This interim document has been developed for liquidity management of Interest Free Cooperative Credit Society) IFCCS keeping in mind the standard guidelines of RBI, and WOCCU documents. Inputs from affiliates are sought based on their ground experience; the same will be accommodated in the interim document after consulting our various stakeholders.

Introduction

Any financial institution mobilizing deposits in the world, be it interest based or interest free, which wants to serve its members has to make sure that it has adequate amount of fund to meet its daily operational expenses and also to meet the loaning/withdrawal demands. Even one day of breakdown of this process may adversely affect the trust of the members. Since Interest Free Cooperative Credit Societies (IFCCS) mostly deal in interest free deposit products and their association with members are based on element of trust. Hence it is even more important for Interest Free Cooperative Credit Societies (IFCCS) to insure that their daily funding position is adequate to meet daily expenses and Loan/withdrawal demands.

Fundamentals of liquidity risk

What is liquidity?

Liquidity is an IFCCS's capacity to fund increase in assets (current assets, loan & Advances) and meet both expected and unexpected cash and collateral obligations at reasonable cost and without incurring unacceptable losses.

What is Liquidity Risk?

Liquidity is a very positive concept where the emphasis is on increase of assets along with meeting the daily operational expenses and loaning/withdrawal demands. Liquidity risk is the inability of IFCCSs to meet such obligations as they become due, without adversely affecting the IFCCSs financial condition. **Effective liquidity risk management;** helps ensure an IFCCS's ability to meet its obligations as they fall due and reduces the probability of an adverse situation developing **(Benefit).** This assumes significance on account of the fact that liquidity crisis, even at a single institution, can have existential implications for IFCCS as well as systemic effects. (**Threat)**

Defining the concept

Liquidity risk for IFCCSs mainly manifests on account of the following:

(i) Funding Liquidity Risk
(ii) Market Liquidity Risk

Funding Liquidity Risk *(see Example 1 and 2)* **– The risk that IFCCSs will not be able to meet efficiently the expected and unexpected current and future cash flows and collateral needs without affecting either its daily operations or its financial condition.**

Let us understand from two examples as to how Sahulat affiliates and organizations similar to it face challenge of liquidity risk in their day to day operations

Example: **1**

A Co-operative Credit Society in Maharashtra was providing interest-free thrift and credit services to members for a period of about 25 years since its inception. The Society while being constantly awarded with 'A' audit classification and acknowledged as the best organized and managed interest free financial institution in the country. It had branches in 19 localities in the region of Maharashtra and its share capital had reached Rs.1.29 crores and its deposits had crossed Rs. 15.15 crores.

In 2000 a concocted news about the society was published by a local newspaper. Members approached the branch offices of the Society en masse, demanding the return of their deposit. The management of the Society made concerted efforts for immediate return of deposits. However, in spite of all liquidity with the management being consumed and efforts to call in outstanding loans and mobilize additional funds (Deployment of fund in the real estate through a Subsidiary leading to illiquidity of assets), the pressure of the members continued unabated. In some cases, on not being repaid their deposits immediately, depositors, turned violent. Observing several offices being attacked, the staff of the Society became fearful and refused to report for duty. Due to the violent behavior of the depositors and absence of sufficient personnel to man the counters management were forced to down the shutters.

Example: **2**

A Nidhi operating in the state of Uttar Pradesh has been facing liquidity crisis regularly since its inception. To address the issue of liquidity risk in the year 1972 it framed a policy based on past experiences and consultations with financial experts to maintain liquidity of 51 percent and make fixed deposits in the local banks. Though as per policy it has not been able to maintain liquidity of 51% however it has been able to maintain up to 30% to 45% of its total deposit.

This Nidhi had been facing liquidity crisis frequently, the management report that it faces such similar situations after three to four year interval. During the Kargil war in 1998 also a rumor against this Nidhi resulted in panic. This resulted in crisis and within 2 days' time about 60% of the deposit was withdrawn.

