken as base and rationalised into 14 or less scales as required. The existing staff may be fitted into the derived scale of pay in such a manner that there is no reduction of pay.

8.8 It is envisaged that the branch would do local business – raising deposits and purveying retail loans in areas that are not covered by PACS. The committee envisages the following structure to emerge – the branch will raise local deposits, both retail as well as bulk and will be specialised in doing only retail loans. All bulk loans will be referred to the regional office – which would be located in Kochi, Kozhikode and Thiruvananthapuram. In addition the Thiruvananthapuram/Kochi office will have a strong IT cell which will act as back office for settlements and information intermediation for dealing with transactions between PACS.

8.9 From the above data, the committee has analysed and concluded that there could be excess staffing particularly in the cadres at the manager and the assistant levels, while the structure is adequately staffed at the clerical level. This is to be expected that in a modern bank, the number of clerical staff would be moderate but given the amount of downsizing in terms of number of branches, there has to be a scheme of redeployment of excess staff which will be discussed in the following section. In addition to the mismatch between the requirements at the gross level, there would be significant mismatch in skill sets required.

8.10New skill sets required: Back office IT team that manages information intermediation; Back office finance team that manages treasury and portfolio. This has not been accounted for in the above calculations and the committee envisages a team size of ten each. These requirements would have to be hired afresh or the existing employees may be retrained if found fit. There are two aspects that the committee has not considered in detail in the above calculation. Given that there is a significant focus on the strengthening the PACS, these institutions as a category would need significant support to ensure that they are fully integrated in the banking system. A team of 100 internal audit/inspection/supervisory function specialists would be needed if we were to inspect and audit each PACS both for systems and housekeeping, assuming a team of two spends one week each twice a year.

8.11In addition, the roll out of other touch points has not been considered. Assuming that each PACS branch as well as the branch of the integrated branch has an ATM, we are talking about more than 4625 ATMs. One way to redeploy the existing staff is to ensure that the entire management of ATMs is done on an inhouse basis, or if it is done on an outsourced mode, the contract should be awarded with an explicit agreement that they would recruit the excess staff of the co-operative system on a priority basis. Both these initiatives would be sufficient to absorb the excess staff detailed above.

Alignment and fitment of staff

8.12Before the merger process starts, the committee recommends that a specific study be done in order to examine the fitment and parity issues of the DCB staff. The principles of natural justice would entail two aspects – that an employee would not be placed as a total compensation which is less than what is being earned now and not in a level lower than what is available. The committee recommends rationalization of the cadres as indicated in the table above. The salaries and entitlements to the staff should eventually match that of the public sector commercial banks. However, that could only be implemented when the complete merger process is over and when the business parameters of the KCB becomes comparable with the public-sector banks. All salaries and allowances should be frozen at the current levels (except for inflation related hikes) till the process of merger is completed. Only when the process of merger is completed should the review of compensation be undertaken.

Performance Appraisal and Promotions and revision of compensation

8.13 The KCB should have a performance appraisal system that is objective and based on business targets. There should be a small economic analysis wing in the KCB that assesses the opportunity sets, looks at the growth parameters and gives the top management on the outlook for business in the following year including doing a sectoral analysis. This document would form the input for the central board. At the beginning of each calender year – say in the month of January, the bank should undertake a target setting process for the ensuing financial year. This target setting will move from the top to down, with the board setting broad business and profitability targets for the bank as a whole. The exercise would be similarly repeated down the line – setting the targets for regional performance by the regional offices and approved by the regional boards and the Regional managers in turn setting the targets for the branches. The targets for the other verticals will be set in the head office. In case any branch or the regional office has a significant problem with the targets set, they could appeal and these targets could be re-negotiated based on the reality locally.

8.14Compensation would be fixed on a regular scale. In case the employees miss the target by more than 10% of the agreed performance, the increment could be withheld for a year. Any over achievement of target by more than 10% may be compensated with a small bonus. However, in the overall appraisal of the employees, the average performance of the employee should be considered. In case an employee has underperformed in a given year while she could have achieved the targets in the previous years, they should be given a favourable dispensation before withholding the increment. In general a string of five years of target achievement should become a basis for considering the employee for an increment.

Training need analysis

8.15 At the beginning of each year, in addition to the target setting exercise, the employees should go through an objective setting exercise – this exercise would consider not only the financial targets, but also the career objectives set by the employee within the organisation. A counselling session with the reporting officer would review how the objective set by the employee has panned out in the previous year and what else, beyond business needs to be done in the following year. Based on this, they should arrive at a plan for objectives beyond business on skill upgradation, training and certification. An employee should have a right to go for at least a one week training programme once in two years – alternating between what the organisation wants and what the employee chooses. After every ten years of service the employee should have the option to go for a longer duration training of the employees choice. Subject to the budgets, the KCB should part or fully fund such programmes.

**Chapter 9: The proposed governance structure**

9.1 In suggesting the approach to a phased integration process, particularly with the technology integration, the integration of HR processes and systems and then a legal integration the committee has kept in the background the larger implications of how this would be perceived and how difficult/easy for the regulators to agree with the plans. The recent withdrawal of specified bank notes (demonetization) by the Reserve Bank of India and its dealing with the co-operative sector has given a practical instance of how the regulators perceive the co-operative sector. Clearly the co-operatives are not seen as modern, technology enabled, well governed institutions that could undertake tasks of strategic importance with faith reposed in the integrity of the processes. This is also amply demonstrated by transgressions in the co-operative sector during the process. While the co-operatives in Kerala are an exception in terms of their overall health, the perception that they are political institutions rather than banking institutions is very strong.

9.2 Some of the committee members have had informal interactions with the officials of the RBI and NABARD at the highest level to sense the level of comfort about the proposed integration and the approach is also guided by the apprehensions and the doubts expressed by the regulators off the record. The committee also had the benefit of interacting with Dr. YV Reddy, former Governor, RBI and the privilege of getting insights from him on how this could be structured.

9.3 The general perception about the proposed integration is seen as being triggered by the fact that State Bank of Travancore has merged with the State Bank of India and there is no local bank catering to the needs of the people of Kerala. The State government has resorted this to get a focus back on Kerala. While this should be an important regional consideration, the committee believes that there are many more advantages to be had from such a merger. While there are criticisms and a perception that the move is triggered by the political motive – given that this was announced both in the manifesto of the ruling party and in the Governor's address to the assembly, the committee has taken a dispassionate and objective view on the process. In the consultations some of the feedback that was received by the committee was:

- The current system was working well and there is no need to change;
- If there is a need to change, there must be a motive of diverting significant chunk of funds at the behest of the State;
- Even if these deployments are made at the behest of the state, there is no assurance that the necessary due diligence will be exercised.
- This will become a large institution and systemically important and difficult to manage in case of a failure.
- The concerns expressed by the co-operators and board members of DCBs across Kerala was that this will take away the localization and bring it to a centralized decision making model. The

argument that SBT's merger with SBI takes away the local focus can also be applied to this merger – in that it takes away the focus from the district to the state level.

9.4 While the committee firmly believes that the decision of the State Government is in the best interests of the co-operatives, is a futuristic decision taken in order to ensure that the co-operative banking sector remains vibrant, the committee also considered the feedback seriously as it believed that it was necessary to address these inputs from the wide range of stakeholders. Given these concerns some of which are not misplaced, issues, the best path is what the committee has suggested in the earlier part of the report – of functionally integrating the co-operative structure, while preparing ground for voluntary and phased merger of co-operative banks from the district level. This will give enough confidence for the RBI to give permissions to certain products and watch the progress before the complete set of permissions applicable to a universal bank are accorded to the bank. The committee noted that that this would be the first time that RBI would be granting such a permission to the co-operative sector (if it does) and they would like to be careful in setting precedents[2]. These views of the committee are based on good evidence, while there are no precedents of a proposal of this nature being presented to the regulator, the committee is confident that there could be no major roadblocks in carrying this forward. Kerala is adequately equipped to get these permissions if the case is made out convincingly.

9.5 One of the strongest ways in which the signaling for regulatory approvals is to ensure that there is a distance and insularity between the government and the operational functioning of the bank. Herein comes the dilemma of how representational the co-operative bank should be from the elected members and how professional should it be in its governance. Unlike milk co-operatives or other commodity co-operatives, financial co-operatives are embedded in the interconnected financial world and therefore pose a greater systemic risk in case of failure.

