



Tools to Avoid financial Stress (Crisis) in Saving and Credit Cooperatives

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Outline

- Dimension
- Current Situation of Saving and Credit Cooperatives
- Reasons behind current situation – economic and others
- Risks in saving and credit cooperatives
- Tools to Avoid Crisis
- Concluding Remarks



Dimension

Dimension

- Large in numbers and size – total number of cooperatives 30,879 (about half of them are saving and credit cooperatives), with equity capital of Rs. 94.1 billion, members of 7.3 million, deposit mobilized Rs 478 billion, credit flow Rs. 426.3 billion as of March 2022 (Economic Survey 2021/22).
- Employment Creation of **91 thousands**.
- More than **15 thousand S & C cooperatives are members** in NCBL.
- NCBL has mobilized **Rs 41.6 billion deposits** and provided **Rs. 33 billion** loans
- ***No regular updated data***
- Cooperative sector has been recognized as one of third pillars of economic development after government and private sector in the Constitution of Nepal.




Current Situation

Current Situation of S & C Cooperatives

- Many saving and credit cooperatives are unable to return deposit to depositors.
- Very low loan recovery- mainly invested in real estate.
- Real estate market is down.
- Many saving and credit cooperatives are facing liquidity problem, and some of them are now closed.
- Depositors are not getting money back
- Credibility of these S & C cooperatives are at risk.





