REPORT OF THE
EXPERT COMMITTEE ON
URBAN CO-OPERATIVE BANKS

July 2021

RESERVE BANK OF INDIA
MUMBAI

Letter of Transmittal

July 31, 2021

Shri Shaktikanta Das
Governor
Reserve Bank of India
Mumbai

Dear Sir,

Report of the Expert Committee on Urban Co-operative Banks (UCBs)

We are pleased to submit the Report of the Expert Committee on Urban Co-operative Banks (UCBs), appointed *vide* memorandum dated February 15, 2021. The Report is in two parts – 'Part - I' contains the Vision Document for the UCB Sector, and 'Part - II' contains the Report examining and giving the Committee's recommendations on the various aspects of functioning of UCBs, their regulation and supervision, in accordance with the Terms of Reference set for the Committee.

We sincerely thank you for entrusting this responsibility to us.

Yours Sincerely,

(N S Vishwanathan)
Chairman, Expert Committee on UCBs

Sd/- (Harsh K. Bhanwala) Member	Sd/- (Mukund M. Chitale) Member	Sd/- (N.C. Muniyappa) Member
Sd/- (R.N. Joshi) Member	Sd/- (M.S. Sriram) Member	Sd/- (Jyotindra M. Mehta) Member

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PART - I

VISION DOCUMENT FOR URBAN CO-OPERATIVE BANKS

July 2021

VISION DOCUMENT FOR URBAN CO-OPERATIVE BANKS

The Primary (Urban) Cooperative Banks (UCBs) play an important role in furthering financial inclusion by generally providing traditional, if not the more modern, banking services to persons in the less included segments of the economic strata. World over, financial cooperatives in different forms, as banks and closed loop societies with access to the payment system, have varying market presence. In India, only the financial cooperatives which are licensed to undertake banking business are regulated and supervised by the financial sector regulator, the Reserve Bank of India (RBI). The banks in the rural cooperative sector are supervised by NABARD, although regulated by the RBI.

2. UCBs have the potential to be the harbinger of economic empowerment of the large number of financially excluded persons in the country. As per information provided to the Committee, the number of borrowers of UCBs is 67 lakh. This is not a small number by itself and there are many cases of transformational changes that UCBs have brought to its customers. However, seen in the context of a very large number of persons yet to have access to formal credit, what has been achieved is not enough either from the standpoint of potential or need. The factors that have resulted in sub-potential performance of the UCB sector are multifarious, some endogenous to the sector and others external.

3. There were two broad sources of constraints because of which the sector has underperformed. The first set of factors are internal to the sector. Many UCBs are small and do not have either the capability - financial or human resources – and/or possibly inclination to provide technology-enabled financial services. These banks continue to leverage on member loyalty to remain in business. This can wane with time, generational changes and, of course, competition. Secondly, because of their small size, a large number of these banks have not had the benefit of professional management and committed governance by people who understand not only the spirit of co-operation but also principles of banking to take a bank to the next level. While one of the arguments for the existence of smaller cooperatives is that they actually reduce intermediation costs, the empirical evidence of the relatively higher Net Interest Margins (NIMs) of the smaller cooperative banks may be pointing to the contrary. These are not translating into sustainable return on assets either. While high cost to income ratio coupled with high NPAs are among the reasons, the unsustainability of the low scale of operations is at the core of the problem.

4. The second set of constraints are external to the banks. These emanate from the rather restrictive regulatory environment under which they have had to operate. This regulatory approach has been driven by several factors. The dual control regime that characterised the regulatory legislation for UCBs meant that many aspects of a bank's functioning, which impinged

on the sustainable operations of the bank, were outside the purview of the RBI. Similarly, the UCBs did not have many avenues to raise capital and the cooperative principle of "one member – one vote" led to the investment horizon of a shareholder being largely borrowing centric, making it even more difficult to raise capital when a bank is unable to lend.

5. In the view of the Committee, there is ample space for financial institutions that operate on the principles of co-operation and the inclusivity that they get. As such, the Vision for the UCB sector should be to emerge as the neighbourhood bank of choice powered by passion for inclusive finance as the core of the business model. This can happen only if their operations are founded on financial strength, strong branding, cutting edge technology driven processes, and skilled human resources coupled with an enabling regulatory environment. These internal drivers can be available to a bank either on a stand-alone basis or acquired through network arrangements. There are now several enabling factors, both for the UCBs themselves and the RBI as the regulator, to actualise this vision. These are - the recent legislative changes on the one hand and the grant of 'in-principle' approval for the setting up of an Umbrella Organisation (UO) on the other. The measures necessary to pursue this vision are the following:

i) Understand the heterogeneity of the sector and frame regulations to harness the USP of each sub-segment

The UCB sector displays extreme heterogeneity. There are a large number of small UCBs which embrace cooperative principles. Their membership has several common factors like community, profession, geographical location, etc. They are, however, stymied due to lack of financial resources, inadequately skilled human resources and unprofessional board governance. These, in turn, are outcomes of low scale of operations and impinge on their ability to provide modern banking services run with support of information technology. The regulatory architecture for this kind of banks should harness the advantages of their being run on cooperative principles while creating an imperative to get networked. In such an environment, these banks may be allowed some operational freedom, but they should not be left to drift away from the inclusive finance model.

At the other end of the spectrum are very large UCBs, a few of which are larger than some of the smaller commercial banks permitted to function as universal banks. The legislative changes, which not only provide greater powers to the RBI but also additional capital raising opportunities for UCBs, should be used to allow such banks to grow within the cooperative structure. Depending on the level of capital, the UCBs should be regulated and enabled to function on the lines of a Small Finance Bank or Universal Bank as the case may be.

ii) Umbrella Organisation should be expedited and empowered

An important recent step has been taken to grant in-principle for the setting up of an Umbrella Organisation. (UO). The thought process on the UO has evolved over a long period of time since it was first mooted in 2006. The UO can and should be seen as a game changer for the sector and as such the National Federation of Urban Co-operative Banks and Credit Societies Ltd (NAFCUB) should expedite the process of setting it up. The UO should be financially strong and be well governed by a professional board and senior management, both of which are fit and proper. As an alternative to mandatory consolidation, the Committee prefers smaller banks acquiring scale through the network of the UO, which is one of the successful models of a strong financial cooperative system globally. The UO should provide cross liquidity and capital support to the UCBs when needed, as also the cloud services for facilitating IT-enabled operations by the member banks. The provision of cloud services has several advantages. It will standardise the IT platform across all the member UCBs and avoid the need for each UCB either to have skills or to hire services for maintaining the IT infrastructure. Further, due to the aggregation being done by the UO, it will provide to all member banks the benefit of innovation on an ongoing basis, including the advantages from emerging advancements on the IT front at lower cost.

Since the basic functionalities of the UO have already crystallised, the UO should be adequately empowered to be able to discharge its role as the apex entity of the federating UCBs. The assessment of the eligibility of the UO to get a Certificate of Registration should *inter alia* look at the control function capabilities of the UO. The UO should be the branding partner for the member UCBs and both because of this and the business model itself, the UO has a significant systemic role. It should therefore be regulated and supervised closely. Recognising the important role of the UO in providing operational and financial strength to the smaller UCBs, the differentiated regulation should have a built-in incentive for the smaller UCBs to join in.

A lot of effort has been made by various stakeholders to strengthen the skill sets of personnel working in UCBs and the members of their boards. The UO can emerge as the focal point for identifying training needs of the staff and directors of its member banks. It will need to train the persons working at the front end of the member banks and also on other aspects of their banking business.

The UO is envisaged as the arrangement for the smaller entities to acquire scale through network. However, it can also emerge as the brand builder for the cooperative banking sector in its entirety. While there may not be a regulatory imperative for the larger banks to federate with the UO, steps should be taken by the system to encourage the larger UCBs to embrace the UO.

The UO’s capital required to get a Certificate of Registration (COR) should be raised by its promoters and others who would support the establishment of the UO. Once the required capital has been raised, COR is issued and permission to commence business has been granted, the RBI could consider providing a one-time grant to the UO for a specific objective tied to the IT support the UO intends to provide to its member banks. This will not be part of the equity capital and hence obviates the typical conflict of interest arising from the regulator being a shareholder in the regulated entity. Since aggregation of IT services will be a financial inclusion enabler and can also contribute to system-stability through standardisation of the IT interface, there is justification for RBI's financial support to the UO.

iii) Enable the larger UCBs to raise capital

The legislative changes have provided new instruments for raising capital. They also enable raising share capital at a premium. In the absence of listing facility, the securities issued by the UCBs do not have a secondary market through an exchange. However, a mechanism for issue of shares at a premium and facilitating bilateral transfer of shares through the concerned bank needs to be put in place. Adequate disclosure requirements, guidance for determining the intrinsic value of shares should be provided. Since, the cooperatives work on the principle of open membership, which implies primary issuance of shares on tap, it must be stipulated that such issues cannot be priced at below the book value of shares. Further, to facilitate investor interest in subscribing to issuances of non-voting securities like Perpetual Non-Cumulative Preference Shares, allowing limited lending to such investors should be explored.

iv) Strengthen Governance, particularly in the Larger UCBs

One of the major concerns with UCBs has been their poor governance. Prior to the recent legislative changes, the RBI did not have any powers with respect to board composition and executive appointments. Now that there is parity in this regard with commercial banks, the compliance with fit and proper requirements should be *sine qua non* for any regulatory authorisation, particularly for the large banks. Concurrently steps should be taken to enhance the skill sets of the Board Members through specially curated training programmes.

v) Make Regulatory Authorisations Automatic

The legislative framework has provided adequate headroom to the RBI to allow UCBs to grow organically. For the commercial banks, the permission to open branches is automatic and it is withdrawn in specific cases as a regulatory response to deal with entity specific concerns. The approach with regard to UCBs has been the contrary. To enable the UCBs to grow and harness their potential, similar approach as with commercial banks may be adopted with suitable modifications having regard to the differential regulation for different tiers of banks. Similar policy-based approach may be applied with regard to scheduling, authorised dealer licensing etc.

vi) Maintain Regulatory Neutrality towards Voluntary Mergers in the normal course but encourage them as an alternative to mandatory amalgamations; Strengthen Supervisory Action Framework

In the past, mandatory merger was not possible. As such wherever consolidation was seen as a possible alternative to avoid a weak bank slipping into insolvency, in the absence of voluntary proposals, RBI could not force any mergers. In the wake of legislative changes, there is a school of thought that the smaller UCBs should be consolidated. The question of an economically viable size of a bank was debated in the Committee. Having regard to the idea of creating scale through network under the UO, a minimum net worth of ₹2 crore for unit banks and ₹5 crore for single district banks on top of the prescribed CRAR was agreed upon. This provides an embedded size requirement for UCBs on a stand-alone basis. The Committee, therefore, believes that while regulatory neutrality towards voluntary mergers should be the default approach, the powers to order compulsory amalgamation should be used as the backstop to encourage voluntary mergers of banks that are not complying with the regulatory capital requirements but are still solvent. This will also require that supervisory interventions are more timely and decisive. The RBI should develop a playbook of alternative options linked to size and complexity of a weak bank to enable the choice of a particular resolution tool.

vii) Empower TAFCUB

The Task Force on Urban Co-operative Banks (TAFCUB) was invented as a non-legislative alternative to deal with the problem of dual control. Its success largely hinged on constructive voluntarism and cooperation. As with any such arrangements, over time, the TAFCUB's role and influence in dealing with weak banks waned, to an extent accentuated by the mandatory nature of responses under the Supervisory Action Framework which left TAFCUB bereft of any leeway to find alternatives to deal with weak banks. One could argue that with the legislative changes TAFCUB may not be necessary at all. The Committee feels otherwise. The TAFCUB should be involved at the incipient stages where signs of stress are seen while the bank has still not hit the SAF triggers. The TAFCUB can also suggest measures beyond, rather than in place of, mandatory actions as per the SAF and could help identify suitors for voluntary mergers. The legislative framework still requires coordination with the RCS of a state or the Central Registrar. TAFCUB can continue to be the forum for such coordination. Once the UO is in place, the functionaries of the UO should be invited to the TAFCUB for dealing with UO-related or member bank-related issues.

viii) Don't target a market share for the UCBs

It is normally a practice to target a market share, or even a specific rate of growth, as part of the vision. Some of the feedback received by the Committee suggested such an approach. The

Committee did not consider this feasible for many reasons. The Committee realises that the market share of UCBs will be influenced by several factors exogenous to the sector, particularly how the competition performs, customer choices and the general economic situation. Whether it is the pursuit of market share or a rate of growth, it could lead to rush for balance sheet growth entailing the risk of adverse selection, thereby sowing seeds of systemic or idiosyncratic instability and proving detrimental to the larger interest of the sector itself. Instead, the Committee is of the opinion that the regulatory policy should be more enabling and the UCBs themselves should act responsibly to achieve sustainable growth.

ix) Licensing of New UCBs may commence after the UO has stabilised

There were suggestions that licensing of new UCBs should be immediately opened up. There are over 1500 UCBs already. The Committee has suggested that the existing UCBs may be allowed to expand their footprint. Proliferation of the number of UCBs is not by itself an instrumentality of strengthening the sector. Globally too, the trend has been for the number of financial cooperatives to come down. The effort of the Sector and RBI should be to instil and deepen public confidence in UCBs as efficient and dependable financial intermediaries by ensuring that the existing entities are working on a sound footing and the weak ones among them are either quickly nursed back to health or resolved in as non-disruptive manner as possible without further loss of time. At the same time, the small UCBs with the support of the UO can emerge as the neighbourhood bank of choice. Therefore, the Committee suggests that the grant of new licences for setting up UCBs could be considered after the UO satisfactorily emerges as a stabilising arrangement.

x) Conclusion

In sum, the vision of the Committee has been to make space for more and more operational and strategic autonomy of co-operative institutions and introducing larger regulatory requirements that provide system stability. This, the Committee hopes, will foster a healthy co-operative as well as a stable banking sector. The specific recommendations contained in Part II are largely driven by this vision.

PART - II

REPORT OF THE EXPERT COMMITTEE ON URBAN CO-OPERATIVE BANKS

JULY 2021

Chapter 1

INTRODUCTION

1.1 Co-operatives are **people-centred enterprises** owned, controlled, and run by and for their members to realise their common economic, social, and cultural needs and aspirations. Historically, co-operatives emerged by challenging the primacy of capital. While all the services rendered by a firm were pre-negotiated, capital was compensated with the residuals. The objective of a capital-centric corporation was completely predicated on maximizing these residuals. The other systems that evolved around this objective were also oriented towards the primacy of and reward for capital[1]. Whether it pertained to control, rewards or performance evaluation, they were broadly focussed on how a firm was delivering returns to the investors of risk capital. In this sense, the co-operatives were a different form of organisation.

1.2 Co-operatives, while acknowledging the importance of capital, started with questioning the primacy of capital and suggested that the usage or patronage could be an alternative basis to determine the primacy, with capital being rewarded on the basis of a pre-negotiated compensation. This was enshrined in the older principle of "limited interest on capital", though the current principles have used the phraseology that represents more complicated financial arrangements that the members might have with the co-operative. It is now termed as 'member economic participation'.