9.6 An indication of how the RBI looks at banking as a whole is evident not only in how it desires the governance of the banks – particularly private sector banks - in general as well as the guidelines it has for issue of new bank licences – whether these are universal banks or small finance banks. The operating principles of the RBI highlight the following issues:

- Ideally the shareholding of the banks should be widely held. While the public sector banks are an exception, there are stringent norms on how much an individual or a group of shareholders (acting in concert) could hold. Even for the new banks, there are very stringent divestment norms and listing norms. In general, at stable state, the RBI ensures that no single shareholder has more than 10% voting rights and any purchase of shares beyond limits need to be notified to the RBI.

[2] There has been a recent instance of RBI permitting the Jharkhand District Cooperative Central Banks to merge with the Jharkhand State Cooperative Bank, but the circumstances are completely different in that the structure is in losses, and the circumstances in which that merger is happening is completely different. In case of Kerala the measure is a pro-active measure than a reactive or inevitable measure.

- The appointment of the chief executive, and chairman is subject to the approval of RBI with fit and proper criteria. There is also specification on how diversified the board should be.
- It is also important to note that the board members or the institutions they represent cannot borrow from the bank, and when they borrow from other banks, the loans have to be approved by the board of the other banks.
- In case of public sector banks, the board is widely diversified, with the shareholders (other than government) get only three positions. The rest of the board is represented by the wholetime directors (Chief Executive, Executive Directors); representative from the Ministry of Finance; representative from the RBI; three eminent persons from diverse fields including agriculture, industry, economy, social services to be appointed by the Government; a chartered accountant; and a representative each of the officers and the clerical cadre.
- Even in case of RRBs the Act was recently amended to ensure that the board has a wide representation.
- Large banks like SBI have an intermediary structure of Local Boards which advise the local offices on the strategy and also take some decisions on behalf of the bank in terms of some loan proposals – thus giving an oversight at the local level for the operational management.

If we were to keep the above principles in mind, then there are significant implications both for the ownership and governance structure of the co-operatives.

9.7 In keeping with the spirit of widespread holdings in banking institutions, the committee suggests that the new integrated bank be a bank of the co-operative sector. This means that all co-operative institutions should be encouraged to hold shares in the bank. These shares should be non-refundable in nature (refundable only on liquidation of the co-operative bank) and given the co-operative principles non-transferable. Only in the unlikely instance of either the PACS going into liquidation or KCB going into liquidation would the question of refund of share capital will arise. In case of the PACS getting into liquidation, efforts will be made to sell those shares to other cooperatives and a refund will be as a last resort. All the shares of PACS currently invested in DCB would be transferred to the KCB on merger of the DCB. The PACS and other co-operatives will continue to invest in the shares of KCB in proportion to the business they do with KCB. Appropriate formulas for this will be worked out in due course.

9.8 In this case the issue for debate is whether the free reserves should be transferred to the KCB as free reserves. While the co-operative principles do not provide for any residual claims on liquidation, the committee thinks that this is a special case. In order to recognize the DCBs that are strong and have built up strong reserves on the basis of their underlying membership, it is suggested that the free reserves also be converted into shares to be held by the primaries in the KCB. The logic for suggesting this, is as follows. The principle of non-distribution of residual claims on liquidation holds to honour the principle of open membership. However, in the case of Banking, the open membership is applicable in principle (and to admit new members) while in practice none of the members withdraw membership. Therefore the appropriate valuation of the shares should be based on the individual shareholding of the PACS + pro-rata share in the free reserves. This may be weighted to the length of membership in the DCB, but that might just complicate matters without significant material benefit. Newer members may be admitted into the integrated structure, with appropriate premium to reflect pari passu status to honour the retained profits of the older members. This will also be fair because the KCB being a merged entity will start on a larger share capital base on which the PACS would be paid dividends. This will also honour the promises made by the DCB managements to get additional share capital to meet the capital adequacy requirements.

9.9 There should be no individual members/share holders in the KCB. State government and other public undertakings may contribute to the class B shares that have no voting rights. Ideally even these contributions are better made in the form of subordinated debt rather than equity. The capital structure should be open to get all tiers of capital that make up for the capital adequacy of the bank.

9.10The committee strongly recommends opening the membership to a wide range of co-operatives and institutions promoted by co-operatives. These would not only include PACS, but also other primary co-operatives, urban co-operative banks, PCARDBS and any other co-operative. This will help in making a case about widely held shareholding to the regulator.

9.11The committee recommends a two-level governance structure. In the previous section the committee has suggested that the bank have 3 regional offices[3]. Each of the regional office would have a reporting structure with a regional board, consisting of 15 members. The regional board will be elected from amongst the member co-operatives in that particular region. Given that the bank will work with PACS closely, and service the PACS for all the value added services, it is important that there is a good coordination between the PACS and the KCB. Therefore it is recommended that PACS have a significant representation in the governance by way of presence in the regional board. The committee recommends 9 positions for PACS– three from each of the slabs recommended below - on each of the regional board from the respective region. There would be a minimum criteria and a graded voting structure for being elected on to the board of the regional board. Each PACS should have a minimum membership of 500 members in order to be eligible to vote. The representation would be in three slabs. At the lowest level, the co-operatives should satisfy the criteria of 500 members. All co-operatives will be classified into three business categories.

- Slab 1 will have PACS in Class 1(including having a deposit base of more than Rs. 18 crore;
- Slab 2 will have PACS in class 2 and class 3 having a deposit base between Rs.7 crore and Rs.18 crore; and
- Slab 3 will have PACS in class 4 to 7 having a deposit base of less than Rs. 7 crore.

[3] In case there is a need for a special dispensation for hilly regions like Idukki and Wayanad, there could be a consideration to open an additional regional office. However, at this point the committee feels that three regional offices will suffice

In addition to the 9 positions earmarked to PACS, three positions will be earmarked for all other co-operatives that have a minimum membership of 500 and have a deposit base of Rs.25 crores. The reason for providing this representation is simple. Unlike the co-operative structure in the rest of the country where the governance is in the hands of the borrowing co-operatives, in Kerala it would be in the hands of member-cooperatives that have a significant size and accountability to their own members who have not only reposed faith in the management of the cooperative by electing them, but also put in their own savings.

Three more positions in the Regional Board will filled by eminent professionals from the field of academics, chartered accountants, lawyers, leaders from civil society organisations. These persons will be nominated by the Governemnt of Kerala and would be subject to the fit and proper criteria and subject to approval from NABARD or RBI. The Regional Manager will be the secretary of the Regional Board and will not have a right to vote. The CEO of the bank and the CGMs will be special invitees to the board. The members will elect a chairperson from amongst the elected members in the regional board. The chairperson will represent the co-operatives in the KCB board as well.

9.12The role of the regional board is review the progress of the region, lay out strategies and to coordinate with the central board in case of necessity. The regional board will also review the loans made by the regional managers. All projects that are within the region and have an exposure of upto Rs.25 crore will be dealt at the level of the regional board. While the regional manager will have an approval power of upto Rs. 1 crore, all other loans beyond this upto Rs. 25 crore have to be approved by a sub-committee of the regional board. The sub-committee of the regional board will have five members, one each from each category of board members, on a rotational basis. The term for a member on a committee should be 6 months. The members will chose a chair from amongst themselves for the sub-committee.

9.13The central board will have a total of 15 members divided as follows:

- Three elected members, who are chairpersons of the regional board will naturally find a place on the central board;
- Three members on the board will be on the board as ex-officio members – and this would include Secretary Co-operation, Secretary Agriculture or Rural Development and the Chief General Manager of NABARD;
- Three members will be from the employees of the co-operative structure. One position would be earmarked for a representative from the clerical cadre of the employees; One position for a representative of the officers cadre and one person would be a PACS secretary. All these positions will be filled up in consultation with the respective recognized unions and will go through and independent approval of RBI.
- Three members on the central board will be co-opted by the board with academic or professional credentials representing diverse fields.

- Three members would be co-opted by the board from amongst eminent citizens drawn with expertise in social sector, economics, agriculture, rural development and related fields. It is expected that none of these persons except the elected representatives from the regional boards can simultaneously be holding a political office.