Despite liquidity management policy in place it again faced extreme liquidity crisis in November 2016. It so happened that a local newspaper reported news of runaway of a finance company in Moradabad but wrongfully mentioned the name of the said organization. The news of runaway created panic among depositors resulting in rush for deposit withdrawal in two of its branches, which had deposit amount in the first branch of Rs. 4 crore and in second Rs. 5.25 crore. The panic was so grave that within three days' time Rs. 2.75 crore was withdrawn by the depositors. On the very first day from one branch deposit withdrawal was made about 75 lakh and from the second branch it was about 95 lakhs. By the

time panic subsided 40% of the total deposit had already been withdrawn. To manage this crisis, fund was arranged from different branches and shifted to the effected branch and fund from overdraft was also utilized.

Taking cue from 2016 incident this Nidhi has devised an internal policy that every branch shall distribute 60% loan of the total deposit and 40% of the total deposit shall be utilized in taking FD in bank branch operating in the same operational area. Since banks normally provide 80%-90% over draft on fixed deposits so that overdraft could be used for managing crisis situation.

Market Liquidity Risk – the risk that IFCCSs cannot easily offset or eliminate a position at the prevailing market price because of inadequate market depth or market disruption.

Example: **1**

Emergence of Small Banks with better access and competitive products: Small Banks like Bandhan having strong interbank money market linkage and Central bank backing may offer products and services on cheaper rates leading to migration of cooperatives members.

Example: 2

Pricing of fund: Due to the high cost of fund mobilization and deployment IFCCSs has high cost to manage. In case it is unable to lower the borrowing cost there are high chances that members may opt out form its services.

How to Manage/Mitigate Liquidity Risk of Sahulat Affiliates?

Deposit: Deposit portfolio of IFCCSs should not be uneven and IFCCSs should try their best that no account has more than the average limit of deposit in one account as decided by the IFCCS. Though big deposits are tempting but once it is withdrawn by the member it will adversely affect the liquidity position of the IFCCSs. Sahulat recommends that affiliates should follow the below method to rationalize the deposit portfolio.

1. If the total deposit of a cooperative is Rs. 1, 00,000 and it has 500 members then no more than Rs. 4,000 should be received from one member, which means 20 times of the average deposit. Maximum balance in one account in any case should not be more 20 times of the average deposit.

   Average deposit = Total Outstanding Deposit / Total Number of Depositor
   Average Deposit = 100,000 / 500
   Average Deposit = Rs. 200
   Hence the maximum amount in one account can be collected = Average Deposit x 20 times
   = 200 x 20

   Maximum Deposit in one account = 4000

(Note: IFCCS's based on their own average deposit balance may increase or decrease the multiplier (number of times) a maximum deposit is to be collected in one account. If the average deposit balance is small then the multiplier may be increased and if the average deposit is big then the multiplier may be decreased.)

Diversifying the Deposit Products: Sahulat affiliates should try to diversify its deposit products portfolio so as to give stability to its liability side.

Introduce lock-in period: Locking period in withdrawal of deposits could be a very useful liquidity management tool for IFCCSs. Sahulat affiliates should try to introduce locking in periods for its daily deposit or saving products so that it gives the IFCCSs some amount of time to utilize the amount. IFCCS may introduce a locking in period of 30 to 60 days depending on the prevailing market condition of area of operations.

Fund retention through minimum balance: Minimum account balance can also be one more liquidity management tool. Minimum balance may be introduced through transition process of minimum account balance to a bit higher account balance. Gradual increment in minimum account balance will effectively address the resistance of the members and help IFCCSs to strengthen its liability side.

Raising long term Deposits: Long term deposit provides a great cushion to the IFCCS to address its short term demands and manage its overall asset volatility. Few long term deposit products suggested are as follows however IFCCS may develop their own innovative long term deposit products based on their jurisdictional demand and need.