1.3 The primacy of patronage shifted the focus from capital to a particular service, drawing from the strength of aggregation of common interests of people. This poses a peculiar problem in case of financial services which are three-fold:

i) Financial co-operatives have, at the core, the very aspect that the co-operatives aim to reject: that of capital;

ii) The financial co-operatives, on the one hand, serve the interests of the savers (thrift) who could be seen as suppliers of capital to the world at large, and on the other hand, serve the interests of the borrowers (credit) who are consumers of capital. These are competing needs; but financial co-operatives have structured them as a unique institutional arrangement on the principle of mutuality where the platform seeks to become an exchange to settle the competing needs within the community without external institutional intermediation leaving the co-operative to go to the outside world only when there is still a residual need, beyond what is cleared by the principle of mutuality.

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[1] The word 'capital' in this Report has been used generally to mean 'capital and reserves' or 'net worth', except where specified otherwise or where the context requires otherwise.

iii) The members are also not uniquely net borrowers or net savers. Their role could change from time to time.

1.4 In the case of financial co-operatives, the unique features of a co-operative entity, *viz.* being member-owned, member-driven and member-controlled businesses, would translate to increasing the return on savings and reducing the interest on loans to members while ensuring adequate margins and surpluses for ploughing back for sustainability and growth. Ideally, a co-operative should do its core business only with its members and not with the public at large. On the other hand, a bank, by definition, is expected to deal with the public at large. By virtue of being a bank, there is a heightened sense of safety because banking institutions are not only licenced after due diligence but are also highly regulated compared to other entities in the financial sector. A financial co-operative becomes a bank when it is licenced to receive deposits, which are withdrawable on demand, from non-members as well. It also becomes eligible to be a part of the payment system. Once an institution is a bank, it can also offer complex products beyond plain vanilla savings and credit facilities. Some of these products could be provided only if the institution is large and a part of the interconnected world – whether it is for remittances through the payment system or offering a credit card facility or facilitating transactions on other instruments such as mutual funds, derivatives, and the like. Since banks are in the business of leverage, the question of capital becomes very important for the stability of the organisation. Herein lies the paradox: an organisation designed to meet the requirements of its members on the principle of mutuality, by becoming a bank, morphs into an organisation where capital is central to its operations.

1.5 Financial co-operatives the world over play a very important role of financial intermediation, particularly for the people who are not readily catered to by the mainstream banks. In India also, financial co-operatives are in existence for more than 100 years. While the financial co-operatives had been working as banks earlier too, they were brought under the purview of the Banking Regulation Act, 1949 (BR Act), and thereby under the regulatory domain of the Reserve Bank of India (RBI), in the year 1966.

Primary (Urban) Co-operative Banks in India

1.6 As stated above, co-operative banks, including Primary Co-operative Banks (popularly known as Urban Co-operative Banks or UCBs), are co-operative societies that transact the business of banking[2]. While co-operative credit societies provide financial accommodation to its members by accepting deposits from its members and lending to them, co-operative banks provide financial accommodation by accepting deposits from the public and lending to its members. For a co-operative bank, the distinction between the deposit of a member and non-member ceases and in

[2] 'Banking' is defined as accepting, for the purpose of lending or investment, of deposits of money from the public, repayable on demand or otherwise, and withdrawable by cheque, draft, order or otherwise (Section 5(b) of BR Act).

view of the normal regulatory capital requirements applied to them, they are able to work with a high leverage. As such, co-operative banks are exceptions in the co-operative sector, wherein the resources used for lending and investment come from the public rather than just their members.

1.7 The legal status of co-operative banks is akin to banking companies in many ways. Both are body corporates by the name in which they are registered, with limited liabilities, which can sue and be sued in their own name, with independent legal personalities distinct from their shareholders/members, with power to acquire, hold and dispose of property and enter into contract. However, there are certain vital distinctions between the two types of banks, primarily arising out of their structure, which need to be considered while formulating a regulatory regime for UCBs. The most fundamental difference between the banking companies and co-operative banks is in the rights of the shareholders to vote in resolutions. While in the case of a banking company, each share has a vote (subject to the limitations imposed by Section 12 of the BR Act), in the case of a co-operative bank, each shareholder has only one vote irrespective of the number of shares held.

1.8 The first watershed moment in the evolution of regulatory framework for co-operative banks in India came when they were brought under the purview of the BR Act in the year 1966. Owing to certain characteristics of the co-operative banks, distinct from the banking companies, a separate chapter was added in the Act. However, some of the important provisions, mainly related to governance, capital, audit and resolution including winding up were not applied on the co-operative banks.

1.9 The regulation of co-operative banks by the RBI so far has largely been restricted to certain aspects of their functions, mainly those directly related to 'banking', giving rise to the dual regulation, with governance, audit and winding-up related functions largely being in the domain of the State Governments in case of 'single-state' banks (i.e. banks whose area of operation is confined to a single state) and the Central Government in case of multi-state banks. Governance functions have rather been loosely regulated even by the Governments because of the perception of them being democratic institutions. The problem has been highlighted in the reports of many of the committees set up by the RBI in the past, more notably by the High-Power Committee on Urban Co-operative Banks (Chair: Shri K. Madhava Rao, 1999), the Expert Committee on Licensing of New Urban Co-operative Banks (Chair: Shri Y. H. Malegam, 2011) and the High-Powered Committee on Urban Co-operative Banks (Chair: Shri R. Gandhi, 2015).

1.10 Owing to lack of the desired level of regulatory comfort on account of the structural issues related to capital and the gaps in the statutory framework, the regulatory policies for co-operative banks have been restrictive with regard to their business operations, which, to some extent, have been one of the reasons affecting their growth. With the enactment of the Banking Regulation (Amendment) Act, 2020, the statutory gaps have been addressed to a very large extent.

Constitution of the Expert Committee

1.11 It is in this context that the RBI, as part of the Statement on Developmental and Regulatory Policies released along with the Monetary Policy Statement on February 05, 2021, announced setting up of an Expert Committee for UCB sector ('the Committee') involving all stakeholders in order to provide a medium-term road map to strengthen the sector, enable faster rehabilitation/resolution of UCBs, as well as to examine other critical aspects relating to these entities. The Committee was constituted *vide* Press Release dated February 15, 2021 with the following terms of reference and composition.

Terms of Reference (TOR)

i. Take stock of the regulatory measures taken by the RBI and other authorities in respect of UCBs and assess their impact over last five years to identify key constraints and enablers, if any, in fulfilment of their socio-economic objective.
ii. Review the current Regulatory/Supervisory approach and recommend suitable measures/changes to strengthen the sector, taking into account recent amendments to the BR Act.
iii. Suggest effective measures for faster rehabilitation / resolution of UCBs and assess potential for consolidation in the sector.
iv. Consider the need for differential regulations and examine prospects to allow more leeway in permissible activities for UCBs with a view to enhance their resilience.
v. Draw up a vision document for a vibrant and resilient urban co-operative banking sector having regards to the Principles of Cooperation as well as depositors' interest and systemic issues.

Composition of the Committee

Shri N. S. Vishwanathan Former Deputy Governor, RBI	Chairman
Shri Harsh Kumar Bhanwala Former Chairman, NABARD	Member
Shri Mukund M Chitale Chartered Accountant	Member
Shri N. C. Muniyappa IAS (Retired)	Member
Shri R. N. Joshi IAS (Retired)	Member

Prof M. S. Sriram IIM Bangalore	Member
Shri Jyotindra M. Mehta President, NAFCUB	Member
Shri Neeraj Nigam, Chief General Manager-In-Charge Department of Regulation, RBI	Convenor

Approach / Methodology

1.12 The Committee held 14 meetings through video conferencing between (and including) March 8, 2021 and July 28, 2021 as detailed in Annex 1. It also held discussions with various stakeholders and experts and sought feedback from the UCB sector with the help of a questionnaire to elicit their responses on some of the issues drawn from the ToR (Annex 2). The questionnaire was emailed to all the UCBs and their Federations to seek their responses. Responses were received from 654 UCBs and 9 Federations (Annex 3).

1.13 The Committee formed sub-groups for interacting with select stakeholders such as Federations of UCBs, UCBs, Registrars of Co-operative Societies, auditors, technology providers and experts. The list of stakeholders who interacted with the Committee along with the dates of the interactions are given in Annex 4. All these interactions were conducted through video conference. The Committee also received feedback submitted to it *suo motu* by certain persons / organizations. The Committee also looked at the data and analyses related to various financial parameters of UCBs presented before it by the secretariat, to be able to formulate its opinion on the relevant areas.

1.14 The Committee has given its report based largely on the unanimous views of the members on the areas covered under the TOR. Differing views in certain areas given by Shri Jyotindra M Mehta, President, NAFCUB are enclosed as Annex 9.

ACKNOWLEDGEMENTS

The Committee gratefully acknowledges the support provided by the secretariat headed by Shri Neeraj Nigam, Chief General Manager-In-Charge, Department of Regulations (DoR), RBI and comprising Shri T V Rao, General Manager, Shri Prabhat Ranjan, Deputy General Manager, Shri Praveen Kumar Yadav, Assistant General Manager, Shri Dinesh Kumar, Manager, Shri Manish Manhar, Manager and Shri Ashish Kumar Meena, Manager from DoR, RBI.

The Committee also places on record its appreciation for the assistance rendered by Shri Abhilash Ankathil, Deputy Legal Advisor, RBI and a special invitee to the Committee meetings, in understanding the implications of various legal issues in general and those arising from the recent amendments to the Banking Regulation Act, 1949 in particular.

The Committee would like to thank the stakeholders including the UCBs and their national and state level Federations who interacted with the Committee and/or responded to the questionnaire. The Committee also benefited from its interactions with Registrars of Co-operative Societies of select states and the Central Registrar of Co-operative Societies, experts in the field of co-operative banking, group of Chartered Accountants (CA-COB) and select IT service providers. The presentation made before the Committee on the Umbrella Organisation (UO) by the NAFCUB's consultants was useful in understanding the shape the UO is expected to take and its business model.

Finally, the Committee would like to thank the Deputy Governor (Shri M Rajeshwar Rao) and his team for agreeing to brief the Committee on the basic issues that the RBI would like the Committee to examine.

LIST OF ABBREVIATIONS

AACS	As Applicable to Co-operative Societies
ACB	Audit Committee of the Board
AD	Authorized Dealer
AFS	Available for Sale
AID	All-inclusive Directions
AIFI	All Indian Financial Institution
ALM	Asset-Liability Management
ANBC	Adjusted Net Bank Credit
ATM	Automated Teller Machine
BC	Business Correspondent
BF	Business Facilitator
BoD	Board of Directors
BoM	Board of Management
BPCE	Banques Populaires-Caisses d'Epargne
BR Act	Banking Regulation Act, 1949
CAMELS	Capital Adequacy, Asset Quality, Management, Earning, Liquidity, and System and Controls
CAPEX	Capital expenditure
CBS	Core Banking Solutions
CD	Credit-Deposit / Certificate of Deposit
CDA	Central Delegate Assembly
CEO	Chief Executive Officer
CEOBSE	Credit Equivalent Amount of Off-balance Sheet Exposure
CET1	Common Equity Tier 1
CGTMSE	Credit Guarantee Fund Trust for Micro and Small Enterprises
CIC	Credit Information Company
CISBI	Central Information System for Banking Infrastructure
COVID	Coronavirus (SARS-CoV-2)
CRAR	Capital to Risk-Weighted Assets Ratio
CRCS	Central Registrar of Co-operative Societies
CRE	Commercial Real Estate
CRE-RH	Commercial Real Estate - Residential Housing
CRILC	Central Repository of Information on Large Credits
CRR	Cash Reserve Ratio
CTS	Cheque Truncation System
CU	Credit Union
DCC	District Consultative Committee
DCCB	District Central Co-operative Bank
DFS	Department of Financial Services
DICGC	Deposit Insurance & Credit Guarantee Corporation
DLRC	District Level Review Committee
DOR	Department of Regulation
DoS	Department of Supervision
D-SIB	Domestically Systemically Important Bank

ECB	European Central Bank
EPN	Entry Point Norm
ESOP	Employee Stock Ownership Plan
FALLCR	Facility to Avail Liquidity for Liquidity Coverage Ratio
FC	Financial Co-operative
FSWM	Financially Sound and Well-Managed
GFC	Global Financial Crisis
GNPA	Gross Non-Performing Assets
GoI	Government of India
GSA	Graded Supervisory Action
G-SIB	Globally Systemically Important Bank
HPC	High Powered Committee
HR	Human Resources
HTM	Held to Maturity
IAS	Indian Administrative Service
IBPS	Institute of Banking Personnel Selection
IDRBT	Institute for Development & Research in Banking Technology
IIM	Indian Institute of Management
IPDI	Innovative Perpetual Debt Instruments
IRAC	Income Recognition and Asset Classification
IT	Information Technology
JPC	Joint Parliamentary Committee
KYC	Know Your Customer
LAB	Local Area Bank
LAF	Liquidity Adjustment Facility
LCR	Liquidity Coverage Ratio
LFAR	Long Form Audit Report
LTD	Long Term (Subordinated) Deposits
LTV	Loan-to-Value
MC	Master Circular
MD	Managing Director
MIS	Management Information System
MLI	Member Lending Institution
MMCB	Madhavpura Mercantile Co-operative Bank
MoU	Memorandum of Understanding
MSF	Marginal Standing Facility
MSME	Micro, Small and Medium Enterprise
MUDRA	Micro Units Development & Refinance Agency Ltd
NABARD	National Bank for Agriculture and Rural Development
NAFCUB	National Federation of Urban Co-operative Banks and Credit Societies Ltd.
NBFC	Non-Banking Finance Companies
NDS-OM	Negotiated Dealing System - Order Matching
NDTL	Net Demand and Time Liabilities
NEFT	National Electronic Funds Transfer
NGO	Non-Government Organization
NHB	National Housing Bank

NHB	National Housing Bank
NIM	Net Interest Margin
NNPA	Net Non-Performing Assets
NOC	No-Objection Certificate
NPA	Non-Performing Assets
NPCI	National Payments Corporation of India
NRE	Non-Resident External
NRO	Non-Resident Ordinary
NSFR	Net Stable Funding Ratio
OPEX	Operating Expenses
OSS	Offsite Surveillance System
PACS	Primary Agricultural Credit Society
PAN	Permanent Account Number
PCA	Prompt Corrective Action
PCPS	Perpetual Cumulative Preference Shares
PCR	Provision Coverage Ratio
PFRDA	Provident Fund Regulatory & Development Authority
PNCPS	Perpetual Non-Cumulative Preference Shares
POS	Point of Sale
PPI	Prepaid Payment Instrument
PSL	Priority Sector Lending
RBI	Reserve Bank of India
RBIA	Risk Based Internal Audit
RCPS	Redeemable Cumulative Preference Shares
RCS	Registrar of Co-operative Societies
RDA	Regional Delegate Assembly
RDB	Recovery of Debt Due to Banks & Financials Institutions and Bankruptcy Act, 1993
RIDF	Rural Infrastructure Development Fund
RNCPS	Redeemable Non-Cumulative Preference Shares
RoA	Return on Assets
RoE	Return on Equity
RRB	Regional Rural Bank
RTGS	Real-Time Gross Settlement System
SAF	Supervisory Action Framework
SARFAESI	Securitization and Reconstruction of Finance Assets and Enforcement of Security Interest
SC/ST	Scheduled Caste / Scheduled Tribe
SCB	Scheduled Commercial Bank
SCRA	Securities Contracts (Regulation) Act, 1956
SEBI	Securities and Exchange Board of India
SEZ	Special Economic Zone
SFB	Small Finance Bank
SGL	Subsidiary General Ledger
SIDBI	Small Industries development Bank of India
SLBC	State-Level Bankers Committee
SLR	Statutory Liquidity Ratio

SME	Small and Medium Enterprise
SRO	Self-Regulatory Organization
StCB	State Co-operative Bank
SWOT	Strengths, Weaknesses, Opportunities and Threats
TAFCUB	Task Force on Urban Co-operative Banks
TDS	Tax Deduction at Source
TOR	Terms of Reference
UNB	Universal Bank
UCB	Primary (Urban) Co-operative Bank
UK	United Kingdom
UO	Umbrella Organization
USA	United States of America
USD	United States Dollar
WTC	Whole-Time Chairman
WTD	Whole-Time Director

Chapter 2

EXECUTIVE SUMMARY

Overview

2.1 The regulation of co-operative banks by the RBI so far has largely been restricted to their 'banking' business, with governance, audit, reconstruction/amalgamation and winding-up related functions being in the domain of the state governments (in case of single-state banks, i.e., banks whose area of operation is confined to a single state) and the Central Government (in case of multi-state banks, i.e., banks whose area of operation extends to more than one state). Governance functions have rather been loosely regulated even by the Governments because of the perception of the UCBs being democratic institutions. (**Para 1.9**)

2.2 Owing to lack of the desired level of regulatory comfort on account of the structural issues including 'capital' and the gaps in the statutory framework, the regulatory policies for co-operative banks have been restrictive with regard to their business operations, which, to some extent, has been one of the reasons affecting their growth. With the enactment of the Banking Regulation (Amendment) Act, 2020, the statutory gaps have been addressed to a very large extent. (**Para 1.10**)

2.3 The Committee considered it appropriate to articulate the guiding principles which would inform its approach to the issues covered by the Terms of Reference, in assimilating the feedback received during stakeholder consultations, directing the deliberations within the Committee, and for identifying most of the recommendations. The Committee notes that having regard to the heterogeneity of the sector, the smaller banks, which are more rooted in co-operative principles, should be allowed to acquire scale through the network of the Umbrella Organisation, while the larger ones should have scale on a stand-alone basis. (**Para 3.1 and 3.2**).