In case of the categories co-opted by the board, it is expected that a sub-committee of the board designated as the nominations committee would do the scrutiny and forward the papers to the regional office of RBI for approval. If we assume a perpetuating board, it is possible to envisage that after a few iterations, there could be independent members on the nomination committee. The Expert committee strongly recommends that the nomination committee be chaired by an independent member.

9.14All the members on the board should sign declaration of independence, that they would not borrow from the KCB and would not have any pecuniary relations. The exception to the declaration of independence are the elected representatives of the co-operatives who might have a financial relationship through their respective primary co-operative. The board members should be compensated adequately for their time.

9.15In addition to all the board matters, a sub-committee of the central board will also take up loan proposals of more than Rs.25 crore. The sub-committee should be of five persons, one each from each of the categories mentioned above on a rotational basis. The CEO will be the secretary for all board and sub-committee meetings, without a voting right.

9.16The chairperson of the board would be elected from amongst the non-official members. While it is desirable that the chair should represent the primary members, the committee would keep it as a recommendatory clause.

9.17The board also should have adequate number of sub-committees for smooth functioning. A nomination and remuneration committee; a committee for technology and related issues; a CSR committee; an audit committee; a customer grievances committee; a risk management committee; and other committees that aid the board. Each of these committees should compulsorily meet once in a quarter. The board should meet atleast once in two months.

9.18KCB should not only have a pro active engagement with the society, it should also voluntarily have an earmarked fund for corporate social responsibility. While it is not mandatory for the co-operatives to earmark funds for such activities, the committee strongly recommends that the KCB earmark 2% of its profits for such activity, to be deliberated and implemented by a board level committee for corporate social responsibility.

9.19The bank will have a very strong customer protection framework. There should be a clear mechanism for any customer from the co-operative system – including PACS to approach the authorities for redressal of all grievances. Given that there would be much integration through the use of technology and value added services will be provided at the PACS level, it would be difficult for the customer to understand if the problem she is facing is at the local level or the systemic level. Therefore a centralized and independent customer protection mechanism should be established. This should be supervised by a customer grievances and protection sub committee of the central board.

9.20 The bank will have the membership of all credit bureaus and self-regulatory organisations. It will also participate in industry level public forums and be an active member in the state level bankers' committee. It will be a good corporate citizen.

Changes in the regulatory architecture

9.21 The committee strongly recommends setting up of a Kerala State Financial Sector Regulatory Authority. While this is not directly related to the terms of reference of the current committee, but given that there are multiple types of financial institutions that are not governed either by the banking regulation act or the RBI Act, it is important that the State takes a view on the orderly growth of financial institutions in the state. Kerala is famous for its gold loan companies, chit funds and other informal and semi formal mechanisms of financial intermediation. Moreover and also importantly, the committee recognizes that the PACS in Kerala has a very large deposit base of over Rs.83,000 Crore which are not subjected to any prudential regulations and also do not come under the cover of DICGC. It also do not have preemptions like SLR/CRR as instruments of depositor protection. Therefore, the committee strongly recommend this arrangement. This authority could interface with the RBI for all regulatory issues. In such a case, a large part of the prudential management of the co-operative system (including the urban co-operative banks) will devolve on the state authority.

**Chapter 10: Next steps**

Based on the report submitted by the committee the government could sequence the following immediate steps:

1. Set up a project management unit and a project advisory board.
2. Make preparations to amend the Kerala State Cooperative Societies Act to facilitate:
    a. Change the name of KSCB to KCB.
    b. Allow the seamless transfer of assets and liabilities of DCBs into the KCB by allowing Primaries of those DCBs who have passed the resolution for merger to become direct members of the KCB.
    c. Ensure that the provisions allow the primaries to get share capital in KCB not on the face value of the shares invested in DCBs, but also based on the valuation based on the free reserves available at the DCB level
    d. Ensure that primaries that are under any other DCBs that may not have not passed a resolution of merger are free to withdraw membership from the DCB and seek membership with KCB.
    e. Ensure that the primaries can only be a member of one federal financial co-operative
    f. Allow other cooperatives to seek membership in KCB
    g. Allow for setting up a special purpose vehicle to transfer the non financial assets of DCBs to be held in trust till they are sold off.
3. Inform RBI and NABARD about the intent of merger. Make presentations to NABARD and Reserve Bank of India – particularly to the top management of these institutions to get their in-principle approval and a timeline on the merits of the argument.
4. Provide for a budgetary allocation of Rs. 1,000 crore for recapitalization of the integrated structure, investments in IT platform and HR realignment expenses. This amount should preferably be given as a long duration (or perpetual) subordinated debt with a soft interest rate and released subject to certain milestones being achieved. If the KCB goes through an aggressive path of growth, the state may have to provide an additional sum of Rs.500 crore each for the next two years. These amounts should be returned by the KCB as and when they fall due, if they are not in the nature of a perpetual debt.
5. Simultaneously start the preparatory work at each DCB – cause a special audit with figures for March 2017, make an inventory of non financial assets, and proforma consolidated balance sheets of the entities that are to be merged in the first instance.
6. Simultaneously start the process of understanding the technology platforms at PACS level and understand what it takes for the PACS to plug and play with the envisaged architecture at KCB and make preparatory efforts.
7. Place this report in public domain and ask for comments and based on the comments take a call on which of the recommendations have to be modified.

# Appendices

## Appendix 1.1 Government Order and Terms of Reference

GO(Rt)No.488-16 dated 29/09/2016

1. Government have decided in principle to explore the possibility of forming a Kerala Co-operative Bank by amalgamating/merging the Kerala State Co-operative bank and 14 District Co-operative Banks
2. Government have declared the intention of the same in the Governor's address on the 24th June 2016. It was also declared in the Budget speech in July 2016, that an Expert Committee will be constituted for submitting a detailed report after studying the various aspects of the formation of the Kerala Co-operative Bank.
3. In the circumstances, Government are pleased to constitute with immediate effect an expert committee with the following members to study the various aspects of the amalgamation/merger of the Kerala State Co-operative Bank and the 14 District cooperative Banks and to furnish a detailed report for the formation of the Kerala Co-operative Bank by amalgamating the Kerala State Co-operative Bank and the 14 District Co-operative Banks.
    1. Sri. M S Sriram, Professor, IIM Bangalore Chairman
    2. Sri. VS Senthil IAS, Additional Chief Secretary, Planning Department
    3. Sri. CP Mohan, Chief General Manager (Retired) NABARD
    4. Sri TP Balakrishnan, General Manager (Retired) Union Bank
    5. Sri P Venugopal IAS, Special Secretary, Co-operation Department
4. The committee will furnish the report within 3 months from the date of its formation.
5. The Terms of reference of the expert committee is appended herewith.

KERALA CO-OPERATIVE BANK

Terms of Reference (ToR)

1. To conduct a detailed SWOT analysis on proposed structural change with sufficient primary and secondary data.
2. To prepare a detailed scheme for merger incorporating all Assets and Liabilities of 15 Banks (14 DCBs + KSCB) and its combined strength with respect to 31.03.2016 and a projected level consequent on the merger with a view to get necessary approval from RBI/NABARD.
3. To review the present status of Human Resources in the DCBs & KSCB and prepare a scheme for cadre merger. A new organizational set up and a plan for post-merger recruitment, training and professional development also be suggested.

4. To review the present status of Technology in each bank and suggest a feasible scheme for merger of technology. Post-merger high end technology and its effectiveness also may be highlighted. Possible methods of technologv network expansion with PACS may also be suggested.
5. To make recommendations for the necessary amendments in the Kerala Cooperative Act, Rules and Bye-laws of the acquiring Bank and member PACS/Societies.
6. To make Suggestions and recommendations for ensuring compliance with the statutory/legal requirements for obtaining approval for merger from RBI/NABARD.
7. To make suggestions and recommendations for ensuring compliance with the statutory procedures for notifying merger alter obtaining the approvals from RBI/NABARD
8. To frame a clear and detailed vision for 'Kerala Co-operative Bank'
9. To prepare model operational guidelines for 'Kerala Co-operative Bank' consequent to merger of 14 District Co-operative Banks with Kerala State Co-operative Bank.
10. To make suggestions for new products and services, marketing and brand development.
11. To provide suggestions and recommendations on the post-merger linkages with member primary banks/societies and other Co-operatives (Verlical & Horizontal)
12. Any other related issues that the committee may want to opine on.