1. Haj Deposit

2. Umrah Deposit
3. Philanthropic deposit
4. Compulsory deposit IFCCS may open a Compulsory Deposit account of all its members. A minimum of Rs. 50 per month / 500-600 per annum may be collected in each account with a lock in period of 3-5 years till the account is in operation. Members may be issued loans against the compulsory deposit after the deposit has completed at least for one year. The amount in the compulsory deposit account can be withdrawn by the account holder any time the account is permanently closed or when lock in period is completed.

Deposit mobilization target: A target may be set for different available products by offering some incentives to the field staffs and encouraging branch managers for the same.

Product design and Marketing Strategy: Cooperatives may design products and services catering to the local needs and the same may be marketed through innovative methods like, promotional activities, seminars, advertisements in social gatherings, contacting community leaders, etc.

Reasonable Loan Repayment schedule: - IFCCSs will be able to maintain its cash flow if the loan repayment schedule is adhered by its members. Hence it is required by the IFCCSs to accurately devise the repayment schedule of its members by keeping in mind the business cycle, seasonal occupation pattern, natural calamity, health issues etc. so that default cases are minimized to the extent possible.

Inter Branch Transfer of Fund: IFCCS having multiple branches, day to day branch liquidity need may be met through inter branch transfer of funds and the excess demand/heavy withdrawals could be managed if the depth and breadth of the society is good, a system of inter branch transfer should be developed by the IFCCSs having multiple branches. A branch which is in excess of fund may lend to the deficit branch and to encourage the fund mobilizing branch an incentive may be introduced for the mobilization branch to be paid by the deployment branch. Incentivizing of inter branch fund would encourage the branches to mobilize more funds so that they can reap benefits. The incentive and the process of inter branch transfer should be decided at Board level of society.

Three recommended costing method for Inter branch transfer:

1. If the IFCCS needs Liquidity for only liquidity management deposit mobilization cost may be charged on the amount lent.
2. If the IFCCS needs fund for demand loan and consumption loan deposit mobilization cost may be charged
3. If the IFCCS needs fund for extending loans based on Murabaha and Musharka then deposit mobilization cost plus some percentage of profit may also be charged.

Investment Options to be explored: - IFCCSs having excess fund, should not keep its fund idle whereas it should explore various Interest free complaint options which may be used to deploy the excess fund in short term instruments with less risk.

Contingency funding plan: - IFCCSs should strive to know and build relationship with its depositor and probable sympathizer so that in case of need it can seek fund needed to meet its liquidity need. IFCCSs

should always bear in mind that it does not have any external funding support (like offered by reserve bank based on repo and reverse rate) to meet its emergency liquidity need therefore they should consider the crisis management as last option. Certain honorary facilities may be formulated for such well-wishers who are always willing to rescue the IFCCS, for example recognition of privileged member, offer of high tea, doorstep withdrawal and deposit facility.

Integration, monitoring and reporting of branches: - All the branches in a cooperative should be integrated with a robust Management Information System (MIS) so that all the necessary information's are exchanged seamlessly and head office is in a position to know the liquidity positions of all its branches and can take required measures whenever needed. Strong monitoring and timely reporting is the key of success of any financial institution hence it is incumbent on the liquidity management team or the head office to strictly monitor the liquidity positions of its branches based on its approved liquidity management strategies and report it to the liquidity management committee/ board for further action.

Identification and Measurement of liquidity risk

Identifying the Liquidity Risk of Sahulat Affiliates: Let us understand what are the real liquidity risks faced by Sahulat affiliates

Single Branch Risk: IFCCSs which has only Single Branch operation may face severe threat of liquidity Risk as they cannot raise fund from within but only from unorganized market which is also not stable source of fund whereas IFCCSs which have multiple branches may face less risk of liquidity as they can manage their liquidity through inter branch transactions.

Excessive dependence on Daily Deposit (Liabilities products): Many Sahulat affiliates have very volatile liabilities products which may require it to pay back anytime leaving it with only illiquid (Land, Building, Machinery etc) assets.