2.4 The Committee observed that focus of the regulatory policies during the last five years has been to mitigate the risks in the banking business of UCBs, keeping in view the various constraints such as heterogeneity of the sector, limitations in the form of constraints in raising capital and non-availability of resolution tools under the provisions of the BR Act and, in general, lack of adequate regulatory control of the RBI. The Committee, however, did not find any regulatory changes brought about in the last five years to be largely limiting the growth of the UCBs. Nevertheless, it noted that the restrictive approach of the earlier years towards branch expansion, scheduling, which continued to be pursued on top of a more enabling regulatory approach towards business operations of the other banking and non-banking entities did hamstring the ability of the UCBs to grow. The Committee also noted that this approach was rooted in the inadequacy of regulatory powers with the RBI under the then existing legislative framework. (**Para 4.4**)

2.5 The Committee noted that the UCB sector has been under stress for quite some time. It felt that given the importance of the sector in furthering financial inclusion and considering the large number of its customer base, it is imperative that the strategies adopted for the regulation of the sector are comprehensively reviewed so as to enhance its resilience and provide an enabling environment for its sustainable and stable growth in the medium term. (**Para 4.5.8**)

2.6 The Committee carried out a SWOT analysis of the UCB sector and identified factors contributing to their strength and weakness as also the opportunities and threats they are likely to encounter. (**Table 3**)

2.7 In the Committee's view, while it was possible that the structural factors arising from the co-operative character underlying the UCBs could still pose some challenges, the amendments to the BR Act address to a large extent the gaps in the legislative framework, which informed the extant approach of the RBI towards regulation and supervision of UCBs. Consequently, since the UCBs have the potential of driving financial inclusion and credit delivery to those with limited means, the regulatory policies can now be more enabling. (**Para 6.2.2**)

2.8 The Committee also discussed the issue of parallel statutory provisions in the BR Act and the co-operative societies' laws, which was raised by UCBs and their federations during their interaction with the Committee. These are considered more to be administrative challenges rather than legislative conflicts. (**Para 6.2.3**)

2.9 The Committee observed that given the heterogeneity in the sector, a tiered regulatory framework with more than two tiers is required to balance the spirit of mutuality and co-operation more prevalent in banks of smaller sizes and those with limited area of operation *vis-à-vis* the growth ambitions of the large-sized UCBs to spread their area of operation and undertake more complex business activities on par with commercial banks. The Committee agreed that the deposit size can continue to be the basis for categorising banks into regulatory tiers, as for a normally functioning bank, deposit size can broadly serve as proxy for capital size and net worth. Further, additional tiers could be created to cater to the aspirations of the larger UCBs to undertake business akin to that of SFBs and UNBs. (**Para 6.4.3**)

2.10 With regard to the minimum capital and reserve (net worth) requirement for UCBs, irrespective of CRAR, one view favoured the *status quo*, arguing that the smaller UCBs have a long history of surviving and serving their customers, despite their small size. **(Para 6.5.1.4)**

2.11 The Committee felt that a liberal regulatory approach may be adopted for UCBs that meet a certain minimum level of capital and reserves (net worth) and CRAR requirements. Further, membership of the UO might also provide an extra comfort to the regulator as the smaller UCBs would benefit from the products and services provided by the UO. It was felt that UCBs meeting the criteria specified for UNBs or SFBs and having comparable risk management abilities may be regulated on the lines of UNBs or SFBs, as the case may be. (**Para 6.6.2**)

2.12 With regard to the existing regulatory approach of prescribing sectoral limits for UCBs, the Committee believed that given the heterogeneity in the sector, the monetary ceilings on different categories of loans may be dispensed with, particularly for larger UCBs. Instead, the Committee felt, the regulatory ceilings may be defined as a percentage of Tier I capital of the bank with appropriate monetary ceilings for smaller UCBs having inadequate risk management and risk bearing capacity. For larger UCBs, the monetary ceilings may be decided by their Boards, within the prescribed general exposure limits (for single/group borrowers). (**Para 6.6.3**)

2.13 At the same time, the Committee recognized the need for UCBs to be well capitalized in proportion to their risk weighted assets. The Committee felt that in line with the principles of proportionate regulation, it may not be desirable to expect smaller UCBs to switch over to Basel III which is complicated and require higher technical competence and skills. However, a higher level of CRAR needs to be prescribed to take care of the market and operational risks, particularly if operational freedom has to be enhanced. While doing so, the Committee also considered that membership of UO, once it becomes operational, would mitigate these risks for UCBs in lower tiers to a certain extent and, therefore, the CRAR requirement can be brought down. However, a glide path should be provided to UCBs to achieve the higher CRAR. (**Para 6.6.4**)

2.14 The Committee is of the view that the recent amendments to the BR Act need to be supplemented by legislative enablement for listing of certain securities issued by the UCBs. As there is no corresponding law in the co-operative realm, it is difficult to categorise the issuance of securities made by co-operative banks into ‘public offers’ and ‘private placements’ in the manner these are known in case of companies. (**Para 7.9.2**)

2.15 The Committee noted that even though the present SAF aims to start the resolution process early, close to one third of all UCBs consistently remain under the SAF over the years. This raises concerns about their functioning as also the efficacy of the resolution process. (**Para 8.5.2**)

2.16 The Committee feels that the ‘multiple indicators - multiple stages’ approach of the existing SAF mechanism needs a relook. If a UCB remains under more stringent stages of SAF for a prolonged period, it may have an adverse effect on its operations and may further erode its financial position. Delay in initiating the resolution process causes inconvenience to the depositors/customers and further leads to erosion in the enterprise value including deposits. Therefore, the Committee, after an extensive deliberation, recommends that the framework may contain a twin indicator only, *viz.* CRAR and Net NPA, with an emphasis on reducing the time spent by a UCB under SAF. (**Para 8.6.1**)

2.17 The Committee also finds it appropriate that the additional provisioning suggested by the Inspecting Officers (IOs) should be adjusted from GNPA to arrive at assessed NNPA similar to the adjustments in Tier I capital done to arrive at assessed CRAR. TAFCUB intervention may also be envisaged if the divergence is large, leading to significant increase in NNPA and reduction in CRAR. Such banks may be flagged for discussions in TAFCUB and early intervention. (**Para 8.6.2**)

2.18 During the process of stakeholder consultation, some UCBs suggested that TAFCUB should have a forum to study early warning signals of UCBs heading towards imposition of SAF. Concerns were expressed over the limited role of TAFCUB after introduction of SAF by the RBI, while some banks also mentioned that the regulatory action taken by the RBI should be in consonance with the decision of the TAFCUB. **(Para 8.8.2)**

Recommendations

2.19 Regulatory Framework

A. Categories of UCBs

Based on the cooperativeness' of the banks, availability of capital and other factors, UCBs may be categorised into following four tiers for regulatory purposes:

- Tier 1 - All unit UCBs and salary earner's UCBs (irrespective of deposit size), and all other UCBs having deposits up to ₹100 crore
- Tier 2 - UCBs with deposits more than ₹100 crore and up to ₹1000 crore
- Tier 3 - UCBs with deposits more than ₹1000 crore and up to ₹10,000 crore
- Tier 4 - UCBs with deposits more than ₹10,000 crore

(**Para 6.7.1.1**)

B. Prescriptions for Tier 1 UCBs

i) Tier 1 banks having area of operation within a district should have a minimum capital and reserves (net worth) of ₹2 crore and other Tier 1 banks should have a minimum capital and reserves (net worth) of ₹5 crore.

ii) A suitable glide path may be provided for achieving the target minimum net worth, provided the banks meet the CRAR requirement.

iii) The minimum CRAR stipulation for Tier 1 banks may be as under:

Sr. No.	Condition	Minimum required CRAR (%)
1.	Meets the minimum net worth criteria of ₹2 crore / ₹5 crore and is a member of UO	9.0

2.	Meets the minimum net worth criteria of ₹2 crore / ₹5 crore but is not a member of UO	11.5
3.	Does not meet the minimum net worth criteria of ₹2 crore / ₹5 crore but is a member of UO	11.5
4.	Does not meet the minimum net worth criteria of ₹2 crore / ₹5 crore and is also not a member of UO	14.0

iv) There may be no differentiated risk weights.

v) Banks meeting the minimum net worth and CRAR criteria may be given general permission to open, during a financial year, branches up to 10 per cent of the number of branches at the end of the previous financial year, subject to a minimum of one branch. The new branch(es) should be opened in an unbanked area within the district of operation of the banks requiring a minimum capital of ₹2 crore, and in current districts of operation or adjoining districts in case of banks requiring a minimum capital of ₹5 crore. The branch in the unbanked area should be front loaded wherever the number of branches to be opened by the bank is less than four. The extant regulations with regard to capital headroom should continue.

vi) All other regulatory prescriptions may be in line with the present regulatory guidelines for UCBs, as amended from time to time and subject to the other recommendations of this Committee.

vii) As already prescribed for all UCBs by the RBI, 75 per cent of the ANBC/CEOBSE of banks in this tier shall meet PSL criteria and 50 per cent of their credit portfolio should consist of loans of ticket size up to ₹25 lakh. The time given to these banks till March 31, 2024 to get their loan book in conformity with these stipulations is reasonable.

(**Para 6.7.1.2**)

C. Prescriptions for Tier 2 UCBs

i) Minimum CRAR of 15 per cent[3] on credit risk. The minimum CRAR requirement may be reduced by one per cent point upon the bank becoming a member of the UO.

ii) Additional timeframe (say two years) and glide path may be provided in case a UCB has to achieve the required minimum CRAR for Tier 2 category, on transitioning from Tier 1 to Tier 2 category on account of size of deposits.

iii) Banks meeting the CRAR requirements may be allowed to open branches in existing districts or contiguous districts (in the state where the bank has its head office) up to 10 per cent of the existing number of branches (subject to minimum one and maximum five) every year under automatic route with a prescription of opening at least 25 per cent of the branches in

[3] Tier two UCBs being larger in size and having the potential to grow further, there is a need for them to be adequately capitalized to compensate for market and operational risks.

unbanked areas, subject to headroom capital availability and reporting to RBI. The branch(es) in the unbanked area should be front loaded wherever the number of branches to be opened by the bank in a year is less than four.

iv) All other regulatory prescriptions may be in line with the present regulatory guidelines for UCBs, as amended from time to time, and subject to the other recommendations of this Committee.

v) As already prescribed by RBI for all UCBs, at least 75 per cent of the ANBC/CEOBSE of the UCBs in this tier shall meet the PSL criteria and 50 per cent of their credit portfolio should consist of loans of ticket size up to ₹25 lakh. The Committee also recommends that the hard timeline for achieving the PSL target be replaced with a stipulation that 95 per cent of the incremental portfolio of these banks should be corresponding to the aforesaid prescriptions till the overall loan book conforms to the stipulated composition.

(**Para 6.7.1.3**)

D. Prescriptions for Tier 3 UCBs

i) Minimum CRAR of 15 per cent as applicable to SFBs

ii) A Tier 3 UCB which meets both the entry point capital and the CRAR[4] requirements applicable to SFBs may, on the RBI being satisfied that it meets the financial requirements and has a fit and proper Board and CEO, be allowed to function on the lines of an SFB. Such UCBs may be eligible for the following:

a) Deemed area of operation across the country and, consequently, deemed permission / NOC from RBI to become a multi-state bank, if it is not already one.
b) Branch expansion throughout the country through automatic route, subject to a prescription of opening at least 25 per cent of the branches in unbanked areas and reporting to the RBI. The branch(es) in the unbanked area should be front loaded wherever the number of branches to be opened by the bank is less than four.
c) Automatic inclusion in second Schedule to the RBI Act
d) AD licensing regime on par with SFBs
e) Any other regulatory permissions normally granted to SFBs

iii) Tier 3 UCBs not fulfilling the conditions as at (ii) above may have operational freedom on par with Tier 2 UCBs.

iv) The loan portfolio of all UCBs in Tier 3 shall conform to the stipulations made for SFBs as per instructions already in place. As in case of banks in Tier 2, the Committee recommends that

[4] Presently, ₹200 crore and 15% respectively

the hard timeline be replaced with a stipulation that 95 per cent of the incremental portfolio of these banks should be corresponding to the aforesaid prescriptions till the overall loan book conforms to the stipulated composition.

v) There may, however, be no sub-target for agriculture under PSL.

vi) These banks may voluntarily become members of the UO.

(**Para 6.7.1.4**)

E. Prescriptions for Tier 4 UCBs

i) Minimum CRAR as per Basel III prescriptions as applicable to UNBs.

ii) A Tier 4 UCB which meets both the entry point capital[5] and CRAR requirements applicable to UNBs as also the leverage ratio may, on RBI being satisfied that it meets the financial requirements and has a fit and proper Board and CEO, be allowed to function on the lines of a universal bank.

iii) Tier 4 UCBs fulfilling the conditions at (ii) above may have all the operational freedom, including for branch expansion (including the obligation to open 25 per cent of the branches in unbanked areas subject to reporting), scheduling, AD license, etc. on par with UNBs.

iv) Any bank which is in Tier 4 by virtue of its deposit size but found ineligible to be authorised to function as a universal bank may be provided operational freedom as applicable to Tier 2 UCBs while their regulatory requirements will continue to be as applicable to banks in Tier 4. The loan portfolio of such UCBs shall conform to the stipulations made for SFBs as per instructions already in place. For the reasons outlined in case of Tier 2 banks above, the Committee recommends that the hard timeline be replaced with a stipulation that 95 per cent of the incremental portfolio of these banks should be corresponding to the aforesaid prescriptions till the overall loan book conforms to the stipulated composition.

v) These banks may voluntarily become members of the UO.