## Appendix 1.2: Co-operative identity, values & principles

### Definition

A co-operative is an autonomous association of persons united voluntarily to meet their common economic, social, and cultural needs and aspirations through a jointly-owned and democratically-controlled enterprise.

### Values

Co-operatives are based on the values of **self-help**, **self-responsibility**, **democracy**, **equality**, **equity** and **solidarity**. In the tradition of their founders, co-operative members believe in the ethical values of honesty, openness, social responsibility and caring for others.

### Principles

The co-operative principles are guidelines by which co-operatives put their values into practice.

#### 1. Voluntary and Open Membership

Co-operatives are voluntary organisations, open to all persons able to use their services and willing to accept the responsibilities of membership, without gender, social, racial, political or religious discrimination.

#### 2. Democratic Member Control

Co-operatives are democratic organisations controlled by their members, who actively participate in setting their policies and making decisions. Men and women serving as elected representatives are accountable to the membership. In primary co-operatives members have equal voting rights (one member, one vote) and co-operatives at other levels are also organised in a democratic manner.

#### 3. Member Economic Participation

Members contribute equitably to, and democratically control, the capital of their co-operative. At least part of that capital is usually the common property of the co-operative. Members usually receive limited compensation, if any, on capital subscribed as a condition of membership. Members allocate surpluses for any or all of the following purposes: developing their co-operative, possibly by setting up reserves, part of which at least would be indivisible; benefiting members in proportion to their transactions with the co-operative; and supporting other activities approved by the membership.

#### 4. Autonomy and Independence

Co-operatives are autonomous, self-help organisations controlled by their members. If they enter into agreements with other organisations, including governments, or raise capital from external sources, they do so on terms that ensure democratic control by their members and maintain their co-operative autonomy.

**5. Education, Training and Information**

Co-operatives provide education and training for their members, elected representatives, managers, and employees so they can contribute effectively to the development of their co-operatives. They inform the general public - particularly young people and opinion leaders - about the nature and benefits of co-operation.

**6. Co-operation among Co-operatives**

Co-operatives serve their members most effectively and strengthen the co-operative movement by working together through local, national, regional and international structures.

**7. Concern for Community**

Co-operatives work for the sustainable development of their communities through policies approved by their members.

Source: International Co-operative Alliance. Accessed from http://ica.coop/en/whats-co-op/co-operative-identity-values-principles accessed on 9th January 2017.

**Appendix 1.3 List of Meetings held by the Expert Committee**

| Date | Meeting |
|---|---|
| 21st October 2016 | First meeting Of the Expert Committee |
| | Meeeting with Honorable Minister for Co-operation |
| | Meeting with Honourable Minister for Finance |
| | Meeting with Chief Secretary, Kerala Government |
| 31st October 2016 | Meeting with Board of Directors of KSCB |
| | Meeting with Board of the Directors of Thiruvananthapuram DCB |
| | Meeting of Expert Committee members |
| 1st November 2016 | Meeting with Board of Directors of Kollam DCB |
| | Meeting of the Expert Committee |
| 7th November 2016 | Meeting with Board of Directors of Alappuzha DCB |
| | Meeting with Board of Directors of Ernakulam DCB |
| 8th November 2016 | Meeting with Board of Directors of Idukki DCB |
| | Meeting with Board of Directors of Pathanamthitta DCB |
| 15th November 2016 | Meeting with Representatives of Co-operative Employees Organisation |
| | Meeting with Representatives of DCB Employees Organisation |
| | Meeting with Representatives of KSCB Employees Organisation |
| | Meeting with Representatives of PACS Association |
| | Meeting with General Managers of District Co-operative Banks |
| 29th November 2016 | Meeting with Board of Directors of Malappuram DCB |
| | Meeting with Board of Directors of Thrissur DCB |
| 7th December 2016 | Presentation of State-e-Governance team (SeMT) before expert committee |
| | Meeting with Administrative Committee members of State Co-operative Union |
| 19th December 2016 | Meeting with Board of Directors of Kasaragod DCB |
| | Meeting with Board of Directors of Kannur DCB |
| 20thDecembr 2016 | Meeting with Board of Directors of Wayanad DCB |
| | Meeting with Board of Directors of Kozhikkode DCB |
| 7th January 2017 | Meeting with Board of Directors of Kottayam DCB |
| 14th January 2017 | Meeting with Eminent Co-operators |
| | Meeting with Presidents of Apex Co-operative Institutions |
| | Meeting with Directors of Co-operative Training Institutions (ICM Kannur, ICM Thiruvananthapuram & ACSTI) |
| 20th January 2017 | Meeting with Vice Chairman, Kerala State Planning Board |
| | Meeting with Hon'ble Chief Minister of Kerala |
| | Meeting with Hon'ble Finance Minister of Kerala |
| 25th January 2017 | Meeting with Board of Directors of Palakkad DCB |
| 13th March 2017 | Discussion with Law Secretary, Govt. of Kerala |
| 18th and 19th April 2017 | Meeting with Dr. YV Reddy, former Governor RBI |
| | Final meeting of the committee |

**Appendix 4.1 List of approvals required for a full-fledged banking institution from various departments of the Reserve Bank of India**

1. Centralised payments system - Current Account
2. INFINET
3. SGL Account
4. SGL IDL Account
5. NDS
6. RTGS & Settlement Account
7. NEFT
8. NECS
9. Membership of credit information companies (such as CIBIL, experian, CRIF High Mark, Equifax)
10. Authorised Dealer License
11. SWIFT registration
12. Obtaining a bank code
13. Fixed Income Money Markets Dealers' Association (FIMMDA) membership
14. Application for inclusion of name in the Second Schedule to the RBI Act, 1934
15. Obtaining a BSR/ AD code
16. Deposit Insurance and Credit Guarantee Corporation (DICGC) membership
17. Indian Banks' Association (IBA) membership
18. Membership of Banker's Clearing House with RBI
19. Mobile banking
20. Money transfer service scheme
21. Membership of the local clearing houses not managed by RBI
22. Membership of the clearing grid)
23. CCIL membership for securities segment
24. Application to various Departments for password, user ID and software for filing returns online
25. Appointment of auditor
26. Application for obtaining MICR
27. Application for IFSC Code
28. Nostro Accounts
29. NPCI Certifications for RuPay, Immediate Payment Systems (IMPS), Aadhar based Electronic Payment Systems (AEPS), Cheque Truncation System (CTS), National Automated Clearing House (NACH), Aadhar Enabled Payments Systems (AEPS), and National Financial Switch (NFS).
30. CERSAI Registration
31. Financial Intelligence Unit (FIU_IND)

**Appendix 7.1 Assessment & Recommendation Report of 11 -District Cooperative Banks Core Banking System**

**State e-Governance Mission Team, Kerala**

Introduction:

This report is an addendum to the assessment report submitted to the committee earlier. This report includes consolidated report of findings and recommendations by state e-Governance Mission Team after the field visit of the eleven District Cooperative Banks. We have to visit remaining DCBs i.e., Thrissur, Malapuram, Thiruvananthapuram and Kerala State Cooperative Bank. In these remaining DCBs except Thrissur DCB all are having Finacle 2.09 SaaS version which are having almost same configuration and issues. This report we can treat as final report for comparison of technical, functional and non-functional parameters found in all the DCBs visited till now.

Recommendations and Standards to be followed for all DCBs and KCB

1 All the DCBs should be brought to one common CBS Systems

2 Mandating the Establishment of Disaster Recovery facility

3 If Disaster Recovery facility is not permissible in case of Software as Service model

- Mandatory Provisioning of regular data backup of the bank should be ensured.
- Regular Disaster Recovery & Business Continuity Process drills should be carried out every quarter without fail to ensure the readiness of the bank in case of any emergency.

4 Backup mechanism should be standardised across all the DCBs

5 Regular Training and capacity building of the IT wing and functional experts should be carried-out in regular interval and imparting of this training should be part of the contract with the vendor. The IT wing should be capable of extracting, data or making dynamic reports as and when required

6 Mandatory ISO/IEC -27001 –ISMS auditing and certification for IT security for all the DCBs and KCB

- Regular internal IT security Audit
- Third party audit of the IT security system

7 Internal auditors should be trained in using the multiple CBS. They should be aware of extracting reports so that they can themselves extract from the live system and verify

8 If any of the accounting reports are made outside the CBS then the underlying reports should be extracted and filed along with the main report for verification. Auditors should verify the correctness. This being temporary recommendation and whereas the permanent one will be to get the system ready to generate report directly wherever it is not available currently

9 Apart from functional audit system audit also should be carried out

10 Third party audits should be brought in as mandatory practice

11 A read only or view only console of all the DCBs should be available at the office of RCS. This should have exposure of bare minimum menus to

- Random verification
- To know current health and status of any of the DCB

12 One time verification of all General ledger items and their codes should be conducted. There should be standard terminologies brought in across the district and schemes.