Reasons behind current situation – economic and others

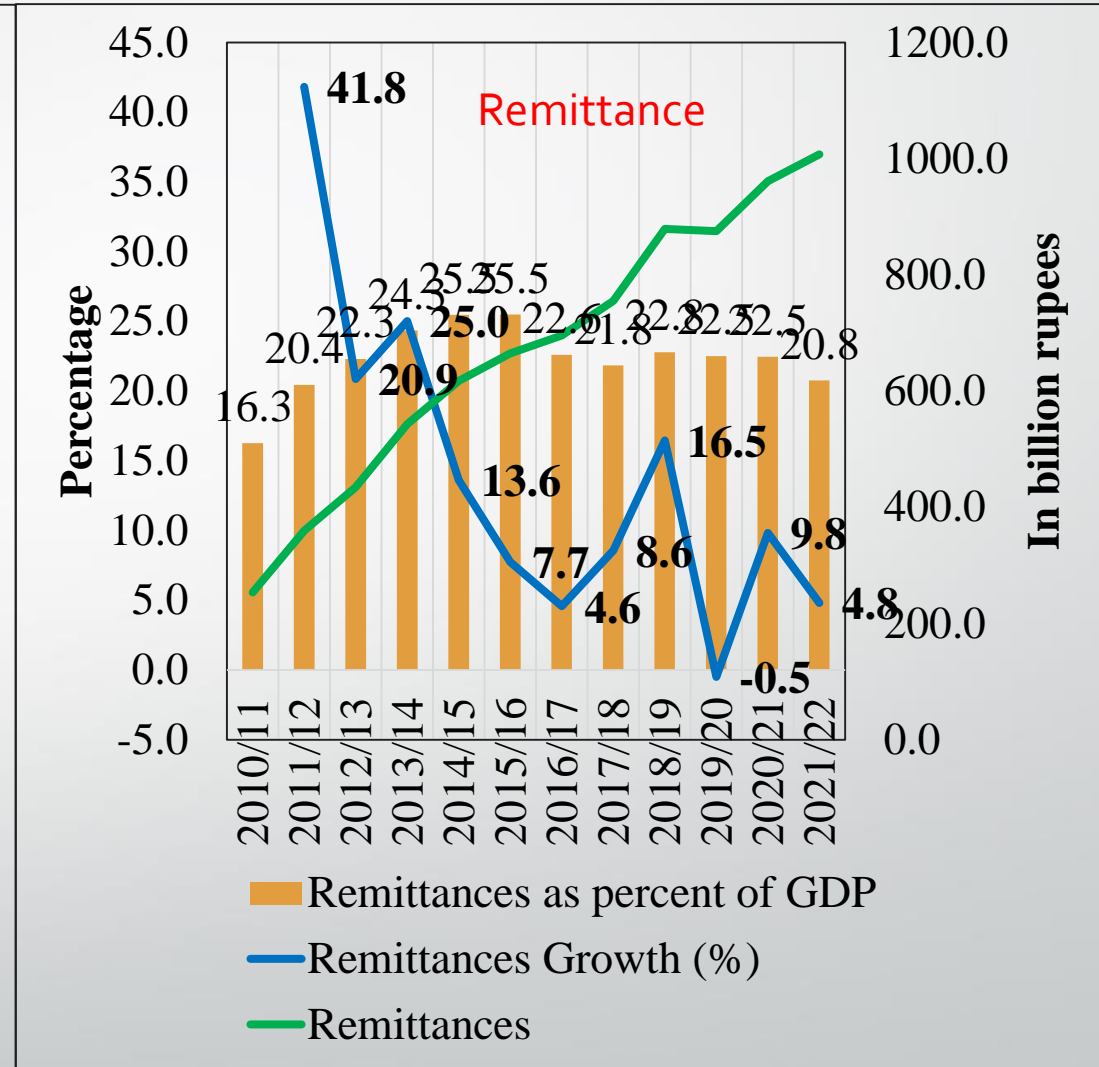