(**Para 6.7.1.5**)

F. Recommendations on Sectoral Exposure Ceilings

Regulation of UCBs in Tier 3 and Tier 4 will be largely on par with SFBs and UNBs, respectively. For Tier 1 and Tier 2 banks, including the banks in Tier 3 and Tier 4 not meeting the financial parameters of SFB and UNB, respectively, the following modifications are recommended to give more operational freedom to these banks, subject to banks meeting the suggested regulatory requirement of CRAR and net worth:

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[5] Presently, ₹500 crore

i) Housing Loan

a) The maximum limit on housing loans may be prescribed as a percentage of Tier 1 capital, subject to RBI-prescribed monetary ceiling for Tier 1 UCBs (but higher than the present ceiling) and respective Board of Directors-approved ceiling for Tier 2 UCBs.

b) For Tier 2 UCBs, the risk weight on housing loans may be prescribed based on size of the loan and loan-to-value (LTV) ratio, in line with SCBs.

ii) Loan against Gold Ornaments with Bullet Repayment Option

a) The maximum limit on loan against gold ornaments extended on bullet repayment terms may be prescribed as a percentage of Tier 1 capital, subject to suitable LTV ratio.

b) There may be an RBI-prescribed ceiling (higher than the present ceiling) for Tier 1 UCBs and respective Board of Directors-approved ceiling for Tier 2 UCBs.

iii) Unsecured Advances

a) For banks in Tier 1 and 2, the maximum limit on individual unsecured loans may be linked to Tier-I capital, subject to a suitable upper cap for Tier 1 banks. Tier 2 banks may have a Board-approved ceiling.

b) The present aggregate limit on unsecured advances, i.e., 10 per cent of total assets may continue. However, the UCBs may be allowed to have a higher limit with the approval of their Boards and subject to the condition that the loans exceeding the aforesaid 10 per cent limit must qualify to be classified as PSL.

iv) For UCBs in Tier 2, the limit on exposure to various sectors may be removed (on par with concentration risk); additional standard asset provisioning may be imposed on exposure to a single sector beyond a specified percentage of the loan portfolio (say 20 percent).

(**Para 6.7.2**)

G. Computation of Tier I Capital

Revaluation Reserve may be considered for inclusion in Tier I capital, subject to applicable discount on the lines of scheduled commercial banks. (**Para 6.7.3.2**)

H. Umbrella Organization

i) The UO is expected to play a crucial role in the strengthening of the sector. For that, it must be a financially strong organization with adequate capital and a viable business plan. The minimum capital for the UO should be ₹300 crore with CRAR and regulatory framework akin to the largest segment of NBFCs. It must be evaluated for quality of internal controls as it will also play the role of an SRO.

ii) In the long run, the UO may take up the role of a Self-Regulatory Organization (SRO) for smaller UCBs, where the UO could run an independent audit/inspection and supervisory division that may conduct both offsite and onsite supervision. Moreover, the membership of the UO could be opened to all types of co-operatives. While financial co-operatives would use most of the services of the UO, the non-financial co-operatives could use certain specific services provided by it, such as wallet services, cash management services and restricted/regulated access to payments and remittance systems. The contribution that the members make to the UO may, *inter alia*, be in the nature of share capital which will be permanently with the UO. It will have incremental membership with new members joining the UO, possibly at a premium that may be decided from time to time.

iii) Once the UO stabilizes, it may explore the possibilities of converting into universal bank and offer value-added services on behalf of its member banks. With suitable structural flexibility to operate as a bank, the UO can be owned by the co-operative institutions even if it is a joint stock company, which may encourage the smaller UCBs to become an extended arm of such a bank.

iv) Once the COR is issued and the UO commences its business, the RBI could consider providing a one-time grant to the UO for a specific objective tied to providing IT support to its member banks. Since aggregation of IT services will be a financial inclusion enabler and can also contribute to system-stability through standardisation of the IT interface, RBI’s financial support to the UO would be justifiable.

(**Para 6.7.4**)

I. Capital Instruments

i) Amendments to BR Act empowering the RBI to declare certain securities issued by UCBs as covered under the Securities Contract Regulation Act to facilitate their listing and trading in a recognised stock exchange may be made. Till such time, the RBI may consider allowing banks in Tier 3 and 4, having the necessary technology and wherewithal, to issue shares at premium to persons residing in their areas of operation subject to certain conditions. (**Para 7.13.1**)

ii) UCBs may be permitted to grant advances to subscribers of PCNPS subject to the amount of loan being a limited multiple of the PNCPS subscribed to by the investor. The number of such borrowers and other nominal members having credit facility shall not exceed 20 percent of the total borrowing members of the UCB. In other words, the PNCPS subscribers who have borrowed from the bank will be akin to nominal members except that there shall not be a monetary ceiling of ₹1 lakh on the loans in their case but a limit in the form of a multiple of their subscription to PNCPS. (**Para 7.13.2**)

iii) For providing an avenue for persons to contribute to capital in the form of donations / grants-in-aid / contribution without accompanying voting rights, feasibility of issuing an alternate instrument, possibly in the form of Redeemable Preference Shares with very low coupon and maturity of 20 years could be considered. (**Para 7.13.3.(ii)**)

2.20 Recommendations on Supervisory Action Framework (SAF) and Consolidation

i) SAF should follow a twin-indicator approach, i.e., it should consider only asset quality and capital measured through NNPA and CRAR instead of triple indicators at present. Additional provisioning suggested by the Inspecting Officers (IOs) should be adjusted from GNPA to arrive at assessed NNPA similar to the adjustments in Tier I capital done to arrive at assessed CRAR to determine whether SAF triggers are hit. The objective of the SAF should be to find a time-bound remedy to the financial stress of a bank. (**Para 8.6.2 and 8.6.3.1**).

ii) As hitherto, actions under the SAF may continue to be segregated into mandatory and discretionary. The action based on the suggested twin indicators may be taken by the RBI without reference to TAFCUB. However, there could be banks with other supervisory concerns like stress in profitability, governance-related concerns, etc., all of which call for further corrective action on the part of the banks. These may be considered for discretionary action in consultation with TAFCUB for banks in Tiers 1 and 2. (**Para 8.6.3.2**)

iii) All-inclusive directions should be treated on par with moratorium under Section 45 of BR Act and, if imposed, a bank should not continue thereunder beyond the time permitted to keep a bank under moratorium *viz.*, three months extendable by a maximum of another three months. It is recommended that at some stage, the weak banks should be visited with a regulatory nudge to explore the possibility of voluntary merger or conversion into a non-banking society at an early stage with the clear understanding that in the absence thereof, the powers for mandatory resolution would be employed. (**Para 8.6.3.3**)

iv) In view of the powers derived from the recent amendment, the RBI may strive to begin the mandatory resolution process including reconstruction or compulsory merger as soon as a UCB reaches Stage III under the SAF. The RBI may also consider superseding the Board if the bank fails to submit voluntary merger / conversion proposal within the prescribed timeframe and take necessary steps to avoid undue flight of deposits once the news becomes public. (**Para 8.6.3.4**)

v) A broad structure for SAF as recommended by the Committee is contained at **Para 8.6.3.5**.

2.21 Recommendations on Resolution of UCBs

i) Under Section 45 of the BR Act, read with Section 56 thereof, RBI can prepare scheme of compulsory amalgamation or reconstruction of UCBs, like banking companies. This may be resorted to when the required voluntary actions are not forthcoming or leading to desired results. (**Para 8.7.1.(ii)**)

ii) The action, other than voluntary responses by the banks may, *inter alia*, provide for one or more of the following:

a) Compulsory amalgamation with another banking institution or a transfer of assets and liabilities to another financial institution. In such cases, the existing members of the transferor UCB may be disenfranchised for a period of five years.

b) Reconstruction through reconstitution of the capital, assets, powers, rights, interests, privileges, liabilities, duties and obligations, change in Board of Directors, alteration of byelaws, etc. for giving effect to reconstruction.

c) The amalgamation or reconstruction scheme may include reduction in the rights of creditors, including depositors and members of the bank; or payment in cash or in any other manner to depositors/creditors in respect of their entire claims or reduced claims, as the case may be.

d) The section also offers flexibility to allot shares/long term debt instruments of the transferee bank (acquiring bank) to the depositors/creditors/members without reducing their claims.

(**Para 8.7.2**)

2.22 Consolidation

The minimum capital stipulation provides an embedded size to a UCB. The Committee feels that RBI should be largely neutral to voluntary consolidation except where it is suggested as a supervisory action. However, the RBI should not hesitate to use the route of mandatory merger to resolve UCBs that do not meet the prudential requirements after giving them an opportunity to come up with voluntary solutions. (**Para 8.9.3**)

2.23 Other Recommendations

i) The existing regulatory neutrality in regard to the voluntary conversion of co-operative banks to joint stock companies as per the operating framework in place therefor may continue. (**Para 6.2.2**)

ii) To obviate difficulties for UCBs due to jurisdictional issues between the RBI and the concerned Registrars of Co-operative Societies (RCS) / Central Registrar of Co-operative Societies

(CRCS), the RBI may consider clarifying the position appropriately to the concerned authorities. (**Para 6.2.3**)

iii) Since the recent amendments to the BR Act largely addresses the issues related to management and governance in UCBs with powers to RBI for prescribing 'fit and proper criteria' for directors and MD/CEO and requirement for minimum of 51 per cent of the directors having special qualification or experience, the extant guidelines related to constitution of Board of Management may be withdrawn. RBI should strictly enforce the new provisions of the BR Act with regard to Governance. A toolkit of appropriate regulatory responses besides enforcement action may be put in place. (**Para 6.7.3.1**)

iv) The Committee recommends that the UCBs should be included as eligible banks under the Government Schemes such as MUDRA, interest subvention/ subsidy scheme. UCBs should also be allowed to undertake Government business subject to them meeting the prescribed criteria. (**Para 6.7.3.3**)

v) TAFCUB, as a forum for coordination should continue. While the mandatory action based on objective criterion under the SAF should be taken by the RBI, discretionary actions to address the deficiencies of other financial or non-financial nature, such as high GNPA, losses, governance issues, inefficiencies, weakness in systems and controls etc. in case of Tier 1 and 2 banks may be deliberated and appropriate supervisory action may be recommended by the TAFCUB. (**Para 8.8.3**)

Chapter 3

GUIDING PRINCIPLES

3.1 The Committee considered it appropriate to deliberate on and articulate the guiding principles which informed its approach to the issues covered by the terms of reference in assimilating the feedback received during stakeholder consultations, directing the deliberations within the Committee, and finally for identifying most of the recommendations. These guiding principles are delineated below.

3.2 The Guiding Principles

3.2.1 Mutuality and Scale

(i) The Committee considered the spirit of mutuality and co-operation at the member level and the principles of banking at the system and regulation level as one of the guiding principles. Traditionally, financial co-operatives have been community-based organisations – whether they are co-operative societies or credit unions – established on the principle of mutuality. Very much like the current day self-help groups, the principle of mutuality addressed the issue of lack of information (credit history or transaction trail) which is used in assessment of loans and leveraged on the knowledge of the community to assess risk. Since these institutions were envisaged as closed-loop institutions, their handshake with the external world was minimal. With the advent of technology and credit scoring systems, this needs to be redefined. Furthermore, a co-operative society leverages on co-operation whereas a bank leverages on capital. This friction is at the core of finding an optimal balance in adoption of the right approach to regulation and supervision of UCBs. The Committee feels that the regulatory framework needs to leverage the advantages that go with the co-operativeness of smaller UCBs in the form of proximity of the bank's business operations to the customers, mutual trust, commonness of objectives leading to greater loyalty, benefit of informal channels of information, etc.

3.2.2 Approach regarding Statutory Provisions

The legislative changes are taken as given and the Committee did not examine the feasibility or maintainability of the statutory provisions in the wake of the recent amendments to the BR Act and noted that by the construct of the legislation, the provisions of the BR Act would prevail, if they are in contradiction to the provisions of the Co-operative Societies' Act under which a UCB is registered. The Committee took the view that it should instead work broadly based on the design principles that were necessary. The Committee, however, took note of some stakeholders' viewpoint that the functionaries vested with the responsibility of the implementation of the Co-operative Societies laws may be prone to acting in a manner similar to the pre-amendment times. This could be a source for friction and cause complications in the smooth conduct of the UCBs' banking business. Nonetheless, the Committee feels that this is primarily an administrative issue that needs to be resolved by mutual consultations and deliberations.

3.2.3 Implications of the Legislative Amendments - Conflict between the Provisions of the BR Act and the Co-operative Laws

During the course of the deliberations with the stakeholders, the Committee was informed that as a result of the recent amendments to the BR Act, certain conflicts had arisen between the provisions of the amended BR Act and that of the various co-operative laws. This, for instance is important when it comes to sources of raising capital. The BR Act explicitly allows co-operative banks to issue shares at a premium, but it is silent on their redemption. Notwithstanding the rather paradoxical outcome, it would imply that if any co-operative societies' legislation provides for redemption of shares only at par, then while a co-operative bank incorporated under that legislation can issue shares at a premium, it can redeem them only at par. However, for the reasons stated in (3.2.2) above, the Committee has let this be.

3.2.4 Shift in Legislative Approach to Co-operative Bank Regulation

3.2.4.1 Co-operative societies carrying on banking business were brought under the purview of the BR Act in the year 1966 by inserting a new Section 56 to the Act, which extended the provisions of the principal Act to them in the manner specified therein. Given the construct of section 56 of the Act prior to the recent amendments, the approach of the legislation was that even if a co-operative society was licensed as a bank, the underlying society had to be more governed by the Act under which it was set up rather than the Act under which it was licensed as a bank. It meant that many aspects of the working of the underlying society, even if they could have a fairly large bearing on the conduct of banking business, had to be seen through the lens of a co-operative society rather than that of a bank. Some such aspects were management, capital, audit, resolution, etc. The BR Act, post the recent amendments, reverses this philosophy to quite an extent and underscores the importance of regulating such entities as banks rather than as co-operative societies in the interest of depositors and in public interest. It, thus, marks a paradigm shift in the legislative approach with regard to regulation of co-operative societies carrying on banking business.

3.2.4.2 One of the major concerns with regard to regulation of UCBs, and perhaps the most important one, has been the absence of regulatory powers for RBI over their management, which made regulation of their banking business difficult insofar as RBI could hardly take any significant steps to bring about improvement in the quality of their management and governance. This and the other elements of what is called 'dual control', including, notably, absence of powers with regard to resolution, have significantly influenced RBI's regulatory and supervisory approach towards UCBs. With a shift in the legislative framework consequent upon the recent amendments to the BR Act, it could be argued that the RBI now stands more empowered to regulate UCBs.