Lack of Time deposit with IFCCS: Sahulat affiliates have very negligible amount mobilized in its time deposit products whereas many do not have any time deposit products. Time deposit gives cushion to the financial institutions while managing liquidity.

No external support is available for IFCCS: Conventional Banks have organized money market support where they can approach to meet their liquidity needs whereas IFCCSs do not have any such avenues to meet its liquidity need.

Non availability of Lender of Last Resort: Conventional banks which are in dire need of liquidity and cannot raise fund from other platforms are helped by Reserve Bank of India as lender of last resort. However unlike Conventional Banks, cooperative credit societies are not supported by the Reserve Bank of India making it more venerable in managing liquidity risk.

Measurement of Liquidity Risk

Liquidity can be measured through stock and flow approaches. Flow approach measurement involves comprehensive tracking of cash flow mismatches.

Measurement – Flow Approach: For measuring and managing net funding requirements, the format prescribed by the RBI under ALM (asset and liability management) System for measuring cash flow mismatches at different time bands (modified by Sahulat) should be adopted. The cash flows are required to be placed in different time bands based on the residual maturity of the cash flows or the projected future behavior of assets, liabilities and off-balance sheet items. The difference between cash inflows and outflows in each time period thus becomes a starting point for the measure of an IFCCS future liquidity surplus or deficit, at a series of points of time. IFCCS are encouraged to prepare structural liquidity statement on a daily basis and report to IFCCS Management on a fortnightly basis.

Liquidity Return (LR)

Statement of Structural Liquidity

Reporting Frequency : Fortnightly

Name of the IFCCS:

Position as on :

Amount in Rupees crores

		Outflows	Residual Maturity										
			Day - 1	2-7 Days	8-14 Days	15-28 Days	29 Days & upto 3 months	Over 3 Months and upto 6 months	Over 6 Months and upto 1 year	Over 1 Year and upto 3 years	Over 3 Year and upto 5 years	Over 5 Years	Total
1		Capital											
2		Reserves & Surplus											
3		Deposits	***	***	***	***	***	***	***	***	***	***	***
		AL-Khair Society											
	(i)	Daily Deposits											
	(ii)	Amanat Deposits											
	(iii)	Child Deposits											
	(iv)	Sahyog Account											
	(v)	Ear Marked Fund A/c											
	(vi)	Hajj A/c											
		Sanghamam											
	(i)	Sambadya Saving Scheme											
	(ii)	Money Bee (Daily Deposit)											
	(iii)	Suraksha (FD)											
	(iv)	Sanghamithra (Group Deposit Scheme)											
	(v)	Aiswarya Bhawan (Home safe deposit scheme)											
	(vi)	Daily Saving (Deposit Scheme)											
	(vii)	Homely Deposit Scheme											
	(vii)	Education Support Deposits Scheme											
	(ix)	Marriage Support Deposits Scheme											
	(x)	Pilgrimage & Tour Support Deposits Scheme											
		Bait -un-Nas'r											
	(i)	Current / Spot Deposit											
	(ii)	Saving Deposit											
	(iii)	Recurring Deposit											
	(iv)	Haj & Umrah Deposit											
		Khidmat & Seva											
	(i)	Daily Deposits											
	(ii)	Savings A/c											
	(iii)	Term Deposit											
4		Borrowings	***	***	***	***	***	***	***	***	***	***	***
	(i)	Call and Short Notice											
	(ii)	Inter-Societies (Term)											
	(iii)	Refinances											
	(iv)	Others (specify)											
5		Lines of Credit committed to	***	***	***	***	***	***	***	***	***	***	***
	(i)	Institutions											
	(ii)	Customers											
6		Unavailed portion of Cash Credit / Overdraft / Demand Loan component of Working Capital											
7		Others (specify)											
8	**A.**	**Total Outflows**											
9	**B.**	**Cumulative Outflows**											