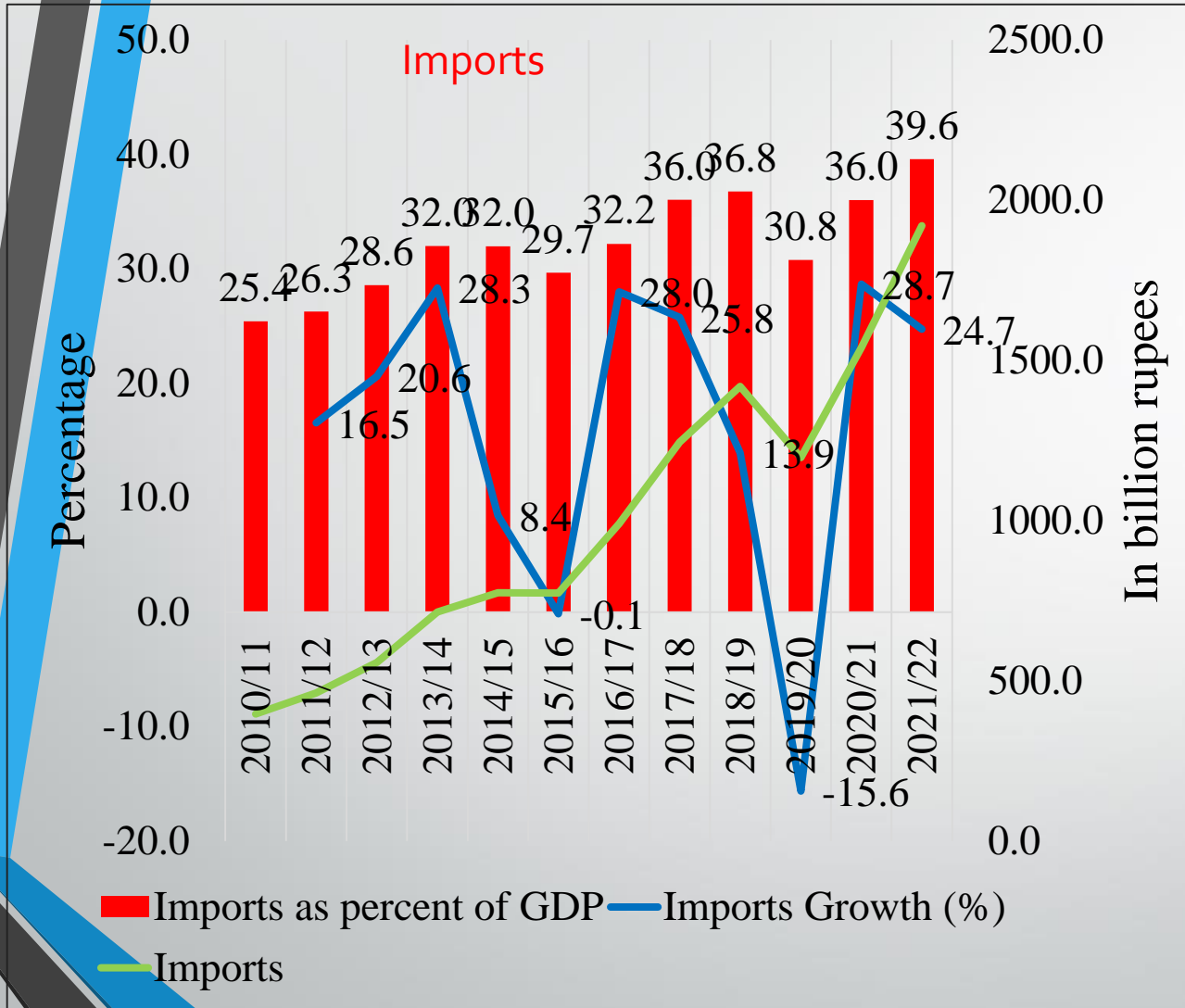
Economic Factors behind current stress