3.2.5 Heterogeneity

Even as it recognized the need for and possibility of revisiting the current regulatory and supervisory template in the wake of the legislative changes, the Committee noted that any revised architecture will have to factor the extreme heterogeneity which the entities in the UCB sector display. The entities in the sector are quite heterogeneous in terms of size, geographical spread, business models, skill levels, technology adoption, clientele, etc. Even the laws bringing the underlying co-operative society into being and governing them are different as every state has its own Co-operative Societies' Act with some such as Karnataka, Andhra Pradesh, etc. having more than one, and there is a multi-state co-operative law as well. Given the heterogeneity, a 'one size fits al'" regulatory approach creates constraints on resilience as well as growth of the banks. The framework should therefore strike an appropriate balance between putting in place tailor-made regulations that adequately recognize heterogeneity on the one hand, and avoiding multiple tiers of regulation to reduce complexity, on the other. In designing the approach, the Committee thought it fit to create, to the extent possible, the divide based on how closer or farther a bank's functioning to co-operative principles is likely to be.

3.2.6 A Different Approach to Centrality of Capital

3.2.6.1 Banking is a complex business, and it was important to recognise the centrality of capital and the safety of public deposits. Therefore, entities undertaking banking business will be benefited by scale of operations. However, in case of UCBs, a dual approach to scale of operations will not only recognise the potential of the smaller entities to continue providing banking services while adhering more to co-operative principles and let the community derive the benefits thereof, but also delineate a framework for differentiated regulation.

3.2.6.2 At the base level, the Committee sees UCBs as the ones serving the underserved in a niche market and deepening the presence of formal banking. It also sees them as local institutions which aim to minimise the intermediation costs (low overheads, low costs of assessment) and thereby make it lucrative for both the savers and the borrowers. Using the above arguments, it is evident that co-operatives move away from the principles of mutuality as they grow in size or area of operations. The Committee believes that while one set of banks can be allowed to acquire scale through network, the others may be required to acquire scale on a stand-alone basis. This is further elaborated below:

(i) Network-Based Scale

While the spirit of co-operation based on the principle of mutuality could be maintained by small units that work within closed loop communities, the ecosystem has significantly changed and maintaining a connection with the complex financial world is important even for the smallest person as it opens up opportunities to access diverse range of financial products. In order to achieve this, the Committee kept the concept of an Umbrella Organisation (UO) as a pivotal point that would provide backstop arrangements for entities that continued to be small. The UO, when fully evolved, would provide the following backstop arrangements:

- Access to cloud-based technology, which could be used on a shared basis
- Access to payment systems, interchange and common branding for offering products based on technology (payments interface, cards)
- Access to other financial products that could be cross sold – insurance, mutual funds, pensions and other financial products
- Access to capital and liquidity support in case of stress to a particular member co-operative
- Access to branding

(ii) Scale through Standalone Growth

The Committee recognised that the changes to the legislative framework have made the RBI a more empowered regulator and supervisor on the one hand and provided additional tools for UCBs for raising capital on the other hand. The Committee was, therefore, of the view that such of the co-operative banks which are large should be treated on par with any other commercial bank for the supervisory and regulatory purposes. They should be required to raise capital as per the prevailing norms and would be provided autonomy to offer services and grow, on par with any other bank offering similar range of services, and there would be no discrimination because of the form of incorporation being that of a co-operative. While there would be some guiding principles on how such organisations could meet the stringent capital requirements, the details could be left to the organisations on how they would adequately capitalise themselves in order to meet the requirements. The role of the regulator would be in applying (a) the test of permanency of capital and (b) fit-and-proper norms for governance and management.

Chapter 4

REVIEW OF REGULATORY POLICIES AND FINANCIAL POSITION OF UCBs

4.1 Role of UCB Sector in the Indian Banking System and its Performance

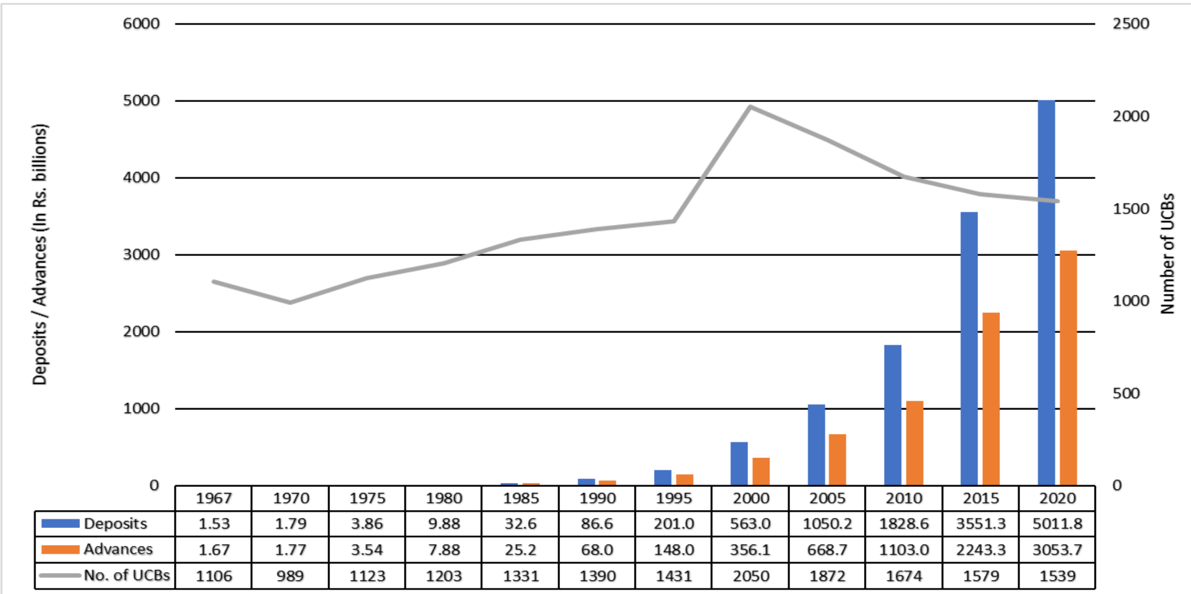
4.1.1 The UCBs have played a significant role in furthering financial inclusion since the time when they had not yet become a significant aspect of public policy in general, and banking policy in particular. It is well known that the co-operative movement began as an alternative to mainstream business models which were seen to be more exploitative and less inclusive of people in the lower economic strata. While it is not the intention of the Committee to trace the co-operative banking movement in India from its origins, it must be emphasised that prior to the amendments brought to the BR Act in 1966 whereby certain provisions of that Act were extended to co-operative societies, they were already undertaking banking business, implying that they were accepting public deposits for making loans and investments. The UCBs are primary co-operatives which, by law, are barred from enrolling another co-operative society as a member.

4.1.2 UCBs have been traditionally centred around communities, localities, work-place groups, etc. and organised on the principles of mutual aid, practice of thrift, and self-help. They play a role in last-mile credit delivery, more importantly, to the segments of the population less welcome by the mainstream banking segment. While a large section of the financially excluded population inhabits rural areas, financial exclusion is widespread in urban and semi-urban areas as well which has been the focus area of the UCBs as they primarily lend to wage earners, small entrepreneurs and businesses residing/operating in urban and semi-urban areas. Furthermore, being rooted in local communities, UCBs can be more responsive to the needs of the local people.

4.1.3 Keeping in view the substantial increase in operations of co-operative banks, it was considered necessary to bring their banking business under the regulatory powers of RBI for protecting the interests of the depositors as also to extend deposit insurance to their depositors. Accordingly, UCBs were brought under the regulatory purview of RBI with effect from March 1, 1966. The trend of the growth in number of banks, deposits, and loans and advances since 1967 is provided in Chart 1 below.

4.1.4 It can be observed from Chart 1 that in 1967, there were about 1106 UCBs with deposits and advances of ₹153 crore and ₹167 crore, which increased to 1390 UCBs with deposits and advances of ₹8660 crore and ₹6800 crore, respectively in 1990. The UCBs witnessed considerable growth in the 1990s on the back of a supportive licensing environment. It is instructive to note here that the UCBs witnessed a growth in market share in the banking business in the country during this period. This was also understandable in view of the UCBs' less formal approach to banking, decisions being based more on personal knowledge of the borrower rather than documents, the advantage of peer pressure in preventing adverse borrower behaviour and proximity enabling a closer monitoring of the business activities of the banks' clients facilitating quick flow of useful information through informal and formal channels.

Chart 1: Growth in the UCB Sector since 1967



4.1.5 Despite the rich history of the co-operative movement, the market share of UCBs in the banking sector has been gradually declining and today stands at around three per cent. The share of UCBs in deposits and advances of the banking sector as on March 31, 2020 is provided in Table 1.

Table 1: Share of UCBs in Banking Sector

(Amount in ₹ crores)

Entity Type	Deposits	Share in Deposits (%)	Advances	Share in Advances (%)
Public Sector Banks	90,48,420	58.50	61,58,112	54.29
Private Sector Banks	41,59,044	26.89	36,25,154	31.96
Foreign Banks	6,84,289	4.42	4,28,072	3.77
Small Finance Banks	82,488	0.53	90,576	0.80
Regional Rural Banks	4,78,547	3.09	2,86,919	2.53
Rural Co-operative Banks[6]	5,13,640	3.32	4,48,659	3.96
Urban Co-operative Banks	5,01,178	3.24	3,05,368	2.69
Total	154,67,606	100.00	113,42,860	100.00

Source: Database on Indian Economy: Primary (Urban) Co-operative Banks' Outlook

[6] Comprises data of State Co-operative Banks and District Central Co-operative Banks as on March 31, 2019

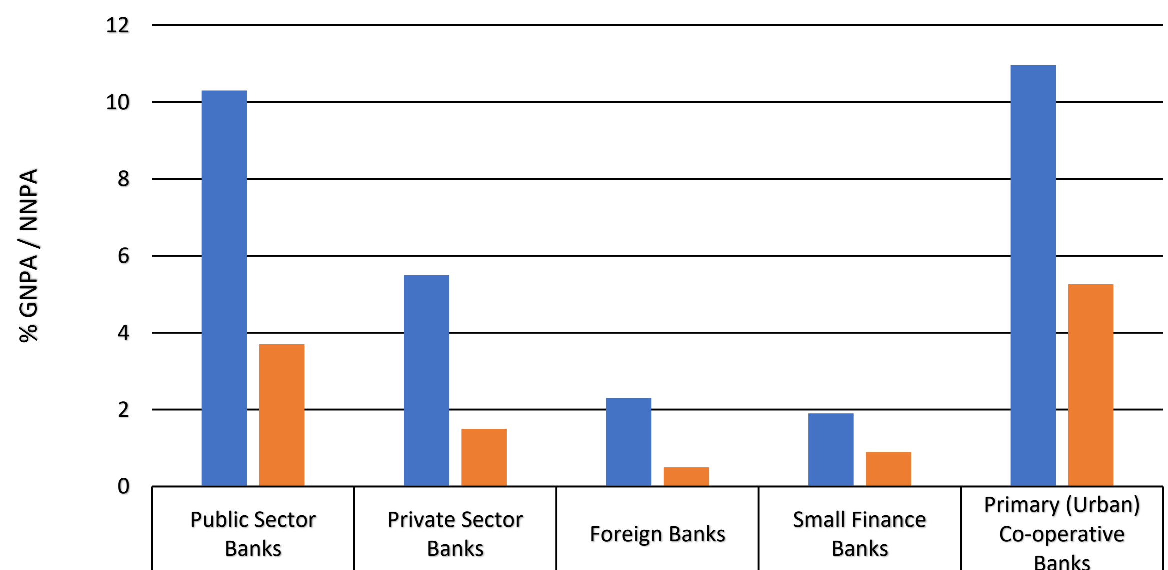
4.1.6 As on March 31, 2020, 94 per cent of the entities in the banking sector were UCBs. However, their share in banking sector's deposits and advances was 3.24 per cent and 2.69 per cent respectively. A few UCBs were quite adaptive to the changes in the way banking operations were undertaken and have grown leaps and bounds while aligning their business strategy with the regulatory framework. It may also be noted that UCBs cater to the financial needs of about 8.52 crore depositors and 67 lakh borrowers[7], who are mainly from low-income segments of the population. Therefore, it can be concluded that despite their lower market share, UCBs have significant role in reaching the last mile.

4.1.7 The UCBs have continued to operate even as the ecosystem for banking and the competitive landscape have undergone a change with advent of SFBs and FinTech entities, on the one hand and technology enabling the commercial banks to scale-up their operations on the other. The new players have come in equipped with state-of-the-art technology and wide reach coupled with financial strength with potential to disrupt the hitherto niche customer segment of the UCBs.

4.2 Performance of UCBs *vis-à-vis* Other Banking Sector Entities

4.2.1 A comparative analysis of UCBs' financial performance *vis-à-vis* other banking sector participants throws some light on their financial strength. The comparative position of key financial indicators is as under:

Chart 2: Gross Non-Performing Asset (GNPA) and Net Non-Performing Asset (NNPA) Ratio (as on March 31, 2020)

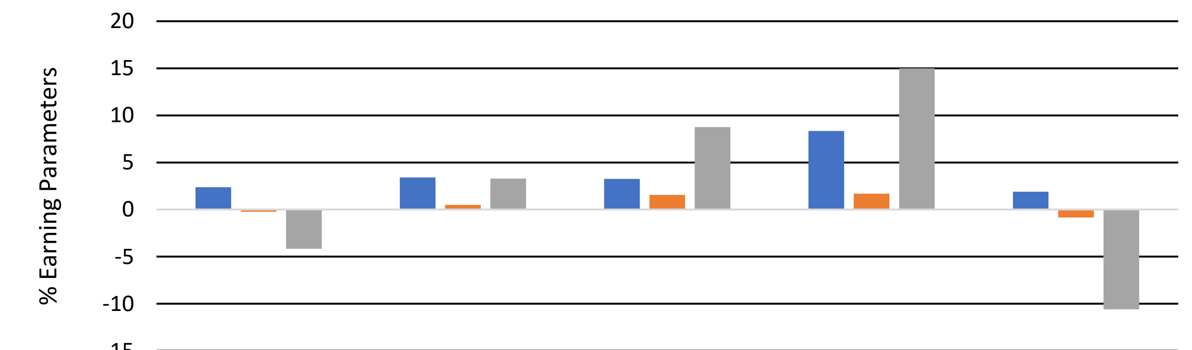


	Public Sector Banks	Private Sector Banks	Foreign Banks	Small Finance Banks	Primary (Urban) Co-operative Banks
GNPA (%)	10.3	5.5	2.3	1.9	10.96
NNPA (%)	3.7	1.5	0.5	0.9	5.26

[7] Data reported by UCBs under OSS

4.2.2 It is observed that the UCBs have highest NNPA (%) and GNPA (%) across the banking sector. Further, NNPA (%) and GNPA (%) level of UCBs is around twice that of Private Sector Banks and around five times that of SFBs. However, while the GNPA levels of Public Sector Banks (PSBs) are at a comparable level with that of UCBs, provision coverage ratio in UCBs is considerably lower than that in the PSBs.