IT resources and CBS system of the 11 DCBs

**Field Study report of IT resources and Comparison Study of CBS system of the 11 DCBs**

| S.No | Location | CBS | Data Centre | Automated Reports | Account Code Standardisation | Configurable parameters | DR availability | DR drill Conducted | Back ups | Team | Skill Set | Interfaced Systems | Issues |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| 1 | Kollam | Finacle 7.0.29 SaaS Model by NABARD | No | Error in Reports. They do manual reporting. | Yes | Yes | Yes | Yes | No | DGM+7 | As show is run by Wipro only basic operating skill will be available | Offline interfaces HO System & HRIS | Serious Connectivity Issue, no Backup provided till now |
| 2 | Alappuzha | DataMate Version 3.28 | Yes | Only formatting is done manually | Yes | Yes | No | No | Tape | DGM+5 | Skill to operate and administer is available | Offline interfaces | |
| 3 | Ernakulum | Finacle7.0.18 | Yes | All reports generated from the system | Yes | Yes | No | No | Tape | DGM+33 | Finacle skill of both usage and administration is high as it is managed internally-Strong Inhouse Team is available | Loan system sends data to CBS for account creation and updation | |
| 4 | Pathanamthitta | DataMate Version 3.28 | Yes | Error in Reports. They do manual reporting. | Yes | Yes | No | No | Tape | GM+4 | Average skills and team sizing is required they can be trained | Offline interfaces Loan and recovery tracking system, HRIS | |
| 5 | Idukki | Finacle 7.0.29 SaaS | No | Reports are extracted | Yes | Yes | No | No | No | GM+10 | Average skills and team sizing | No-Offline Interfaces | Serious Connectivity Issue, no |

| | | | | | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | | Model by NABARD | | from the system and updated manually | | | | | | | is required they can be trained | | Backup provided till now |
| 6 | Kasargod | Finacle 7.0.29 SaaS Model by NABARD | No | Reports are extracted from the system and updated manually | Yes | Yes | No | No | No | | Average skills and team sizing is required they can be trained | Offline interfaces Loan and recovery tracking system, HRIS | Serious Connectivi ty Issue, no Backup provided till now |
| 7 | Kannur | Veeramathi 2.5 | Yes | All reports generated from the system | Yes | Yes | No | No | Tape | | Skill to operate and administer is available - Good Hardware Team is Available | No- Offline Interfaces | MIS Reports |
| 8 | Wayanad | Finacle 7.0.29 SaaS Model by NABARD | No | Reports are extracted from the system and updated manually | Yes | Yes | No | No | No | | Average skills and team sizing is required they can be trained | Offline interfaces Loan and recovery tracking system, HRIS | Serious Connectivi ty Issue, no Backup provided till now |
| 9 | Kozhikode | Finacle 7.0.29 SaaS Model by NABARD | No | Reports are extracted from the system and updated manually | Yes | Yes | No | No | No | | Strong team with good skills which is Medium Sized Team and they can be utilised for other development | Offline interfaces Loan and recovery tracking system, HRIS, | Serious Connectivi ty Issue, no Backup provided till now |

| | | | | | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | | | | | | | | | | | al purposes also | | |
| 10 | Kottayam | Finacle 7.0.29 SaaS Model by NABARD | No | Reports are extracted from the system and updated manually | Yes | Yes | No | No | No | Sr Manager + 9 | Average skills and team sizing is required they can be trained | Offline interfaces Loan and recovery tracking system, HRIS, | Serious Connectivity Issue, no Backup provided till now |
| 11 | Palakkad | Intellect from Intellect Design Arena LTD a Subsidiary of Polaris | Yes | All reports generated from the system | Yes | Yes | No | No | yes | DGM+ 15 Members team | Average skills and team sizing is required they can be trained Only One technically trained resource is available for entire technical operations | Offline interfaces Loan and recovery tracking system, HRIS, | No issues |

* Internal auditors need to be consulted on the reports which they get to audit

** Exit management part of the contract with respective vendors need to be studied

**Appendix 7.2 List of Approvals required and status**

| No | List of approvals required | Thiruvanant hapuram | Kollam | Pattanamthi tta | Palakkad | Malapura m |
|---|---|---|---|---|---|---|
| | | 1 | 2 | 3 | 4 | 5 |
| 1 | Centralised payments system - Current Account | | Kollam DCB has current account with Reserve Bank of India. Currently we are using the account for CTS/NACH settlement. | Approval required | Implemented | Current Account |
| 2 | INFINET | Nil | Bank has no membership with Indian Financial Network. | Approval required | Required | No |
| 3 | SGL Account | SG020076 with IDBI | Bank has CSGL with SBI DFHL | Already have SGL account | Required | No |
| 4 | SGL IDL Account | Nil | | Already have SGL account | Required | No |
| 5 | NDS | Nil | | Approval required | Required | No |
| 6 | RTGS & Settlement Account | Direct Account : nil | Bank has introduced the RTGS by sub-membership model. The sponsor Bank is M/s Yes Bank Ltd. The settlement deals by the sponsor Bank. | Approval required ( Currently having sub membership through IDBI Bank Ltd) | Sub Membership with AXIS bank | Obtained as sub member of IDBI |
| 7 | NEFT | Sub membership -IDBI | Bank has introduced the NEFT by sub-membership model. The sponsor Bank is M/s Yes Bank Ltd. The settlement deals by the sponsor Bank. | Approval required ( Currently having sub membership through IDBI Bank Ltd | Sub Membership with AXIS bank | Obtained as sub member of IDBI |
| 8 | NECS | Nil | Bank has membership with National Electronics Clearing Service. | Approval required ( Currently having sub membership through | Obtained | Obtained |

| | | | | | | |
|---|---|---|---|---|---|---|
| | | | | Federal Bank Ltd) | | |
| 9 | Membership of credit information companies (such as CIBIL, experian, CRIF High Mark, Equifax) | CIBIL, CRIF, EQUIFAX | Bank has membership with Equifax, Highmark & CIBIL | Already have membership in all CIC companies | Registered | Obtained |
| 10 | Authorized Dealer License | SBI-DFHI, IDBI, STCI | Bank has not any type of foreign money dealing License. | Approval required | Required | Not available |
| 11 | Intimation to RBI for commencement of business | Nil | | Already have | Obtained | Intimated and obtained license |
| 12 | SWIFT registration | Nil | Bank has no registration with SWIFT | Approval required | Required | Not obtained |
| 13 | Obtaining a bank code | Nil | All branches of the Bank has MICR code which provided by RBI | Already have | Required | Not obtained |
| 14 | Fixed Income Money Markets Dealers' Association (FIMMDA) membership | Nil | Bank has no membership with FIMMDA, but selected employees are trained by FIMMDA | Approval required | Required | No |
| 15 | Application for inclusion of name in the Second Schedule to the RBI Act, 1934 | Not Applied | Bank has not submitted application for the inclusion of name of the Bank in the second schedule to the RBI Act, 1934 | Approval required | Required | No |
| 16 | Obtaining a BSR/ AD code | Nil | Bank has submitted application for BSR code to RBI, but not yet allotted. | Approval required | Obtained | Not obtained |
| 17 | Deposit Insurance and Credit Guarantee Corporation (DICGC) membership | Registration No: 3710 | Bank is a member of DICGC | Bank already have DICGC membership | Obtained | Obtained |
| 18 | Indian Banks' Association (IBA) membership | Nil | Bank has no membership with IBA | Already have | Obtained | No |
| 19 | Membership of Banker's Clearing House with RBI | Member | Bank has membership with | Approval required | Obtained | Obtained |