- During post Covid 19 recovery in 2020/21 and 2021/22, imports had increased at a very higher rate of 28.7 percent and 24.7 percent. Rising prices of petroleum products, commodities and food following the Russia-Ukraine War (started from February 2022) and currency depreciation increased the import bills.
- High imports but subdued remittance resulted in **current account deficit of Rs. 623 billion (about 12 percent of GDP)** and **balance of payments deficit of Rs. 255 billion in 2021/22**.
- Because of continuous BOP deficit, **the first half of FY 2021/22 witnessed heavy fall in foreign currency reserves from 11.4 billion USD in the first month of 2021/22 to 9.6 billion USD in the eighth months of that fiscal year.**

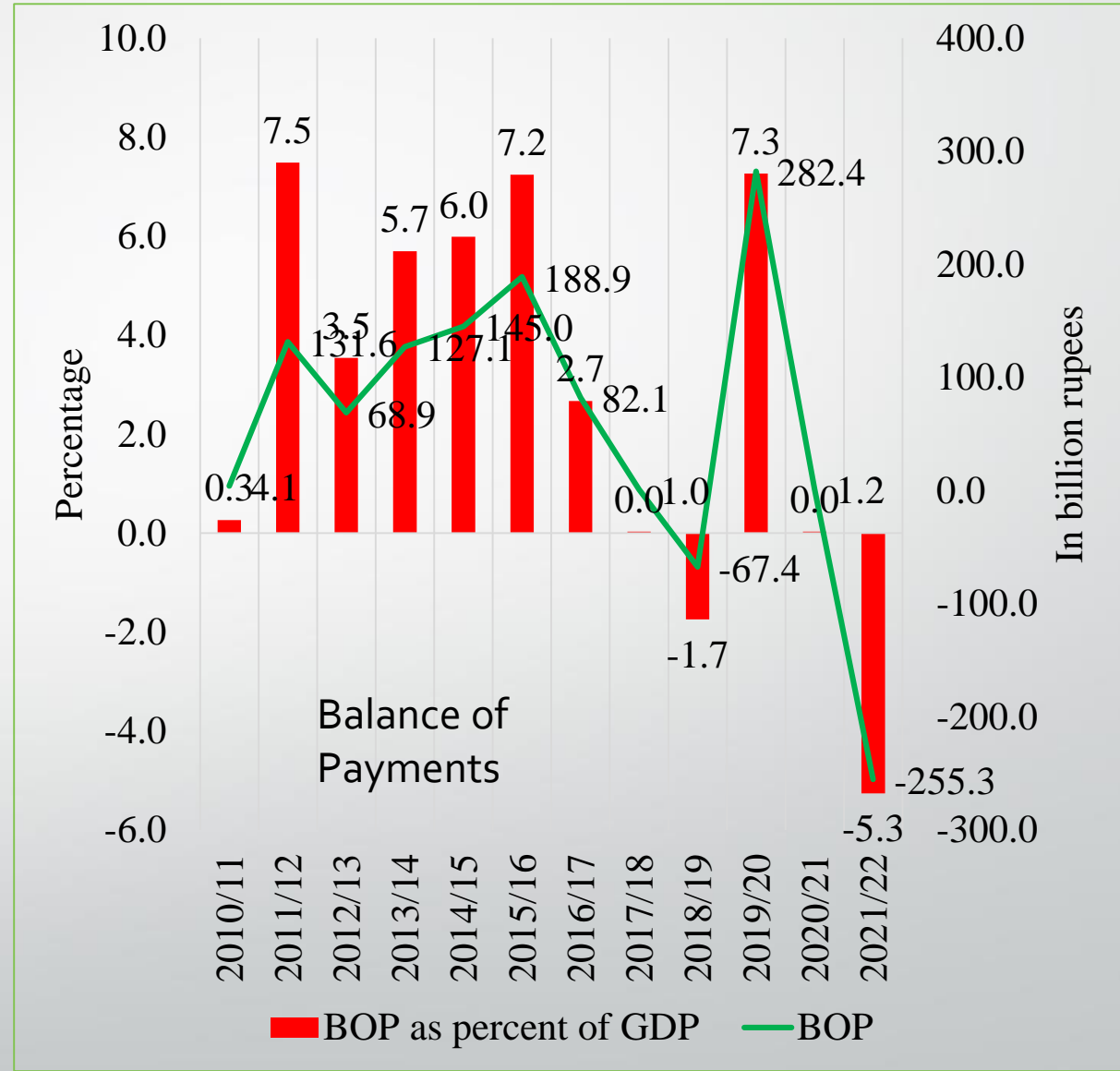
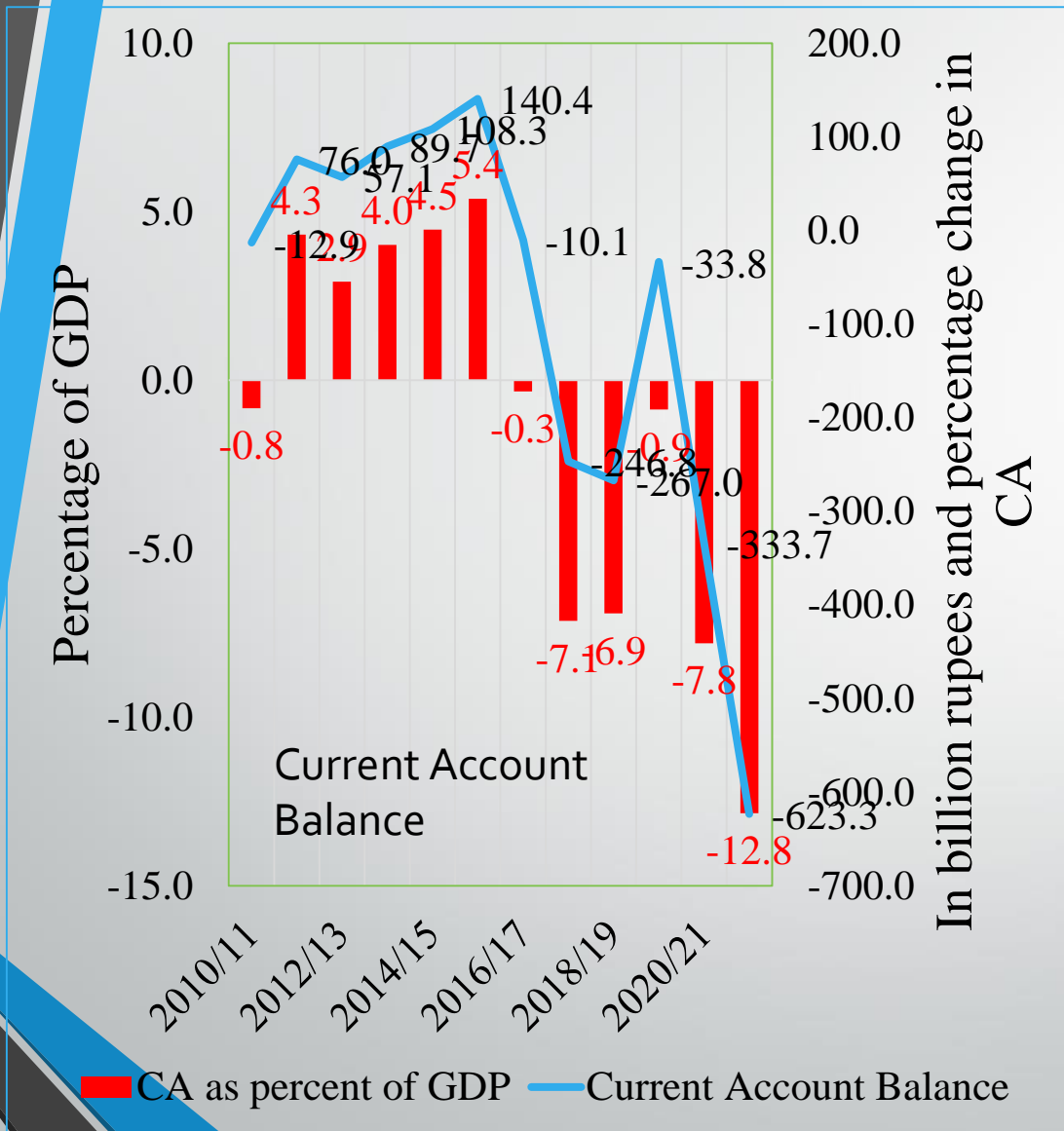
Economic Factors behind current stress