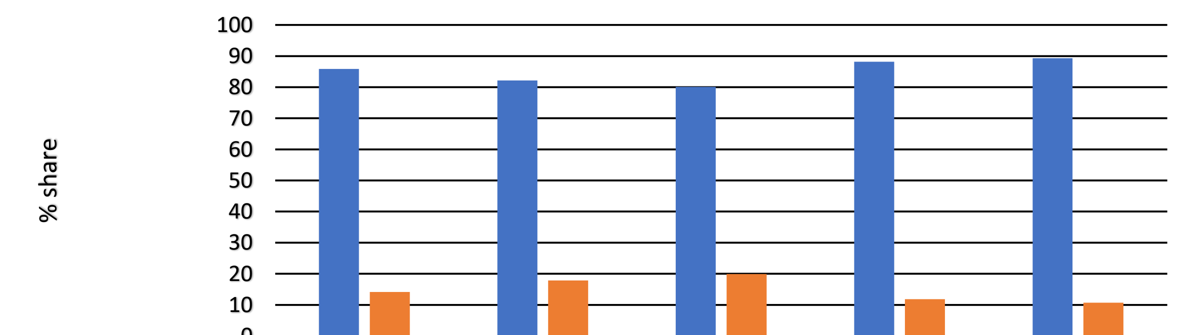
Chart 3: Earning Parameters – Net Interest Margin (NIM), Return on Assets (RoA), and Return on Equity (RoE) (as on March 31, 2020)



	Public Sector Banks	Private Sector Banks	Foreign Banks	Small Finance Banks	Primary (Urban) Co-operative Banks
NIM (%)	2.37	3.42	3.26	8.34	1.89
RoA (%)	-0.23	0.51	1.55	1.7	-0.85
RoE (%)	-4.16	3.3	8.76	15	-10.59

4.2.3 When compared with other banking sector participants, UCBs, on aggregate levels, have the lowest NIM, RoA, and RoE. While this can be argued as the natural outcome of the business model of a co-operative bank, in many cases, lower profitability has also been an indicator of stress.

Chart 4: Interest Income on Loans & Advances (as on March 31, 2020)



	Public Sector Banks	Private Sector Banks	Foreign Banks	Small Finance Banks	Primary (Urban) Co-operative Banks
Int Inc. / Tot Inc. (%)	85.84	82.15	80.11	88.18	89.3
NI Inc. / Tot. Inc. (%)	14.16	17.85	19.89	11.82	10.7

Legend: *Int Inc = Interest Income, Tot Inc. = Total Income, NI Inc. = Non-Interest Income*

4.2.4 The sector's interest income to total income ratio is generally comparable with other players. However, their non-interest income is on the lower side, which is understandable given their limited avenues for generating fee-based income.

4.3 Regulatory Measures during the Last Five Years

The Committee noted and discussed certain important regulatory measures taken by RBI in the last five years. These measures can broadly be categorized under Prudential, Business Conduct and Governance related measures. The Prudential Measures can further be divided into General Measures and Risk Mitigation Measures.

These measures are described in brief hereunder:

4.3.1 Prudential Measures

4.3.1.1 Risk Mitigation Measures

i) **Placement of Deposits with Other Banks by Primary (Urban) Co-operative Banks (UCBs)** – With a view to reducing the concentration risk in respect of placement of deposits with other UCBs, prudential gross interbank exposure limit and prudential counter party limits were set at 20 per cent and 5 per cent of the deposit liabilities, respectively, *vide* circular dated November 19, 2015. The circular also stipulated the criteria subject to which Scheduled UCBs would be able to accept deposits from other UCBs.

ii) **Unsecured Exposure Norms for UCBs – Relaxation** – Circular dated April 21, 2016 was issued to give impetus to financial inclusion by UCBs with a large priority sector loan portfolio by permitting them to have larger unsecured loan portfolio, subject to fulfilment of certain conditions.

iii) **Reporting of Large exposures to CRILC** - Circular dated December 27, 2019 provided instructions on reporting of large exposures of UCBs, i.e., loans of more than ₹5 crores to CRILC for timely identification of stress, and categorisation of accounts based on incipient stress.

iv) **Comprehensive Cyber Security framework** – Circular dated December 31, 2019 prescribed a graded approach for cyber security by categorizing UCBs into four levels based on their digital depth and interconnectedness to the payment systems landscape.

v) **Revised Exposure Limits and target for Priority Sector Lending** – With a view to mitigating concentration risk by increasing granularity in the loan portfolio, single borrower and group borrower exposure limits for UCBs were reduced, *vide* circular dated March 13, 2020. UCBs were also mandated to have at least 50 per cent of their aggregate loans and advances comprising loans of not more than ₹25 lakh or 0.2 per cent of their Tier I capital, whichever is higher, subject to a maximum of ₹1 crore, per borrower/party. Priority Sector Lending target for UCBs was increased from 40 per cent to 75 per cent of ANBC/CEOBSE. An appropriate glide path was provided to UCBs to achieve the above targets by March 31, 2024.

vi) **System Based asset classification of UCBs** – Circular dated August 12, 2020 provided instructions for implementation of system-based asset classification in UCBs to improve the efficiency, transparency and integrity of the asset classification process. The instructions have been made applicable on UCBs with assets of ₹1000 crores or more.

vii) **Ad-hoc/Short Review/Renewal of Credit Facilities** - Circular dated August 21, 2020 highlighted the supervisory concerns and suggested corrective measures for frequent/repeated ad-hoc review/renewal of credit facilities instead of regular review/renewals, non-capturing and/or inaccurate capturing of review/renewal data in the banking/information systems, and non-coverage of review/renewal activities under the concurrent audit/internal audit mechanism.

4.3.1.2 General Measures

i. **MSF for Scheduled UCBs** - Circular dated August 16, 2018 specified the eligibility criteria for granting Scheduled UCBs access to MSF for managing their liquidity. It may be mentioned that access to LAF was already provided to them in 2014.

ii. **Review of Supervisory Action Framework** - Circular dated January 06, 2020 further rationalized the SAF to make it more effective in bringing about the desired improvement in the UCBs as also expeditious resolution of UCBs experiencing financial stress.

iii. **Risk-Based Internal Audit (RBIA)** – Circular dated February 03, 2021 was issued to UCBs with asset size of ₹500 crores and above, with a stipulation of implementing Risk Based Internal Audit (RBIA) framework by March 31, 2022 in accordance with the Guidelines provided in the circular. The Guidelines are intended to enhance the efficacy of internal audit systems and processes followed by the UCBs.

4.3.2 Business Conduct Measures

i. **Customer Protection - Limiting Liability of Customers of Co-operative Banks in Unauthorised Electronic Banking Transactions** - Circular dated December 14, 2017 was issued in the wake of increased thrust on IT enabled financial inclusion and related customer protection issues, surge in customer grievances relating to unauthorised transactions resulting in debits to their accounts/cards. The circular brought parity in instructions on liability of customers of UCBs in unauthorized Electronic Banking Transactions with commercial banks.

ii. **Revision in Proforma and Reporting of Bank / Branch details under the Central Information System for Banking Infrastructure (CISBI)** - Circular dated October 11, 2019 provided guidelines to UCBs with respect to transition from existing email-based submission of quarterly Bank Branch Statistics to a web based system called CISBI. The system has additional functionalities to capture important non-financial parameters of UCBs.

iii. **Guidelines on Merchant Acquisition for Card Transactions** **-** Circular dated April 28, 2017 provided guidelines on merchant acquisition for card transactions by UCBs through third party POS terminals or their own POS terminals.

iv. **Regulatory requirements for issue of Pre-paid Payment Instruments by Co-operative Banks** **–** UCBs were allowed to issue semi-closed and open system Pre-paid Payment Instruments (PPIs), subject to fulfilment of the prescribed criteria, *vide* circular dated May 25, 2017.

4.3.3 Governance and Other Measures

i. **Monitoring of Large Value Frauds by the Board of Directors** **–** Circular dated January 07, 2015 contained instructions on monitoring of large value frauds by BoDs of UCBs by constitution of a Special Committee for monitoring and following up cases of frauds involving amounts of ₹1 crore and above exclusively. Audit Committee of Board (ACB) would be required to continue to monitor all the cases of frauds in general.

ii. **Voluntary Transition of Primary (Urban) Co-operative Banks (UCBs) into SFBs** **–** Circular dated September 27, 2018 delineating a scheme to enable eligible UCBs to voluntarily transition into SFBs was issued on the basis of recommendation of the High-Powered Committee on UCBs (2015).

iii. **Constitution of Board of Management (BoM) in Primary (Urban) Co-operative Banks (UCBs)** – With a view to improving quality of governance, circular dated December 31, 2019 provided guidelines on constitution of BoM in UCBs with deposits of ₹100 crore and above. The circular, *inter alia*, provided eligibility criteria for members of BoM and CEO as also functions of BoM.

iv. **Loans and advances to directors, their relatives, and firms / concerns in which they are interested** **–** Circular dated February 5, 2021 was issued pursuant to the recent amendments to the BR Act, *vide* Banking Regulation (Amendment) Act, 2020.

v. **Interest Subvention Scheme for MSMEs** **-** Circular dated October 07, 2020 was issued informing UCBs about their inclusion as Eligible Lending Institution under the 'Interest Subvention Scheme for MSMEs 2018', on par with commercial banks. The scheme provides for an interest relief of 2 per cent per annum to eligible MSMEs on their outstanding fresh/incremental term loan/working capital during the period

4.3.4 Although not a regulatory measure but a statutory enablement, the recent judgement of the Supreme Court on the applicability of the provisions of the SARFAESI Act, 2002 on co-operative banks has strengthened the hands of UCBs by providing them with an effective tool for recovery of NPAs. UCBs are expected to make use of the law, to the extent possible, in terms of the provisions of the Act.

4.4 The Committee observed that the focus of the regulatory policies during the last five years, has been to mitigate the risks in the banking business, keeping in view the various constraints such as lack of adequate regulatory control in the absence of enabling statutory provisions, heterogeneity of the sector and the limitations in the form of constraints in raising capital and non-availability of resolution tools under the provisions of the BR Act. Further, there has been an attempt to leverage the benefits arising out of use of IT in banking and to prepare UCBs for the challenges arising out of it. The Committee, therefore, did not find any regulatory changes brought about in the last five years to be largely limiting the growth of the UCBs. In fact, some of the changes like extension of interest subvention scheme have been more enabling. Nevertheless, it noted that the restrictive approach of the earlier years towards branch expansion, scheduling, which continued to be pursued on top of a more enabling regulatory approach towards business operations of the other banking and non-banking entities did hamstring the ability of the UCBs to grow. The Committee also noted that this approach was rooted in the inadequacy of regulatory powers with the RBI under the then existing legislative framework.

4.5 Analysis of Financial Performance of UCBs during the Last Five Years

4.5.1 While a comparative analysis of UCBs with other market players on certain financial indicators was done earlier in the chapter, the Committee analysed the financial performance of UCB sector over a period of the last five years to understand the emerging trends. The analysis of major financial indicators is presented in charts and tables below.

4.5.2 It can be observed from Table 2 and Chart 5 that there is a higher concentration of UCBs in Western and Southern Region, primarily in the states of Gujarat, Maharashtra, Karnataka, and Tamil Nadu.

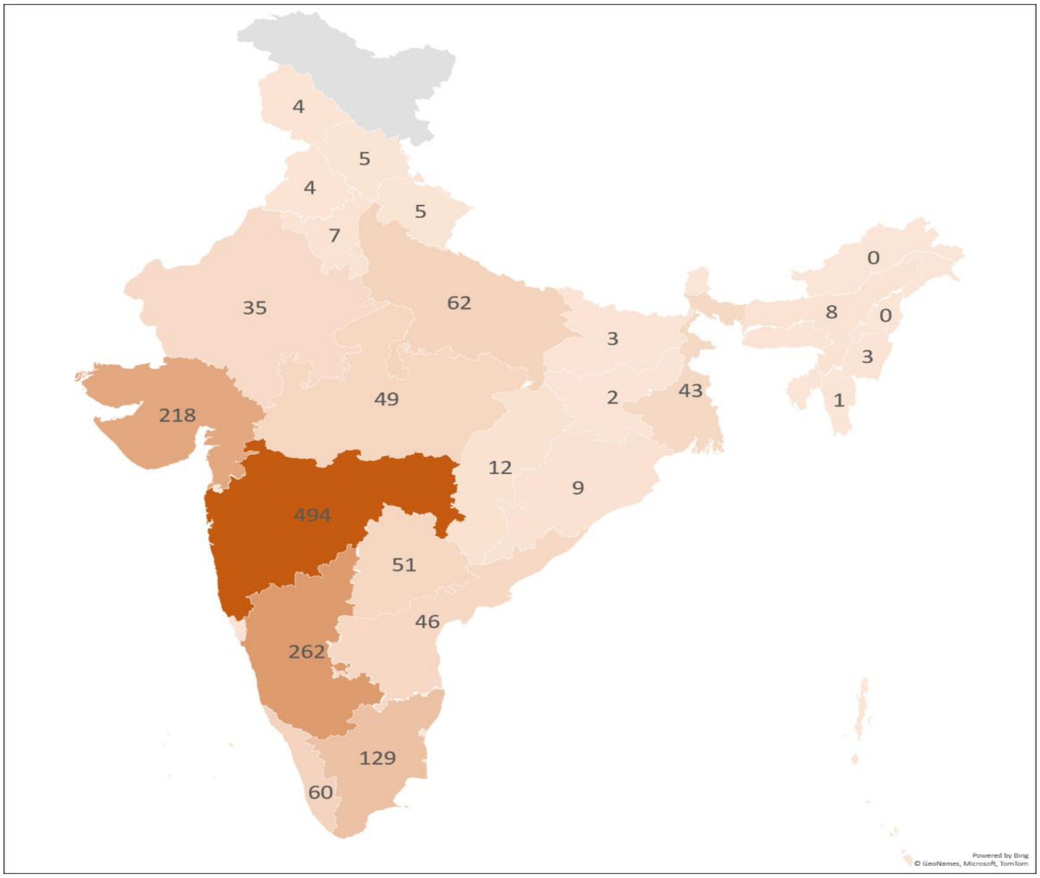
Table 2: Region-wise distribution of UCBs, branches, deposits, and advances

(As on March 31, 2020; Amount in ₹ crores)

Region	No. of UCBs	No. of Branches	Deposits	Advances
Northern Region	70	451	14490	7587
North-Eastern Region	16	52	1547	730
Eastern Region	58	164	7652	4141
Central Region	128	474	15599	7857
Western Region	718	7771	375931	229804
Southern Region	549	2283	85959	55250
All India	**1539**	**11195**	**501178**	**305368**

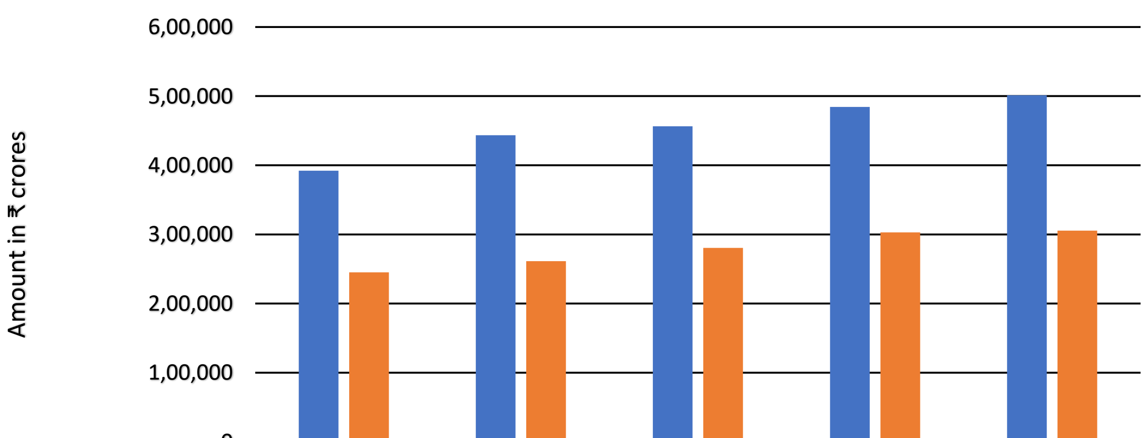
Chart 5: State-wise Distribution of UCBs