Amount in Rupees crores

		Inflows	Residual Maturity										
			Day - 1	2-7 Days	8-14 Days	15-28 Days	29 Days and upto 3 months	Over 3 Months and upto 6 months	Over 6 Months and upto 1 year	Over 1 Year and upto 3 years	Over 3 Years and upto 5 years	Over 5 years	Total
1		Cash											
2		Balances with other Banks	***	***	***	***	***	***		***	***	***	***
	(i)	Current Account											
	(ii)	Money at Call and Short Notice, Term Deposits and other placements											
3		Advances Performing	***	***	***	***	***	***	***	***	***	***	***
	(i)	Cash Credits, Overdrafts and Loans repayable on demand											
	(ii)	Term Loans											
4		NPAs (Advances and Investments)											
5		Fixed Assets											
6		Other Assets	***	***	***	***	***	***	***	***	***	***	***
	(i)	Leased Assets											
	(ii)	Others											
7		Others (specify)											
8	**C.**	**Total Inflows**											
9	**D.**	**Mismatch (C-A)**											
10	**E.**	**Mismatch as % to Outflows (D as % to A)**											
11	**F.**	**Cumulative Mismatch**											
12	**G.**	**Cumulative Mismatch as a % to Cumulative Outflows (F as a % to B)**											

Measurement – Stock Method: Certain critical ratios in respect of liquidity risk management and their significance for IFCCSs are given in the Table below. IFCCSs may monitor these ratios by putting in place an internally defined limit approved by the Board for these ratios. The Banking industry averages for these ratios are given for reference of IFCCSs. They may fix their own limits, based on their liquidity risk management capabilities, experience and profile. The stock ratios are meant for monitoring the liquidity risk at the solo IFCCSs level at a given point of time.

S.No.	**Ratios**	**Significance**	**Industry Average* (in %)**
1	(Volatile Liabilities[i] - Temporary Assets[ii]) / (Earning Assets[iii] - Temporary Assets) X 100	Measures the extent to which volatile money supports IFCCSs basic earning assets. Since the numerator represents short-term, high cost sensitive funds, a high and positive number implies some risk of illiquidity.	40
2	(Core Deposits[iv] / Total Assets[v]) X 100	Measures the extent to which assets are funded through stable deposit base.	50
3	(Temporary Assets / Total Assets) X 100	Measures the extent of available liquid assets. A higher ratio could impinge on the asset utilization of banking system in terms of opportunity cost of holding liquidity.	40
4	(Temporary Assets / Volatile Liabilities) X 100	Measures the cover of liquid investments relative to volatile liabilities. A ratio of less than 1 indicates the possibility of a liquidity problem.	60
5	(Volatile Liabilities / Total Assets) X 100	Measures the extent to which volatile liabilities fund the balance sheet.	60

Liquidity Management through CRR and SLR

Interest free Cooperative credit societies (IFCCS) are member based organizations which provide thrift facilities to its members and also provide loan products. Cooperatives being the member based organization is governed by the respective society's acts and monitored by the Society's Registrar, hence it is not governed under the RBI regulation. However due to cooperative credit society's core functioning of banking activities it is also prone to the similar challenges faced by the banking sector one of them being the liquidity risk. Reserve Bank of India has set certain ratios for the banks to maintain at the RBI against its deposits. The purpose of the maintenance of these ratios is to mitigate the risk of illiquidity. There are two kinds of ratios required by the banks to maintain at the RBI by the banks which are Cash Reserve Ratio (CRR) and Statutory Liquidity Ratio (SLR).

Cash Reserve Ratio (CRR): - Each bank has to keep a certain percentage of its total deposits with RBI as cash reserves. CRR is required to maintain the comfortable liquidity in the bank. Liquidity ensures that the bank can pay to its depositors whenever they ask their deposits. The bank cannot touch this reserve for any purpose, no matter what. RBI does not provide any return or interest on CCR which means the amount of CCR does not earn any return.