- To prevent the further fall in foreign currency reserves, monetary policy has to increase policy rates.
- The banking sector also witnessed higher growth of credit than deposit, facing liquidity shortage. This compelled to increase interest rates in both deposit and credit.
- The Cooperative sector also started facing the problem of liquidity shortage.
- Higher interest rates have lowered the aggregate demand in the economy, thereby slowing down the economic activities – difficulty for loan recovery.

Economic Factors behind current stress

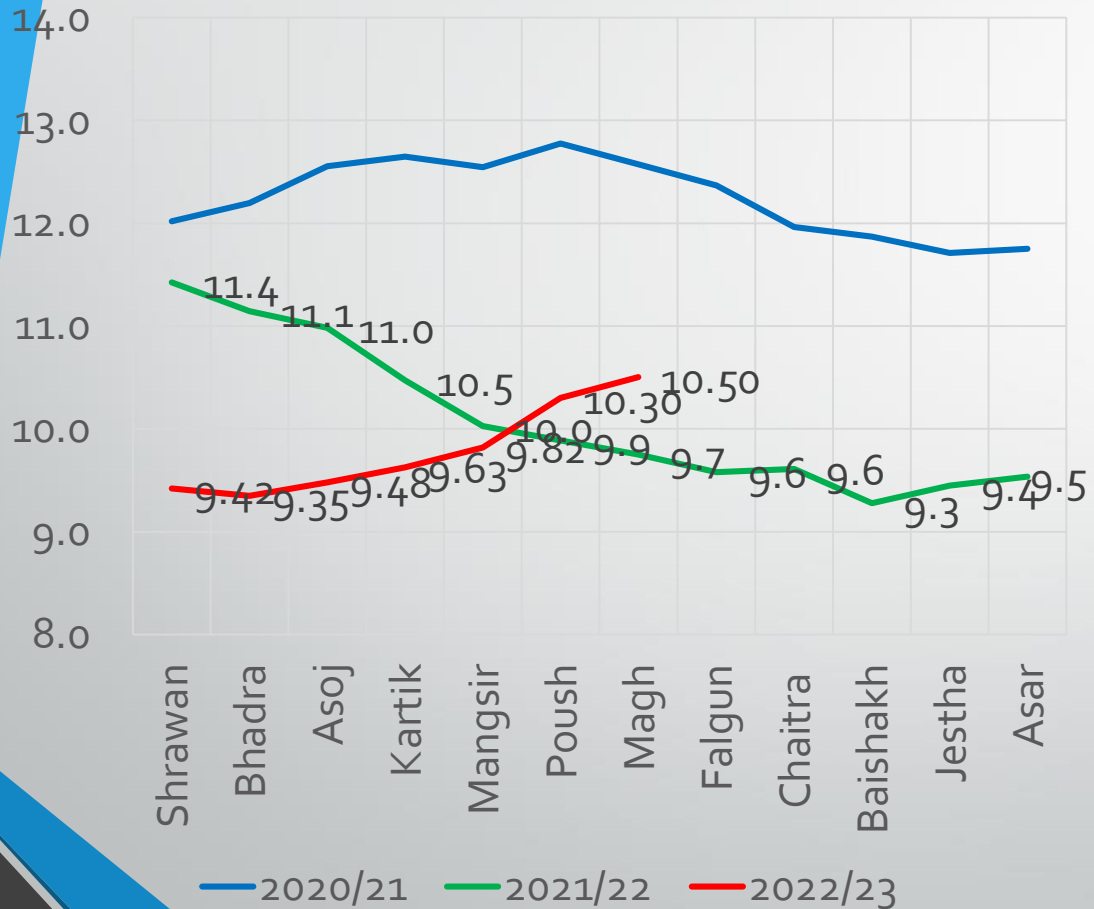


Economic Factors behind current stress

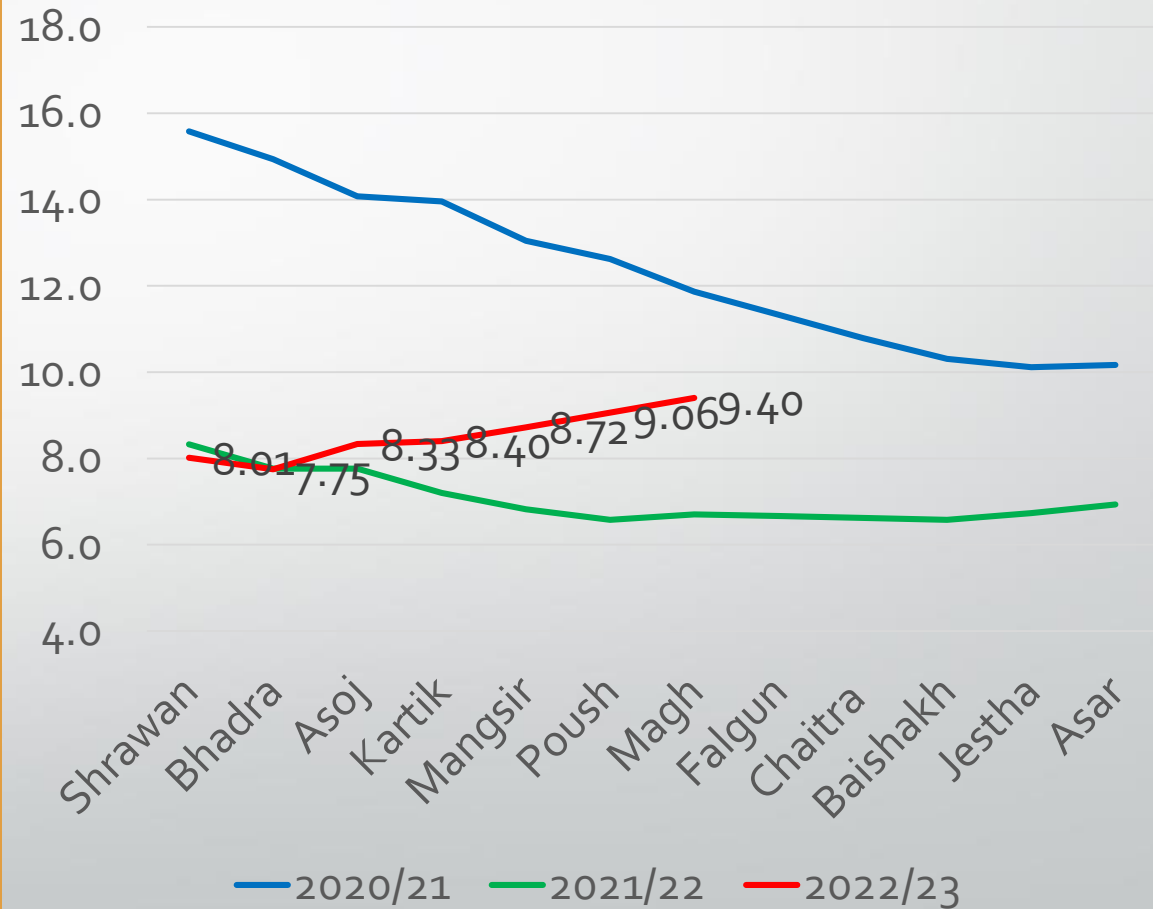


Current Situation

Foreign Currency Reserves (Billion USD)