(As on March 31, 2020)



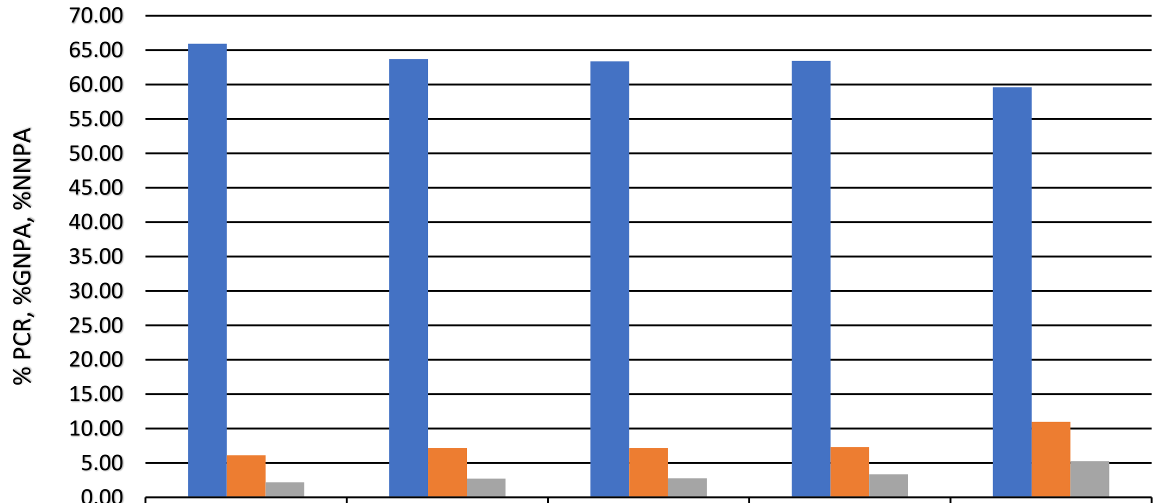
4.5.3 As may be seen from Charts 6 and 7, the UCBs witnessed a downward trend in deposit and advances growth over last five years, whereas an increasing trend was observed in GNPA. A decline in PCR also leads to higher NNPA.

Chart 6: Deposits, Advances, and Corresponding Growth (2016 to 2020)



	2016	2017	2018	2019	2020
Deposit	3,92,179	4,43,468	4,56,507	4,84,316	5,01,178
Advances	2,45,013	2,61,225	2,80,501	3,03,018	3,05,368
Deposit Growth (%)	10.43	13.08	2.94	6.09	3.48
Advances Growth (%)	9.23	6.62	7.38	8.03	0.78

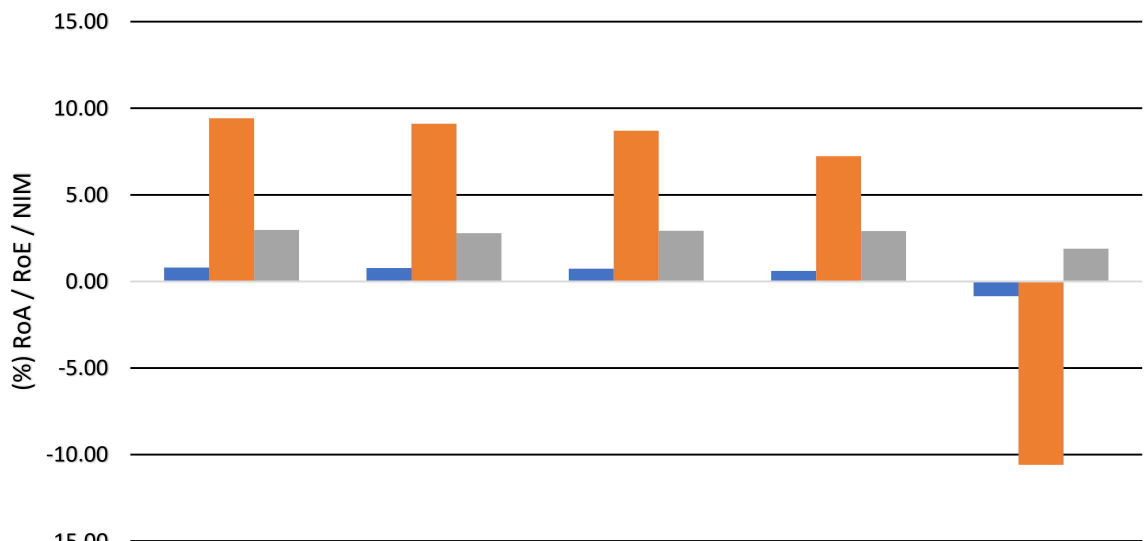
Chart 7: Gross Non-Performing Assets (GNPA), Net Non-Performing Assets (NNPA), and Provisioning Coverage Ratio of UCBs (2016 to 2020)



	2016	2017	2018	2019	2020
PCR(%)	65.94	63.70	63.37	63.45	59.60
GNPA(%)	6.11	7.16	7.16	7.29	10.96
NNPA (%)	2.17	2.72	2.75	3.34	5.26

4.5.4 The trend of deterioration in financial performance is also visible from the earning parameters of the UCBs, i.e., Return on Assets, Return on Equity, and Net Interest Margin as presented in Chart 8 below.

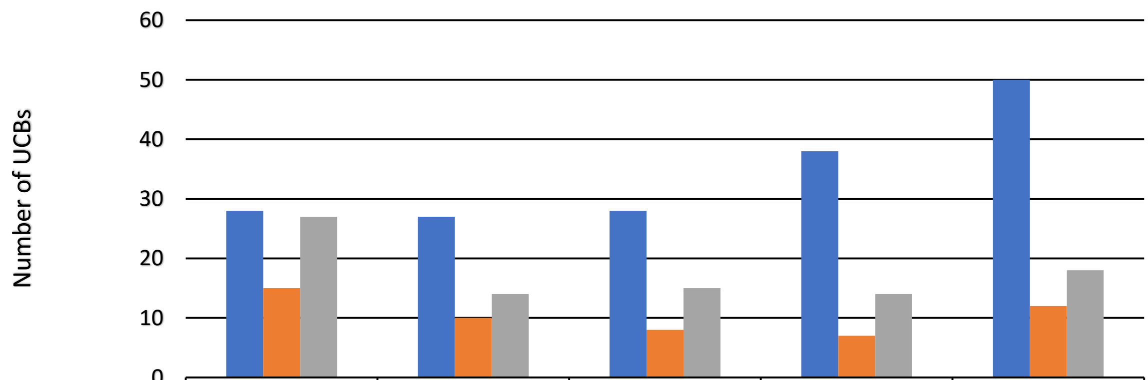
Chart 8: Return on Assets (RoA), Return on Equity (RoE), and Net Interest Margin (NIM) of UCBs (2016 to 2020)



	2016	2017	2018	2019	2020
RoA (%)	0.80	0.77	0.74	0.61	-0.85
RoE (%)	9.42	9.11	8.70	7.23	-10.59
NIM (%)	2.97	2.79	2.93	2.91	1.89

4.5.5 As is evident from Chart 9, the number of UCBs with CRAR of less than 9 per cent has increased from 70 in 2016 to 80 as on March 31, 2020 and rather disconcertingly, the surge has been driven by increase in the number of banks with CRAR below 3 per cent.

Chart 9: Distribution of UCBs with CRAR < 9% (2016 to 2020)

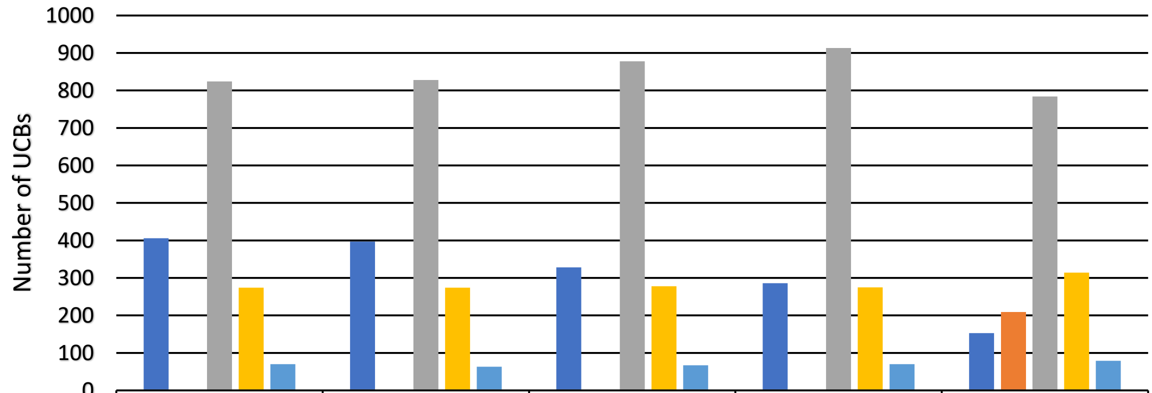


	2016	2017	2018	2019	2020
CRAR < 3	28	27	28	38	50
3 <= CRAR < 6	15	10	8	7	12
6 <= CRAR < 9	27	14	15	14	18

4.5.6 After each supervisory assessment, RBI assigns a composite supervisory rating to UCBs based on Capital Adequacy, Asset Quality, Management, Earning, Liquidity and System and Controls (CAMELS). The rating is reflective of the financial health and the quality of the internal systems of a bank at a given point in time. The ratings were being assigned till March 31, 2019 on a four-point scale ranging from A to D in decreasing order of financial strength and quality of the management. The rating model has been reviewed with effect from March 31, 2020 to a five-point scale inserting a new rating point of B+. It may be observed from Chart 10 that the number of UCBs which have been rated C or D has increased from 21.86 per cent to 25.53 per cent of the total UCBs over the last five years.

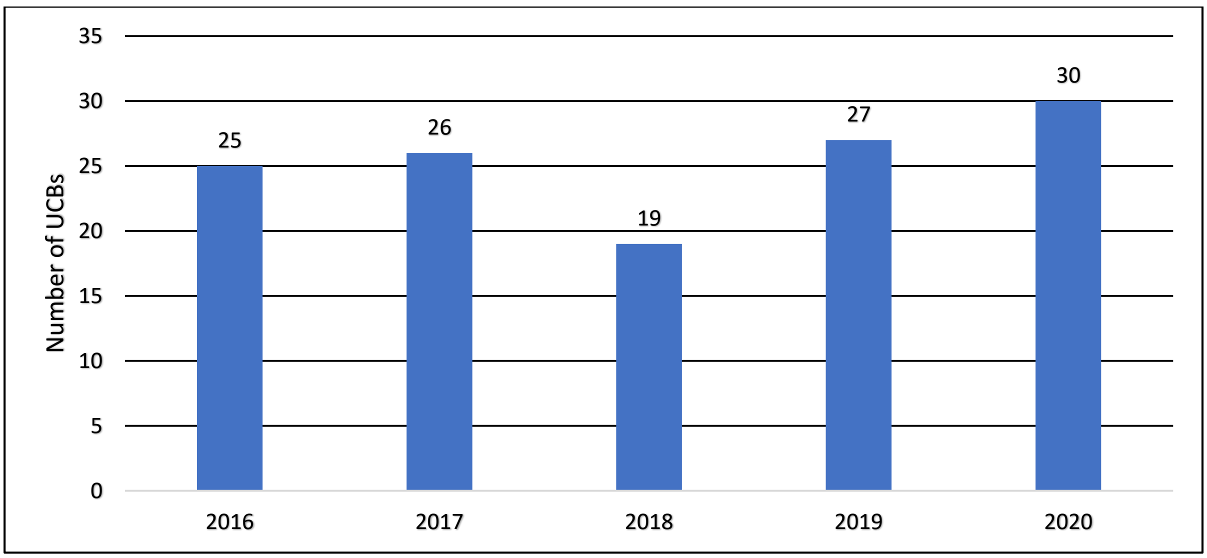
4.5.7 Further, RBI imposes All-inclusive Directions (AID) restricting, among other things, payment to the depositors up to a certain ceiling based on availability of liquidity, on UCBs which have a negative net worth. It may be observed from Chart 11 that the number UCBs under AID is also witnessing an increasing trend.

Chart 10: Rating-wise Distribution of UCBs (2016 to 2020)[8]



	2016	2017	2018	2019	2020
A	406	397	328	286	153
B+	0	0	0	0	209
B	824	828	878	913	784
C	274	274	278	275	314
D	70	63	67	70	79

Chart 11: Number of UCBs under All-inclusive Directions (AID) (2016 to 2020)



4.5.8 From the above analysis, the Committee noted that the UCB sector has been under stress for quite some time. The Committee felt that given the importance of the sector in furthering financial inclusion and considering the large number of its customer base, it is imperative that the strategies adopted for the regulation of the sector are comprehensively reviewed so as to enhance its resilience and provide an enabling environment for its sustainable and stable growth in the medium term.

[8] The B+ rating was introduced w.e.f. supervisory cycle of 2019-2020.

4.6 SWOT Analysis and Key Constraints

Keeping the above objective in view, the Committee deliberated on the Strengths, Weaknesses, Opportunities and Threats for the UCB sector. For this purpose, the Committee also considered the inputs received from the stakeholders with whom it had interacted and from the questionnaire-based survey.

4.6.1 SWOT Analysis

4.6.1.1 Strengths

The Committee observed that UCBs mainly derive strengths from their co-operative character. The principle of democratic member control gives a sense of ownership to members and ensures high customer loyalty. Further, their closeness to the grassroots and consequent understanding of the local environment makes them well placed to further financial inclusion and facilitating last mile delivery of financial services. The UCBs have been observed to be taking quick decisions, primarily because of less bureaucratic systems in their organizations. Interestingly, as a UCB grows, it tends to move away from the co-operative character and, thus, the strengths arising out of the same keep on diminishing. The Committee observed that the above-mentioned strengths are more relevant to smaller UCBs in the sector.

4.6.1.2 Weaknesses

The Committee noted that, like strengths, the major weaknesses of the sector also stem from its co-operative character. The three major weaknesses are constraints in raising capital, lack of professional management often leading to weak internal control systems and inadequate IT capabilities coupled with lack of skilled personnel. The problem other than that of raising capital is more prevalent in the smaller banks and have a bearing on their ability to remain relevant in the changing landscape of banking.

4.6.1.3 Opportunities

The Committee observed that the sector is poised with a ‘still to be explored’ and untapped market, particularly for smaller ticket loan segment of low-income groups. The growing opportunities come from the agenda of financial inclusion and from the sector’s ability to tailor products and offer fee-based income products. This will of course require the smaller UCBs in particular to keep their local feel while finding solutions to the problems associated with their smaller size, which the proposed UO could cater to.

4.6.1.4 Threats

The Committee was of the view that the biggest threat to the sector is acute market competition emanating from multiple existing players and new entrants like payment banks, SFBs, FinTechs, etc. which are equipped with state-of-the-art technology coupled with deep pockets. These have the potential to disrupt UCBs’ traditionally natural market segments both due to regulatory compulsions and commercial considerations. Notwithstanding the sector's existence over a century, given the limited capabilities for investment in technology and resource raising, the competition is seen as a survival threat in the medium to long term. Further, instances of failure of some larger UCBs in recent years have adversely affected the sector's image and has led to loss of public trust.