| | | | | | | |
|---|---|---|---|---|---|---|
| | | | Chennai clearing house of NPCI | | | |
| 20 | Mobile banking | Nil | Not yet introduced. | Approval required | Required | Not obtained |
| 21 | Money transfer service scheme | Nil | IMT service not introduced | Approval required | Required | Not obtained |
| 22 | Membership of the local clearing houses not managed by RBI | Nil | Yes | Already have | Obtained | Obtained |
| 23 | Membership of the clearing grid) | Southern Grid | Bank has membership with southern grid of NACH clearing house | Approval required | Required | Obtained |
| 24 | CCIL membership for securities segment | Nil | Bank has no membership with CCIL | Approval required | Required | 1 |
| 25 | Application to various Departments for password, user ID and software for filing returns online | RBI, FIU-IND,TDS, ENSURE,ITDREIN | Bank is using online software for filing return to RBI & NABARD | Already have | Required | Available |
| 26 | Appointment of auditor | Nil | Co-operative Department, Govt. of Kerala is appointing the Concurrent Auditor of the Bank | Already have | Obtained | Obtained |
| 27 | Application for obtaining MICR | Micr Code:69518000 | All branches of the Bank has MICR code | Already have | Obtained | Obtained |
| 28 | Application for IFSC Code | IBKL0046T01 | Bank has IFSC on the basis of sub-membership with M/s Yes Bank Ltd | Already have | Obtained | Obtained as sub member of IDBI |
| 29 | Nostro Accounts | Nil | Bank has Nostro Account | Approval required | Required | No |
| 30 | NPCI Certifications for RuPay, Immediate Payment Systems (IMPS), Aadhar based Electronic Payment Systems (AEPS), Cheque Truncation System (CTS), National Automated Clearing House (NACH), Aadhar Enabled Payments Systems (AEPS), and National Financial Switch (NFS). | NPCI certifications for RuPay, CTS,NACH,NFS | Bank has sub-membership with NPCI for RuPay debit card, EMV chip based Kisan Card, ABPS, CTS, NACH &NFS. | Only IMPS & AEPS certifications pending | NPCI Certification, CTS, NACH. NFS- Obtained<br><br>IMPS, AEPS - Required | |

| | | | | | | |
|---|---|---|---|---|---|---|
| 31 | CERSAI Registration | NIL | Bank has no membership with CERSAI | Approval required | Required | Not done |
| 32 | Financial Intelligence Unit (FIU_IND) | BADCB00397 | Bank has regularly reporting regarding CTR &STR to FIU_IND | Already have | Obtained | Obtained |

| No | List of approvals required | Kozhikode | Wayanad | Kannur | Kasaragod | KSCB |
|---|---|---|---|---|---|---|
| | | **6** | **7** | **8** | **9** | **10** |
| 1 | Centralised payments system - Current Account | Received Approval to participate in CPS Current A/c OK | No | Nil | YES, Sub membership | Nil |
| 2 | INFINET | Got membership From RBI | No | Nil | No | Nil |
| 3 | SGL Account | YES | No | NIL | YES | CSGL Obtained |
| 4 | SGL IDL Account | YES | No | Nil | No | Nil |
| 5 | NDS | YES | No | Nil | NO | Nil |
| 6 | RTGS & Settlement Account | YES | Sub Membership with Federal bank | Sub membership mode, settlement with Axis Bank | YES, Sub membership | Sub membership mode, settlement with IDBI |
| 7 | NEFT | YES | Sub Membership with Federal bank | Sub membership mode, settlement with AXIS Bank | YES, Sub membership | Sub membership mode, settlement with IDBI |
| 8 | NECS | YES | Yes | NIL | No | Obtained |
| 9 | Membership of credit information companies (such as CIBIL, experian, CRIF High Mark, Equifax) | YES | Yes | NIL | YES | registered |
| 10 | Authorised Dealer License | Nil | No | Nil | No | Nil |
| 11 | Intimation to RBI for commencement of business | | Yes | obtained | Yes | obtained |
| 12 | SWIFT registration | Nil | No | Nil | No | Nil |
| 13 | Obtaining a bank code | Nil | 839 | obtained | Yes | obtained |

| | | | | | | |
|---|---|---|---|---|---|---|
| 14 | Fixed Income Money Markets Dealers' Association (FIMMDA) membership | Nil | No | Nil | No | Nil |
| 15 | Application for inclusion of name in the Second Schedule to the RBI Act, 1934 | Application Submitted | No | Nil | No | obtained |
| 16 | Obtaining a BSR/ AD code | Nil | 673839 | Nil | No | Nil |
| 17 | Deposit Insurance and Credit Guarantee Corporation (DICGC) membership | YES | Yes | obtained | Yes | obtained |
| 18 | Indian Banks' Association (IBA) membership | Nil | No | obtained | No | obtained |
| 19 | Membership of Banker's Clearing House with RBI | YES | Yes | obtained | Yes | obtained |
| 20 | Mobile banking | YES,Licence Received | Implementation under process | Nil | No | Nil |
| 21 | Money transfer service scheme | Nil | No | Nil | No | Nil |
| 22 | Membership of the local clearing houses not managed by RBI | YES | Yes | Nil | Yes | obtained |
| 23 | Membership of the clearing grid) | YES | No | Direct Membership | Yes | Sub-membership |
| 24 | CCIL membership for securities segment | Nil | No | Nil | No | Nil |
| 25 | Application to various Departments for password, user ID and software for filing returns online | YES | | obtained | Yes | obtained |
| 26 | Appointment of auditor | Yes | Yes | obtained | Yes | obtained |
| 27 | Application for obtaining MICR | YES | Yes | obtained | Yes | obtained |
| 28 | Application for IFSC Code | YES Obtained IFSC Code | Yes | Sub-member of Axis Bank | Yes | Sub-member of IDBI |
| 29 | Nostro Accounts | Nil | No | Nil | No | Nil |
| 30 | NPCI Certifications for RuPay, Immediate Payment Systems (IMPS), Aadhar based Electronic Payment Systems (AEPS), Cheque Truncation System (CTS), National Automated Clearing | Rupay - OK<br>IMPS - in progress<br>AEPS- in progress<br>CTS-- OK<br>NACH-OK | AEPS, CTS, NACH,NFS-Yes | CTS in live mode, NACH ,AEPS Direct membership ,NFS sub membership with | Yes | Rupay card and CTS in Golive mode, NACH sub membership with IDBI,NFS sub |

| | | | | | | |
|---|---|---|---|---|---|---|
| | House (NACH), Aadhar Enabled Payments Systems (AEPS), and National Financial Switch (NFS). | AEPS-OK NFS -OK | | Federal Bank for ATM & POS services | | membership with SBT for ATM services |
| 31 | CERSAI Registration | Nil | No | NIL | No | |
| 32 | Financial Intelligence Unit (FIU_IND) | YES | Yes | obtained | No | obtained |

**Appendix 7.3 Methodology Recommended by NABARD for Issuing RuPay Credit Cards by PACS**

Methodology:

Where the DCCB branch maintains a digital member Register (DMR) in respect of the PACS account and the PACS member opens a KCC/SB account with the DCB.

This will be a new product introduced by the bank

**Background and suitability**: This is a completely automated model and it also takes care of all the checks and balances required. In this methodology; the PACS member who does not have a KCC S/B account with the DCCB, is required to open a KCC S/B account with the DCCB branch to facilitate issue of KCC Rupay card. This account will then be linked to the Digital Member Register (DM R) of the member, details of which are already present in the designated DCCB.

**Operations and Transaction flow:**

1. DCCB branch maintains DMR in respect of the PACS account where individual details of each of the borrowing members of PACS including sanctioned credit limit is captured in digital form.
2. Members open a "KCC S/B account" in the DCCB complying with KYC requirement and are issued a debit card.
3. Any debit transaction by the electronic debit card in ATM/POS is first routed to the members KCC/Savings account but gets reversed/nullified immediately. This transaction after reversal will then reflect in the PACS account with the DCCB as well as the DMR in the person's folio. The balance in the KCC S/B will always be "NIL".
4. An O/D limit, equal to the member's KCC limit is required to be sanctioned by the DCCB to the member.
5. The drawable limit in the account will be controlled through balance in the DMR.
6. All credits by the members will also get credited to the PACS account and the DMR.
7. The member will be able to withdraw from his limit only electronically through ATM/POS/micro ATM.
8. In other words, DCCB or PACS will not operate on this account for any purpose including debiting the same for interest recovery.
9. For DBT/savings requirement of the member another savings bank account/ account under PMJDY will be opened based on the same user lD and KYC, and would be linked to Aadhaar. The advantage in this system will be that the PACS member will be able to operate his loan account through electronic means 24x7.
10. Appropriate documentation also has been suggested by NABARD.