Reserve Adequacy (Months of Imports of goods and services)



Other Factors behind current stress

- Lack of self-regulation as well as absence of capable institution to regulate and supervise SACCOS
- Ignoring the cooperative principles and no any regulatory provisions
- **Weak risk management and poor governance system – financial activities are always in risk.**
- Speculative Investment - Over exposure to the real estate sector (partly also in share market)
- **Not contributing to developing productive economies- heavy reliance on imports and remittances.**





Risks in Saving and Credit Cooperatives



Risks in Saving and Credit Cooperatives

- Saving and Credit Cooperatives are also part of banking and financial sector of the country – *do the financial intermediation (mobilizing deposits and lending to borrowers)*.
- Financial Sector is always prone to crisis – several financial crises in the world, e.g. saving and loan crisis in the 1980s USA, East Asian Crisis of 1997, Global financial crisis of 2007/08.
- Financial sector is highly leveraged sector and subject to several types of risks
- Operates on public trust
- Some Major Risks of the financial sectors are
 - Credit Risk
 - Market Risk (Interest rate and exchange rate risk)
 - Liquidity Risk
 - Operational Risk

Excessive Risk Build up leads to panic and crisis.

Climate changes can increase these risks.





Tools to Avoid Crisis

Tools to Avoid Crisis

- Sound Risk Management
- Good regulation and supervision, otherwise there should be good self-regulation to manage risks and avoid crisis.
- Some tools for major risk management

(NRB has issued Risk Management Guidelines for the bank, which can be used for Cooperatives by customizing it,
<https://www.nrb.org.np/contents/uploads/2021/08/Risk-Management-Guidelines-2018.pdf>)

Tools to Avoid Crisis- Credit Risk

- **Credit Risk** - the potential that a borrower fails to meet its obligations in accordance with agreed terms
- Selecting good borrowers considering collateral as well as cash flows.
- Some Regulatory Provisions to withstand credit risks are
 - Capital Adequacy Ratio - to absorb the shocks or credit default (e.g equity capital and reserves as a certain percentage of risk weighted assets)
 - Loan classification (based on overdue) and Loan Loss Provisioning – to regularly follow up the quality of loan and to provide back up for any default.
 - Single Obligor Limit (Individual as well as sector) – lowering concentration ratio (**Don't put all your eggs in one basket**)
 - Loan to Value Ratio (to secure enough back up)
 - **Good Governance, transparency**
 - Loan Recovery – continuous follow up and support to borrowers
 - Black listing provisions; credit information system

• *Minimum paid up capital of 5 million shillings in Tanzania*

Tools to Avoid Crisis- Credit Risk

Existing Provisions

ऋण हानिका लागि व्यवस्था गरे नगरेको: (१) बचत तथा ऋणको मुख्य कारोबार गर्ने सहकारी संस्थाले लगानीमा रहेको ऋणमध्ये भाखा नाघे, ननाघेको मासिक रुपमा वर्गीकरण गरी भाखा नाघेको ऋणको हकमा बाह्र महिनासम्म भाखा नाघेको भए कम्तीमा पैतीस प्रतिशत र त्यसभन्दा बढी अवधि भाखा नाघेको भए एक सय प्रतिशत नै ऋण हानिका लागि व्यवस्था गर्नुपर्नेछ ।

(२) उपदफा (१) मा जुनसुकै कुरा लेखिएको भएतापनि संस्थाले प्रवाह गरेको कर्जा जोखिममा परेको विश्वस्त भएमा त्यस्तो कर्जाका लागि सत प्रतिशत ऋण हानिको व्यवस्था गर्नुपर्नेछ ।

बचतऋणको मुख्य कारोबार गर्ने सहकारी संस्थाहरूको सुपरिवेक्षण, निरीक्षण तथा अनुगमन निर्देशिका, २०७७