Statutory Liquidity Ratio (SLR): - Amount of liquid assets such as precious metals (Gold) or other approved securities that a financial institution must maintain as reserves other than the cash. SLR ensures that amount of depositor's money is in safe investment; it ensures solvency of the bank. SLR is a reserve where some leniency has been provided and this amount can be invested in liquid asset like gold, government securities (which are approved by Reserve Bank of India). So the banks do earn some profit on these reserves.

Although Interest free Cooperative Credit Societies (IFCCS) do not come under the purview of RBI guideline but owing to the same nature of risks faced by the IFCCS as like banks it is strongly advised to the IFCCS to adopt the banking norm of maintaining of CRR and SLR at the cooperative or at the Federation of Cooperative level.

As per RBI website on 16th August 2017, it mandates banks to maintain 4% of CRR and 20% of SLR at the RBI. IFCCS is also advised to maintain 24 percent of cumulative CCR and SLR in a nationalized bank in the form of Cash or Gold. IFCCS cannot invest in government securities as government securities offer a fixed rate of interest on the securities. IFCCS may explore the possibility of low risk equity funds which is relatively safe and also provide small rate of return.

Few Proposals by Sahulat for Liquidity Management

Liquidity Fund: - It is being envisaged that any one interest free cooperative credit society affiliated to Sahulat (legality to be explored) may be mandated to collect 5-10 (to be agreed by affiliates) percent of the total deposit to be deposited in the liquidity fund. All Sahulat affiliates would deposit the agreed portion to the said IFCCSs with clearly stipulated terms and condition. The cooperative which may need fund to meet its liquidity requirement will be provided the fund after the payment of agreed service charge. However the overall cost of managing the fund will be borne by all the affiliates in case the transaction cost does not meet the management cost.

Federation formation at the national level: - As per the Multi-State Cooperative Societies Act, 2002 a federation of cooperative credit societies may be formed which can *"undertake business services on behalf of its member cooperative, if specifically required by or under the resolution of the general body or the board, or bye-laws of a member of cooperative"* (24 2g). A federation of Sahulat affiliates which may devise some strategies or plan to manage the liquidity of Sahulat affiliates by creating the liquidity fund or any other viable alternatives.

NBFC to fund IFCCSs based on borrowing cost/Investment: - NBFC is being explored to fund IFCCSs in case it needs fund to meet its liquidity requirement. The fund may be arranged based on borrowing cost basis or any other suitable method agreed by both the parties.

Protection (Liquidity Management Bench Mark Ratios): Sahulat has suggested five liquidity management ratios for its affiliates to monitor its liquidity position and also suggested industry average as a benchmark. However it is for the IFCCSs to decide as to what would be the bench mark average for their cooperatives based on their past experiences and the same may be approved by the shareholders in the AGM with two distinct objectives. 1. To educate its members about the risk undertaken by the IFCCSs 2. To protect the management from legal persecution in case it has religiously observed the approved benchmark.

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[i] **Volatile Liabilities: -** Daily Deposits, Saving Deposits, Term Deposit (Payable within one year), Spot Deposit, Call Deposit, Other, Deposit (Payable within one year), Other liabilities Including loan (Payable within one year)

[ii] **Temporary Assets: -** Cash Balance, Bank Balance

[iii] **Earning Assets:-** Total Assets – (Fixed assets + Balance current accounts with other Banks + Other assets excluding leasing + Intangible assets)

[iv] **Core Deposits: -** All deposits (Including Current Account and Saving Account "CASA") above 1 year (as reported in structural liquidity statement) + Net worth

* The industry average is based on 4 or 5 years average for the banking system (domestic operations data used – Committee on Financial Sector Assessment Report 2009) Bank industry average may be adjusted as per IFCCSs experiences based on available data analysis of IFCCSs

Note: - *Compulsory and Statutory deposits like telephone deposit, locker deposit and meter deposit etc., and inter office deposit not to be considered in* ***core deposits****.*

Note: - *The terms have been classified based on the presentation of balance sheet of all Sahulat Affiliates.*