**Appendix 8.1 HR Details with Age Profile**

| No | Name of DCCB | Number of cadres | Total Staff | Total Bank Function staff | Other staff | Employees above 55 years | 52-55 years | 50 to 52 years | 48 to 50 years |
|---|---|---|---|---|---|---|---|---|---|
| 1 | Thiruvananthapuram | 37 | 705 | 614 | 84 | 58 | 88 | 57 | 98 |
| 2 | Kollam | 37 | 523 | 468 | 55 | 70 | 82 | 42 | 63 |
| 3 | Pathanamthitta | 37 | 455 | 380 | 75 | 34 | 60 | 40 | 41 |
| 4 | Alappuzha | 37 | 444 | 375 | 69 | 39 | 68 | 42 | 42 |
| 5 | Kottayam | 37 | 418 | 353 | 65 | 39 | 56 | 38 | 54 |
| 6 | Idukki | 37 | 345 | 236 | 109 | 22 | 40 | 24 | 40 |
| 7 | Ernakulam | 37 | 464 | 371 | 93 | 41 | 65 | 34 | 55 |
| 8 | Thrissur | 37 | 472 | 446 | 26 | 38 | 70 | 39 | 76 |
| 9 | Palakkad | 37 | 344 | 301 | 43 | 36 | 40 | 20 | 46 |
| 10 | Malappuram | 37 | 399 | 360 | 39 | 36 | 43 | 29 | 40 |
| 11 | Kozhikode | 37 | 504 | 429 | 75 | 48 | 47 | 40 | 63 |
| 12 | Wayanad | 37 | 197 | 167 | 30 | 14 | 24 | 10 | 17 |
| 13 | Kannur | 37 | 522 | 434 | 88 | 28 | 61 | 47 | 75 |
| 14 | Kasargod | 37 | 308 | 211 | 97 | 11 | 25 | 16 | 29 |
| 15 | KSCB | 37 | 284 | 254 | 30 | 28 | 25 | 28 | 37 |
|  | TOTAL |  | 6384 | 5399 | 978 | 542 | 794 | 506 | 776 |
|  | % to Total |  |  |  |  | 8.49 | 12.44 | 7.93 | 12.16 |

Appendix 8.2 HR Details Employee Profile : Consolidated Data –DCBs

| Sl.No. | Designation | Cadre | No. of Staff | Ave. Age | Ave. Year of Service | Academic Qualification | | |
|---|---|---|---|---|---|---|---|---|
| | | | | | | PG | Graduate | UG |
| 1 | General Manager | I | 12 | 48 | 9 | 10 | 2 | 0 |
| 2 | Deputy General Manager | II | 41 | 52 | 27 | 10 | 25 | 6 |
| 3 | Executive Officer | III | 247 | 54 | 22 | 27 | 148 | 66 |
| 4 | Inspector of Branches | III | 18 | 55 | 9 | 0 | 15 | 3 |
| 5 | Senior Branch Manager | III | 147 | 54 | 12 | 21 | 108 | 18 |
| 6 | Agricultural Officer | III | 9 | 40 | 6 | 5 | 3 | 1 |
| 7 | Branch Manager | IV | 791 | 49 | 18 | 134 | 531 | 125 |
| 8 | Superintendent | IV | 9 | 47 | 3 | 1 | 7 | 1 |
| 9 | Chief Accountant | IV | 1 | 42 | 1 | 1 | 0 | 0 |
| 10 | Marketing Officer | IV | 0 | 0 | 0 | 0 | 0 | 0 |
| 11 | Public Relations Officer | IV | 3 | 40 | 3 | 2 | 0 | 1 |
| 12 | Senior Inspector | V | 0 | 0 | 0 | 0 | 0 | 0 |
| 13 | Senior Accountant | V | 738 | 48 | 15 | 70 | 500 | 157 |
| 14 | Chief Cashier | V | 0 | 0 | 0 | 0 | 0 | 0 |
| 15 | Assistant Manager | V | 0 | 0 | 0 | 0 | 0 | 0 |
| 16 | Accountant | VI | 745 | 45 | 10 | 105 | 441 | 175 |
| 17 | Inspector | VI | 0 | 0 | 0 | 0 | 0 | 0 |
| 18 | 1 st Grade Typist | VI | 0 | 0 | 0 | 0 | 0 | 0 |
| 19 | Clerk | VI | 598 | 21 | 3 | 69 | 451 | 78 |
| 20 | Clerk/Cashier | VII | 904 | 24 | 3 | 103 | 531 | 252 |
| 21 | Cashier | VII | 23 | 48 | 1 | 3 | 16 | 4 |
| 22 | Steno Typist | VII | 9 | 46 | 5 | 0 | 1 | 7 |
| 23 | Typist | VII | 15 | 49 | 9 | 0 | 5 | 7 |
| 24 | Typist cum Clerk | VII | 4 | 46 | 2 | 0 | 1 | 3 |
| 25 | Telephone - Telex Operator | VII | 4 | 50 | 2 | 1 | 2 | 0 |
| 26 | Data Entry Operator | VII | 12 | 50 | 5 | 1 | 7 | 4 |
| 27 | Record Keeper | VIII | 18 | 50 | 6 | 0 | 0 | 18 |
| 28 | Bill Collector | VIII | 169 | 44 | 18 | 0 | 3 | 139 |
| 29 | Daffedar | VIII | 2 | 52 | 3 | 0 | 0 | 2 |
| 30 | Shroff | VIII | 52 | 63 | 9 | 0 | 0 | 52 |
| 31 | Driver | VIII | 42 | 43 | 15 | 0 | 1 | 35 |
| 32 | Caretaker | VIII | 4 | 36 | 5 | 0 | 0 | 3 |
| 33 | Peon | IX | 646 | 43 | 7 | 12 | 117 | 458 |
| 34 | Watchman | IX | 3 | 48 | 0 | 0 | 0 | 3 |
| 35 | Lift Operator | IX | 1 | 48 | 1 | 0 | 0 | 0 |
| 36 | Part - Time Sweeper | X | 828 | 44 | 11 | 0 | 13 | 731 |
| 37 | Gold Appraiser | | 2 | 56 | 3 | 0 | 0 | 0 |

**Appendix 8.3 HR Details Employee Profile : Consolidated Data –KSCB**

| *Sl.No.* | *Designation* | *No. of Staff* | *Ave. Age* | *Ave. Year of Service* | *Academic Qualification* | | |
|---|---|---|---|---|---|---|---|
| | | | | | *PG* | *G* | *UG* |
| 1 | Chief General Manager | 1 | 49 | 1 | 1 | | |
| 2 | Deputy GM | 7 | 55 | 33 | 1 | 6 | |
| 3 | Senior Manager | 34 | 51 | 24 | 9 | 25 | |
| 4 | Law Officer | 1 | 56 | 23 | | 1 | |
| 5 | Manager | 29 | 48 | 21 | 2 | 27 | |
| 6 | Project Specialist | 1 | 41 | 8 | 1 | | |
| 7 | Assistant Engineer | 1 | 28 | 2 | | 1 | |
| 8 | Oversear | 1 | 50 | 25 | | | 1 |
| 9 | Accounts Officer | 12 | 39 | 7 | 4 | 8 | |
| 10 | Senior Accountant | 32 | 38 | 5 | 11 | 21 | |
| 11 | Accountant | 26 | 38 | 5 | 6 | 19 | 1 |
| 12 | Electrician | 3 | 53 | 25 | | | 3 |
| 13 | Plumber | 1 | 49 | 25 | | | 1 |
| 14 | Clerk Gr I | 26 | 37 | 1 | 11 | 15 | |
| 15 | Receptionist /Pbx Operator | 1 | 33 | 1 | | 1 | |
| 16 | Clerk Gr II | 12 | 49 | 23 | 1 | 1 | 10 |
| 17 | Fair Copy Supt. | 1 | 56 | 31 | | 1 | |
| 18 | Typist Gr I | 4 | 51 | 22 | | | 4 |
| 19 | Typist Gr II | 5 | 30 | 0 | 1 | 4 | |
| 20 | Steno Typist II | 5 | 37 | 0 | | 4 | 1 |
| 21 | Driver | 1 | 43 | 5 | | | 1 |
| 22 | Record Keeper | 1 | 50 | 32 | | | 1 |
| 23 | Care Taker | 1 | 57 | 32 | | | 1 |
| 24 | Daffadar | 1 | 56 | 34 | | | 1 |
| 25 | Gold Appraiser/Cash Asst. | 17 | 45 | 18 | 1 | 1 | 15 |
| 26 | Bill Collector | 20 | 46 | 17 | | 4 | 16 |
| 27 | Peon / Peon Attender | 12 | 42 | 5 | | 2 | 10 |
| 28 | Guest House Attender | 9 | 42 | 3 | | 2 | 7 |
| 29 | Part Time Contingent | 28 | 51 | 19 | | | 28 |
| Total | | 293 | | | 49 | 143 | 101 |