(६) सहकारी संस्थाले बचत रकम सदस्यबीच ऋण लगानी, नेपाल सरकारले जारी गरेको ऋणपत्र वा नेपाल राष्ट्र बैङ्कले जारी गरेको ट्रेजरी बिल खरीद गर्न बाहेक अचल सम्पत्ति खरीद, पूर्वाधार निर्माण, कारोबारमा लगानी, फर्म वा कम्पनी वा कुनै बैङ्कको (सहकारी बैङ्क बाहेक) शेयर खरीद वा अन्य कुनै प्रयोजनमा उपयोग गर्नु हुदैन ।

Tools to Avoid Crisis- Market Risk

- **Market Risk** (Interest rate and exchange rate risk) – risk arises due to change in market prices like interest rate and exchange rate
- Since SACCOS don't have external exposures, exchange rate risk may not be a major concern.
- **Interest rate risk is the exposure of a financial institution's condition to the adverse movement in interest rate.** Changes in interest rates affect an institution's earnings and also affect the underlying value of the institution's assets and liabilities.
- **High interest rate can also lead to default – credit risk.**
- Some Regulatory Provisions to withstand Interest Rate risks are
 - Asset and Liability management
 - **Avoiding Maturity Mismatched**
 - Management Information System
 - Stress Testing

Tools to Avoid Crisis – Liquidity Crisis

- **Liquidity Risk** – not having enough liquidity (liquid fund) to settle the obligations. If there is no enough liquidity, the institutions can not give back deposit to depositors-credibility risk.
- Some Regulatory Provisions to withstand Liquidity risks are
 - Cash Reserve Ratio
 - Statutory Liquidity Ratio (holding liquid assets like government securities -certain percentage of deposits)
 - Liquidity ratio
 - Avoiding Maturity Mismatch – short term deposit but long term lending
 - Limit on deposit collection

(३) सहकारी संस्थाले सबै प्रकारका बचत खाताहरू सञ्चालन गर्न सक्नेछन् ।

(७) सहकारा संस्थाल प्राथमिक पूजा काषका पन्ध्र गुणासम्म बचत संकलन गर्न सक्नेछ ।

Since SACCOS are not getting liquidity support from the Central Bank, they should give more attention to liquidity management to avoid likely liquidity crisis.

A credit society shall maintain deposits in a bank or financial institution supervised by the Bank of Tanzania or in securities issued by the Government or by the Bank of Tanzania, for an amount of not less than 20% (twenty percent) of its total savings and deposits.

(<https://www.findevgateway.org/sites/default/files/publications/files/mfg-en-paper-savings-and-credit-cooperative-societies-regulations-2004-2004.pdf>)

Tools to Avoid Crisis- Operational Risk

- **Operational Risk** – the risk of direct or indirect loss, or damaged reputation resulting from inadequate or failed internal processes, people and systems or external events.
- The major sources for operational risk are:
 - Inadequate procedures and controls,
 - External and Internal frauds,
 - IT related activities and system failures,
 - Damage to physical assets
- Some Regulatory Provisions to withstand Operational risks are
 - Internal and external audit system
 - Security of IT system
 - Sound HR management – capacity and control
 - Good Governance – effective oversight by the board of directors ; shouldn't have conflict of interest

Concluding Remarks

- **The financial sector by its nature is always prone to crisis. SACCOS are no different.**
- There are major four types of risks the financial sector has to face- credit, market, liquidity and operational.
- Internal and external factors can exacerbate these risks in the financial sector.
- Shocks in the economy also adversely impact the financial sector by amplifying these risks.
- Hence, the financial sector is heavily regulated and supervised sector in the world.
- **There is no effective regulatory and supervisory mechanism for SACCOS in Nepal. Hence, problems arise time and again in SACCOS, some actually fail and collapse.**
- **Until effective regulation and supervision, SACCOS should follow self-regulation; Cooperative principles actually demand this. Member control and disclosure.**
- **Right regulations are also necessary to make cooperatives climate friendly.**

Timely revisions and effective implementation of Cooperative Act and Bylaws.

२३. सहकारीका मूल्य, मान्यता र सिद्धान्त पालना गर्नु पर्ने : सहकारी संस्थाको गठन तथा सञ्चालन गर्दा सहकारीका मूल्य, मान्यता र सिद्धान्तको पालना गर्नु पर्नेछ ।