

## **Annex – VIId**

### **Cooperative Scam**

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In 1983 it was reported to the State Bank that cooperative societies were involved in the exceptional business of banking. These allegations were dismissed by the Registrar, Cooperative Societies, Lahore and Circle Registrar, Islamabad. The State Bank was doubtful of the validity of its powers vis-à-vis Cooperative Societies and advised the matter to be examined by the Attorney General before exercising these powers. The Ministry of Finance was of the view that the SBP could proceed against these societies under the banking law. Accordingly, inspection of some cooperative societies was conducted under the BCO on the basis of material collected during the informal inspection. The SBP was doubtful about its powers to proceed against these societies, who were operating under the cooperative laws. The Government was apprised to review the legal position with the assistance of an eminent constitutional lawyer before the SBP could proceed against the cooperatives. The Government's clearance was also sought for issue of show cause notices.

In the year 1988, the Ministry of Finance advised that, based on recommendations of Justice Division, a summary was submitted to the then Prime Minister who approved taking of action by State Bank. Consultation by the Bank with a constitutional lawyer was also approved. Opinion of a learned counsel was obtained who recommended that fresh inspection may be conducted as evidence collected in the past years could not be relied. Fresh inspections were accordingly conducted by the end of same year. It was simultaneously suggested to the Government that the cooperative departments in the provinces and Federation may be moved to tighten up regulation and supervision of cooperative societies besides not allowing opening of branches by societies.

While returning files of four societies on March 1, 1989, Ministry of Finance advised that the Finance Minister had directed that inquiry against all the societies said to be contravening the law may be completed in one go and piecemeal action be avoided. The SBP set about identifying, through its offices, the societies that were suspected of doing banking business. Seven more societies were so suspected. The Bank started inspecting these societies and transmitting inspection reports to the Ministry. By January, 1990 reports on more societies were sent to the Government and clearance was sought for issuing show cause notices. Government's clearance was received on April 14, 1990.

While the Bank was about to issue notices, a telex dated 2<sup>nd</sup> July, 1990 was received from the Ministry advising that a meeting had been fixed for 10<sup>th</sup> July, 1990 on the question of cooperative societies at Islamabad and that the Bank should wait for the outcome of deliberations of that meeting. Subsequently another meeting was held at Islamabad on 20<sup>th</sup> January, 1991 under the chairmanship of Finance Secretary. In view of the decision taken in the meeting, the State Bank issued show cause notices to 14 Cooperative Societies. Replies to show cause notices were

received from some societies. The Government clearance was sought for initial legal proceedings against the cooperatives. The Ministry in turn referred the matter to Law and Justice Division and copy thereof was endorsed to the State Bank advising that action against the cooperative societies may be kept pending till such time the special committee of National Assembly finalizes its recommendations. In the meantime, there was a run on these societies and consequently they got burst. The State Bank's action, therefore, became infructuous.

In conclusion, the Cooperative Scam is attributable to poor regulation and supervision of Cooperative Societies, a task which was the responsibility of Registrars, Cooperative Societies. Also, the State Bank was not clear about its authority vis-à-vis Cooperative Societies' operations. A slow and cautious response from various authorities to State Bank's move to seek clarity about its jurisdiction only aggravated the situation. Therefore, State Bank cannot absolve itself from a measure of responsibility for this scam.

Earlier, the State Bank was unable to play a positive role in taking action against finance companies, both in 1979 (in Punjab) and in 1987 (in Sindh). That too emanated from lack of clarity about State Bank's jurisdiction. By the time the State Bank made a move, the vested interests had disappeared with people's savings. The State Bank has to be proactive in a concrete way to protect depositors' interest and, in fact, the entire payments system. Ambiguity in the State Bank's authority provided unscrupulous elements with an opportunity to take advantage of poor, credulous savers in the country.