JYOTINDRA MEHTA
PRESIDENT

NAFCUB

Ref.No.: NF/R-1/2020-21/447 Dated : February 12, 2021

Dear Shri Rajeshwar Rao,

Sub: Three issues of paramount importance for the UCB sector

I am writing this letter directly to you to underscore the importance of the three issues mentioned below with a request to kindly bestow your personal attention to resolve them.

1. **Repercussions on cooperative banks of prohibition of declaration of dividends by all banks**

The National Federation, many State Federations and Urban Banks had made submissions to the RBI in the wake of its circular no RBI/2020-21/75/ DOR. BP.BC.No.29/ 21.02.067/2020-21 dated 4th December 2020, prohibiting all banks from declaring and paying dividends. This was follow up of its earlier instructions of 17th April, 2020 to banks not to disburse dividends. Many cooperative banks have perhaps announced dividends stating that payment would be made after RBI gives permission to make payment. Such banks are finding it difficult to convince the members that they have now to cancel the dividends altogether.

NAFCUB has recently received a reply from RBI (vide DOR.Coop.BPD.No.465/09. 50.001/2020-21 dated January 21, 2021) to its submission, stating *"in view of ongoing stress and heightened uncertainty on account of ongoing pandemic, the payment of dividend shall not be paid for the financial year ending March31,2020 to conserve capital and absorb losses"*

At the cost of being repetitive, it is submitted that the concept of shares and share capital in cooperatives are very different from that of corporate. Dividend to members, which is generally in correlation with interest paid on the deposits to the depositors of the cooperative banks, is a very important aspect of conserving the

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capital. While non-payment of dividend for one year at the instance of regulator is understood well by shareholders off commercial banks and it will have no adverse impact on their capital or deposits, it is not the case in urban cooperative banks. Non-payment of dividend for a year may appear to conserve some capital in the short run, but it's adverse repercussions for cooperative banks could be far reaching.

From the figures announced by RBI, the total share capital of 1540 UCBs is of the order of Rs.14,000 cr. and the aggregate deposits is around Rs.5 lac crores. It is a fact that profitability of the banking sector including urban cooperative banks has taken a major hit this year. It is our estimate that the dividend payout by all the profit making banks may not exceed Rs.700 cr. It is also our estimate that well over half of the dividends declared is normally either reinvested in shares of the bank or are kept as deposits. So, even if the banks are allowed to declare dividend, the possible effective outgo from the 1540 banks put together may not exceed Rs.350 cr. This figure is far less than the annual accretion of capital by way of fresh addition to share capital in the normal course.

However, if the prohibition of dividend stays, while it may appear to conserve around Rs.700 cr. of capital for 1540 banks for the year, it would not only dry up additional inflow of normal capital for some time, it may also impact the growth of deposits on account of the disenchantment among vast number of members of UCBs who are also the depositors. A good number of the members of cooperative banks all over the country are senior citizens who have shares as well as keep deposits with the banks and all of them will be adversely affected.

In view of what we have stated above, it is the submission of NAFCUB and the sector that it will not be fair to treat cooperative banks like commercial banks in all respects. Withholding of dividend in case of cooperative banks will not have the

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same impact of conserving capital as it has in respect of commercial banks for the simple reason that the character of share capitals of both are very different. It is therefore requested that the instructions of prohibition of payment of dividends by urban cooperative banks may kindly be reviewed and withdrawn.

2. Constitution of BOMs by all Tier II UCBs

The instructions by Regulator for constitution of Board of Management by all Tier II urban cooperative banks were given pursuant to the recommendations of the Expert(Malegam) Committee which were endorsed by the High Power(Gandhi) Committee. The RBI circular of 31st December, 2019 prescribed that all banks with deposits of Rs.100 cr. and above should constitute BOM. We understand that RBI has since informed the Gujarat Federation that UCBs with deposits of Rs.100 cr. and above should complete the process of constitution of BOM by June 30, 2021.

The need for constitution of another Board in addition to the BOD was felt by RBI on account of the fact that under the then existing provisions of Banking Regulations Act, it did not have the powers to control the Board or its members individually in the same manner that it could control Boards of commercial banks. Further, it also had no say on the composition of the Boards of urban cooperative banks as Sections 10, 10A,10B were not applicable to them.

However, since the amendment carried out through enactment of Banking Regulation (Amendment) Act 2020 in June 2020, the entire scenario has changed completely. The amendment now provides for practically the same powers to RBI to regulate the cooperative banks as it has in regulating the commercial banks. In particular, the amendment deletes clause((g) of Sec.56 (AACS) which means that

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Sections 10,10A (Board of Directors to include persons with professional or other experience),10B,10BB,10C and 10D will be applicable to UCBs. These read with other amendments, give RBI all the powers over qualification, of board members and powers of removal and also on appointment/removal of the Chief Executive of the banks. It is very evident that BOM a concept which *ab initio* was perhaps on weak wicket and could have had destabilizing effect, now need not be pursued for the reason that now RBI can get the BOD to perform all what it expected BOM to do.

We therefore earnestly request that RBI be kindly convinced about the redundancy of the BOM after the amendment to Banking Regulation Act and withdraw the instructions on constitution of BOM.

3. Resumption of new branch licensing of urban cooperative banks

It may not be an exaggeration if it is said that no other section of the financial intermediation system has been so ruthlessly curbed from growing naturally for so long as has been the urban cooperative banking sector. It was as far back as in 2001-02 that in the aftermath of the failure of the Madhavapura Mercantile Cooperative Bank that RBI stopped issuing licences to urban cooperative banks to open branches. Since then, it has really neither resumed the practice of approving annual action plan of banks nor has it started issuing licenses to them for branches on regular basis. A whole generation has gone by in these two decades without seeing normal growth of the sector. It is really a monumental injustice that will take some time for its magnitude to sink in. Had the licensing of branches been resumed after a reasonable period say, 2-4 years, the sector would have had aggregate deposits of around Rs.10 lac crores which would mean a business mix of double the present figure. It is difficult to justify such a treatment to the sector particularly when

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