**Appendix 8.4 HR Details – Part Time Sweepers and Peons with Average age**

| No | Name of DCCB | Number of PTS | Avg Age of PTS | Number of Peons | Avg Age of Peons |
|---|---|---|---|---|---|
| 1 | Thiruvananthapuram | 84 | 45 | 62 | 41 |
| 2 | Kollam | 52 | 46 | 60 | 43 |
| 3 | Pathanamthitta | 71 | 34 | 68 | 45 |
| 4 | Alappuzha | 66 | 45 | 34 | 42 |
| 5 | Kottayam | 62 | 48 | 51 | 42 |
| 6 | Idukki | 53 | 45 | 42 | 44 |
| 7 | Ernakulam | 86 | 48 | 43 | 43 |
| 8 | Thrissur | 25 | 38 | 24 | 45 |
| 9 | Palakkad | 43 | 48 | 37 | 43 |
| 10 | Malappuram | 38 | 41 | 63 | 42 |
| 11 | Kozhikode | 70 | 45 | 66 | 42 |
| 12 | Wayanad | 27 | 43 | 27 | 40 |
| 13 | Kannur | 59 | 43 | 25 | 43 |
| 14 | Kasargod | 49 | 42 | 44 | 43 |
| 15 | KSCB | 28 | 51 | 16 | 39 |
| | Total | 813 | 662 | 662 | 637 |

*(The following explanatory note contains views of Task Force formed for the formation of Kerala Cooperative Bank only. The Government decsions on all recommendations of Expert Committee as well as the Task Force will be finalised only after considering the views and feedbacks from all stake holders including general public)*

**Explanatory note on recommendations of Expert Committee and road map for formation of Kerala Coopertive Bank**

***Background***

The resolve of Government of Kerala to reform the federal structure of the credit co-operatives of the state from the existing three tier to a two tier system, by merger of all the 14 District Cooperative Banks with the Kerala State Cooperative Bank was announced in the Hon'ble Governors' address to the State Assembly on 24 June 2016. As a sequel to this, the State Govt. appointed an Expert Committee headed by Prof.M.S.Sriram to go into all aspects related to the merger and come out with a blue print for the merger of the 15 entities into one single entity.

The Expert Committee submitted its report to the State Govt. on 28 April 2017. The State Cabinet, in principle, approved the recommendations contained in the Expert Committee report and decided to implement the same taking into consideration the socio economic fabric of the state of Kerala. Towards this end in view, the State Government constituted a Task Force headed by Shri. V.R. Raveendranath, Chief General Manager, NABARD (Rtd.) and experts from the domain of Banking, Cooperation and Information Technology, to examine the recommendations made by the Expert Committee and prepare a road map for the formation of the new bank, based on the recommendations of the Expert Committee by seeking necessary approval from the regulators.

The Task Force examined in detail various recommendations made by the Expert Committee, mainly from the regulators perspective, the prevailing competitive banking environment, legal framework in place, the fast changing socio economic canvas of the state and suggested a few changes.

The major proposals made by the task force on the salient features of the new bank, after considering the recomendations of the Expert Committee, are as follows.

***Name of the new entity***

The new bank to be formed by merging all 14 DCCBs with KSCB shall be known a ----------------------------- (stake holders may suggest suitable names), which shall be a full service universal bank in the cooperative sector. It will be ***"a people's own bank"***, which shall serve all segments of the society. The new bank shall be offering all traditional and modern banking products and services to the people of the state at affordable cost.

***Membership***

Primary Agricultural Cooperative Societies (PACS/Service Cooperative Banks) and Apex Cooperative Societies shall be the members of the proposed new bank. However, all other cooperative societies can be its customers. Being a full service universal bank, the merged entity shall have a client base covering all segments of the society, including those who are not members of PACS and those who are unable to avail the services of PACS.

Since the new bank shall not have any individuals and cooperative societies other than PACS as its members/shareholders, retiring the share capital contributed by them in DCCBs shall be decided by the State Government, after examining the legal and regulatory aspects.

***Governance***

The new bank will have a professional Board of Directors, consisting of 22 members with an experienced banker as the Chief Executive Officer, 14 representatives of PACS (one member from each district with minimum qualifications prescribed), two members representing Apex Cooperative Societies, three representatives from domain/subject experts by adopting fit and proper criteria, two ex - officio representatives one each from NABARD and Dept. of Cooperation, Govt. of Kerala. No Regional Boards are suggested.

***Organisational set up***

The headquarters of the new bank shall be at Trivandrum and it shall have seven Regional Offices, one covering two districts, headed by Regional Managers, with adequate sanctioning powers. Besides overseeing the functioning of the branches within the region, the Regional Offices shall have a dedicated team to handhold the PACS under their jurisdiction by assuming the role of a mentor.

The present network of branches of the entities to be merged shall continue. However, based on the suggestions of the working group constituted by the Task Force, a review shall be undertaken, after merger, to rationalise the number of branches keeping in view the types of business and services undertaken by the new bank.

***Augmentation of share capital***

The State Government shall be taking steps to augment the capital of the new bank by bringing in additional capital, whenever necessary, to ensure that it meets the statutory requirements prescribed by the regulators for undertaking all technology driven products and services like internet banking, mobile banking, FCNRE deposits etc.

***Valuation of assets***

The assets of the entities to be merged shall be valued by a professional valuation agency, upon whose recommendations suitable decisions relating to appropriation shall be taken by the State Government.

***IT Integration***

Though at present KSCB and all 14 DCCBs are CBS platform, the software used by them are different. While KSCB and 9 DCCBs are using finacle software, the remaining DCCBs are using software other than finacle. There is a need to go for a common software and ensure smooth transition to it which is critical for the smooth functioning of the new bank.

The new bank, besides providing all banking services to its customers, shall also use PACS as an effective platform to market/sell all its products and services at a nominal fee. A common IT platform for the PACS and integrating it with the CBS of the new bank is also envisaged under the new dispensation, by adhering to all regulatory requirements, including compliance to KYC norms

***H R Integration***

A working group set up by Task Force, through a consultative process, shall study all aspects related to HR integration and make suitable recommendations to facilitate the State Government to take appropriate decisions in the matter.

***Amendments to Acts/Rules***

The State Government shall be initiating necessary steps for amending the relevant Acts and Rules, where ever necessary, for facilitating the smooth transition of the three tier structure to a two tier structure.

***Focus of business***

Besides playing a leadership role in institution building, the new bank shall play a proactive role in ensuring adequate and timely credit to the small & marginal farmers and other weaker sections of the society through the wide network of PACS by accessing concessional finance from refinancing agencies like NABARD. Besides extending credit support to the SME sector, the new bank shall also cater to the credit needs of the service sector.

The new bank shall tap the huge potential available for mobilising NRE deposits by seeking the regulator's approval for the same, besides sourcing deposits from state government departments, local bodies, government owned Corporations, Boards etc., and utilizing such resources for improving the credit flow to the desired sectors for the overall development of the state.

Apart from maintaining a comfortable percentage of Credit Deposit Ratio, the new bank shall also focus on ensuring a better recovery climate by taking effective steps for reduction of non - performing assets through proper post sanction follow up and risk mitigation measures.

The new bank shall also engage itself in all emerging areas of banking business after seeking the regulator's approval wherever necessary and by meeting the required statutory requirements. The new bank shall endeavour to become the most preferred bank for the people of Kerala within a short span of time.

***Conclusion***

The Task Force, in consultation with the State Government, shall take appropriate steps for the launching of the new bank on a sound footing.

---