4.6.1.5 The analysis is summarized in Table 3 below:

Table 3: SWOT Analysis of UCBs

Strengths	Weakness
Business oriented towards serving the small customers with flexibility of operations tailored to local conditions	Inadequate avenues for raising capital and even greater difficulty in raising capital during stress.
Ability to quickly design products suited to local conditions.	Lack of professional management, poor corporate governance.
Proximity to the borrower and better understanding of local requirements leading to informal sources adding to credit quality	Weak internal control and audit system.
High customer loyalty due to mutuality of objectives	Small Area of operation resulting in absence of economies of scale which in turn results into inadequate ability to invest in IT infrastructure and hire skilled manpower.
Opportunities	**Threats**
A large untapped market particularly in respect of small borrowers to whom UCBs generally cater to.	Acute competition emanating from differentiated banks, MFIs and FinTechs in the niche market segment of UCBs
Huge business potential emanating from financial inclusion initiatives.	Dent to the image of UCBs because of frequent failure of UCBs including certain large UCBs
Offering third party products, digital payments, etc.	Shift in customer preference towards digital channels of banking
Likely boost after establishment of UO	Geographical concentration risk to smaller UCBs due to small area of operation

4.6.2 Constraints

4.6.2.1 Structural Constraints

Some of the major constraints which the sector faces emanate from its co-operative structure itself. The co-operative societies are guided by certain core principles like voluntary and open membership, democratic control by members through the concept of, one-person-one-vote, etc. In a financial co-operative doing the business of banking and, therefore, requiring higher capital as well as professional management, these become constraining factors. A few such constraints are elaborated below:

i) Constraints in Raising Capital

One of the factors contributing to the 'less than satisfactory growth' of UCBs is their limited ability to raise capital and, thus, restricting the capacity to reinforce resilience and expand business. As per the co-operative principles and laws, the share/equity capital must be issued and is refundable, and both at face value only. The absence of any accretion to the value of investment by way of premium and the lack of a formal mode of realising premium even if the book value of the shares has gone up, makes buying shares of a co-operative bank an unattractive investment proposition. Furthermore, they are not of interest to a potential investor seeking control as the 'one member one vote' principle does not render a UCB amenable to acquiring controlling interest. Yet another constraint is the non-permanence of capital because of 'voluntary and open membership' in the co-operative structure. Any person can become a member of co-operative society voluntarily by subscribing to a minimum number of equity shares subject to the admissibility. The members can leave the society at their will, subject to certain conditions, by withdrawing their share capital. Thus, the refundable or withdrawable nature of share/equity capital adversely affects the conservation of capital resulting in share capital of co-operative society lacking perpetuity.

Box 1: Structuring Capital in UCBs

Co-operatives were established on the principles of mutuality and by questioning the primacy of capital. The principles of co-operation do not provide enough incentives or the glue to ensure long horizon commitment of members. Literature recognises this as a horizon problem where the members do not look at long-term investments of resources (Furubotn and Pejovich)[9]. In a corporation, the shareholders have not only *pari-passu* rights on the residual claims on current income, but also claims on the undistributed profits. The voting rights of the members are usually aligned with the share ownership, thereby completing the integral loop of stakes, control and pay-offs as a perfectly aligned arrangement.

Co-operatives on the other hand put 'patronage' at the centre; membership and share capital are only a token transaction to indicate the continuing association. The co-operative has to keep membership open, and entry and exit are not compensatory. Involvement of the members in the capital of the venture is token to the extent of registering membership.

[9] Eirik G. Furubotn, Svetozar Pejovich (Ed) 1973: The Economics of Property Rights. Penascola (Florida) Ballinger Publishing Company

The Principles[10] that Matter and the Contradictions Within

In a financial co-operative, the above approach to capital naturally becomes a little more complicated with the services being financial. In a closed loop financial co-operative, lending to members is technically limited to the extent of savings by the members and therefore there is no 'public' interest or concerns involved. However, when the co-operative moves beyond the closed loop, it involves non-members without giving them the rights to become members or making it obligatory for them to become members. So now, we have two categories of people who are transacting with the entity, for the same purposes – depositing money and taking a loan: some of them are inside the loop and have a say and vote, and some do not. This is the first contradiction.

Unlike the corporation where the control emanates from the proportion of the stake held in the entity, the control in a co-operative follows an unrelated principle of democratic control. This creates the second contradiction, where people getting on to the governance position need not necessarily represent a significant 'skin in the game' even by the alternate definition of patronage.

In a corporation the risk of mal-governance emanates from the design of a limited liability; ability to leverage and possibility of the dual role of governance and management having been vested in a limited set of people. Since the point of risk is clearly identified, it is possible to build in incentive-disincentive structures to anticipate such instances of mal-governance. In case of co-operatives, while there is no incentive for any member to invest more, all the downside costs are vested in the capital. Further, the co-operative principle that undistributed profits and reserves should not be vested with a membership at a given point in time (because of open membership) but have to be vested with the 'system' – which could be another co-operative with a similar objective or with the State, queers this paradox further. This means that the governance system works largely on good faith with limited damage for a downside risk. Therefore, by design, co-operatives would work only with people who are 'well intentioned' and not through a system of rationally arrived at incentive and disincentive structures.

It is in this context that the regulatory lens of adequacy of capital for protection of interest of depositors runs into a problem. With member share capital being withdrawable and return on capital being limited, there is no incentive to keep the capital if it is not used as a leverage for the member to borrow. This makes the co-operatives weakly capitalised by design. From a regulatory perspective, this is a conundrum and when the institution is a bank and

[10] The principles and values of co-operatives are explained by the International Co-operative Alliance and the document is available on the website: https://www.ica.coop/en/cooperatives/cooperative-identity

becomes systemically important, it creates not only a problem in effectively protecting public deposits, but also has implication on interconnectedness.

Possible Ways to Address the Issue[11]

The issues outlined above would call for ways to square the contradictions. This could include the following:

1. Convert a very significant portion of the profits into member identifiable and distributable/withdrawable pool and reduce to the extent possible resources in the no-person zone.
2. Ensure that these resources remain somewhat permanently; or at least a significant core remains stable.
3. Introduce an entry premium for new members coming in by marking the entry to the book value of the shares thereby getting the new members to contribute not only to the equity, but through an entry premium in a member identifiable non-withdrawable pool.
4. While honouring the principle of open membership, impose some level of stickiness in the principle to recognise the business of banking and need for stability.

In essence, we are looking at member resources with reasonable restrictions on withdrawability as that could be treated as capital for the prudential purposes of capital adequacy. How can we do this?

1. Capital can be withdrawn only on cessation of membership. However, while the cessation of membership is possible at any time, the withdrawal of capital could be only after a certain minimum time period from which it was invested – say ten years, which gives a 10-year stickiness to the capital.
2. A significant part of the current profits to be compulsorily transferred to member-identifiable reserves. However, pay-outs at the time of cessation of membership shall be subject to capital adequacy.
3. All new members to purchase shares at face value and also *pro-rata* contribute to the per-share reserves that are accumulated by the co-operative, thereby providing an entry premium.

[11] See for instance:

1. Sriam MS, Prathap Reddy K and Agrawal, Rajesh (1996): Capital Formation Strategies of District Level Dairy Co-operative Unions in Gujarat in Rajagopalan, R (Ed.): *Rediscovering Co-operation Vol-II.* Anand: Institute of Rural Management.

2. Agrawal, Rajesh; Raju KV; Reddy, Prathap K; Srinivasan R and Sriram MS, Member Funds and Co-operative Performance *Journal of Rural Development*, Vol.22, No.1, Jan-March 2003. Hyderabad: National Institute of Rural Development.

4. A member wanting to cease to be a member could also have the option of finding a new member to purchase the shares and transferring the elements of stickiness to the new member.

The regulator should also be given overriding powers to prevent the co-operative from redeeming the capital if the regulator believes that the co-operative bank will not be adhering to the minimum capital norms as specified, if the retirement of capital is given effect to.

ii) Democratic Member Control

UCBs are democratic organisations which are controlled by their members and managed through a representative body, the 'Board of Directors'. In pursuance of the democratic principles, the members of the Board are necessarily elected from amongst the members of the bank. This often translates into insufficient skill sets, lack of required expertise and desired qualifications amongst the directors leading to lack of professional management of the UCBs.

iii) Duality of Regulation

The UCBs are registered as co-operative societies under the Co-operative Societies laws of Centre or States. They are also regulated by RBI since 1966 when some of the provisions of the BR Act were extended to UCBs. Thereafter started the era of dual regulation, wherein the banking related functions of a UCB were regulated by RBI under the provisions of BR Act and powers with regard to incorporation, management, audit and winding up continued to be governed by the co-operative societies acts concerned. This system of dual regulation is often claimed to have been one of the important factors responsible for the less than satisfactory performance of the UCB sector. Over the years RBI had taken non-legislative measures to mitigate some of the conflicts created by this system of duality of regulation, by entering into Memoranda of Understanding (MoU) with all the state governments and the Central Government creating a working arrangement between RBI and the governments. As a part of the MoUs, a forum of Task Force for Urban Co-operative Banks (TAFCUB) was set up for each state (and one for the Centre) with representations from RBI, the concerned government and the UCB sector representatives. While the TAFCUB mechanism resolved the problems of duality of regulation to some extent, the core problems continue to persist. Therefore, the Committee was of the view that legislative steps undertaken through the Banking Regulation (Amendment) Act, 2020, which brought management / governance, audit, reconstructions / amalgamation, winding up, etc. of co-operative banks under RBI's purview, is the best approach to deal with the issue of dual control in an impactful manner.

Box 2: Dual Control of UCBs

The aspect of dual control of co-operative banks in general and UCBs in particular has been discussed in great detail in the reports of various committees constituted over the years to address the issues concerning the sector. Co-operative banks are basically co-operative societies which are registered under the Co-operative Societies Act of the State concerned or under the Multi-State Co-operative Societies Act, 2002. Co-operative societies laws generally deal with incorporation, regulation and winding up of the co-operative societies. When a co-operative society carries on the business of banking, it needs to be licensed under the provisions of the BR Act and the provisions of the act also apply to them. As a result, co-operative banks come under dual regulation.

Certain provisions of the BR Act were not made applicable to co-operative banks when they were brought under the purview of the Act in the year 1966. Aspects related to management / governance, audit, reconstructions / amalgamation, winding up, etc. (i.e., those not perceived to be directly related with the 'banking' activity) of UCBs were regulated under the co-operative societies laws concerned. Such dual control made the regulation of these banks difficult. To start with, RBI could not take any meaningful / significant steps to improve the quality of management and governance of UCBs as it had no power to deal with delinquent members of the Board / management.

Co-operative banks are unique entities in as much as they deal in money, unlike other types of co-operatives. However, provisions of co-operative societies laws treat all types of co-operative societies, be it a housing co-operative or a milk co-operative or a fertilizer co-operative or a financial co-operative or other non-financial co-operatives, in a similar manner. In today's era, UCBs face multiple challenges and function in a complex and dynamic environment where innovations are the norm of the day. Innovations in the financial sector are qualitatively as well as quantitatively different from those in the other sectors. For this reason, persons in charge of the affairs of the UCBs need to have appropriate qualification and experience and be fit and proper to run the entity in a manner that protects the interest of the depositors and other stakeholders.

Under the dual regulation system, besides the inability to inculcate necessary professionalism at the Board / management level, RBI also needed to approach the respective state / Central authorities for supersession of Board, amalgamation, merger and winding up of UCBs. Every state (and the Centre) having its own Co-operative Societies Act containing divergent provisions and some states, e.g., Karnataka, Telangana, having more than one Act governing the sector made the situation even more challenging, especially in case of amalgamation of

UCBs carrying on business in more than one state or that of a single-state UCB with a multi-state UCB. Similarly, framing a scheme for revival of a weak UCB or winding up of a non-viable UCB fell under the domain of the respective state/Central authorities and RBI could not take timely action in such cases, thereby affecting effective resolution of the UCBs concerned.

Several attempts to mitigate the challenges arising out of dual regulation were made through non-legislative changes such as institution of TAFCUB, etc. However, most of the challenges could not be addressed through these steps as the success of these frameworks depended on constructive voluntarism and cooperation. In this backdrop, the recent amendment to the BR Act has conferred greater regulatory powers upon the RBI to regulate hitherto off-limit areas of functioning of UCBs. It is expected that the BR Act provisions related to management now made applicable to UCBs will enable improvement in the quality of their management and the standards of their co-operative governance. Nevertheless, it is pertinent to note that although these amendments have reduced the extent of duality of control to a great extent, it has not been fully eliminated as the state/Central Government authorities continue to have concurrent powers on several aspects of functioning of UCBs for which appropriate consultation and co-ordination will be required between them and the RBI. A well-coordinated regulatory approach will, however, go a long way in ensuring a financially sound and well-managed UCB sector.

References:

a) Urban Co-operative Banks: Agenda for Future Reforms, Shri Jagdish Capoor, Speech at Seminar on Urban Co-operative Banks: Future Reforms, organized by FICCI on May 10, 2001
b) Draft Vision Document for Urban Co-operative Banks, RBI, March 4, 2005

4.6.2.2 Other Constraints

i) Heterogeneity

a) The UCB sector has a significantly high degree of heterogeneity among banks in terms of size, area of operation and geographical distribution. As on March 31, 2020, almost 82 per cent of the total UCBs and around 90 per cent branches of all UCBs are concentrated in the Western and Southern regions of the country. At the state level, Maharashtra alone accounts for one-third of the total number of UCBs. Maharashtra, Gujarat and Karnataka together account for two-thirds of the total number of UCBs. In terms of area of operation, the sector has unit banks, multi-district UCBs operating within a state and multi-state UCBs with the area of operation in more than one state.

b) Categorization of UCBs by deposits size shows that UCBs with a deposit base of up to ₹100 crore constitute 57 per cent of the total number of UCBs, but they account for only 6.80 per cent of the total deposits and 6.38 per cent of the advances of the UCB sector. It also shows that there are only 88 UCBs (5.7 per cent of the total number) having deposits exceeding ₹1000 crore, but they account for 60 per cent of the total deposits and total advances of the UCB sector.

c) Further, UCBs are registered under different statutes of the states/centre based on their area of operation. The differences in the provisions of these laws combined with the differences in approaches of the authorities vested with powers of implementing the statutes add another hue to the heterogeneity. While the difference in size between the smallest and largest among the other types of banks is also very wide, it is heterogeneity in many other features and the likely presence of a number of entities in different sub-categories under any approach to their classification that makes drawing up a homogeneous regulatory approach for UCBs even more challenging.

ii) Level of Technology Adoption

a) With the increasing IT penetration, the brick-and-mortar model of banking is giving way to digital channels of banking. This process has been further accelerated by disruption caused by FinTechs. In this context, the Committee observed that the present level of technology adoption in UCBs, particularly the medium and smaller UCBs, is low and does not reflect the fast-changing banking technology landscape. The level of IT adoption is a differentiator for customer preferences. Resultantly, the UCB sector could be losing its remaining competitive edge to scheduled commercial banks, small finance banks, payments banks and MFIs that are equipped with the modern technology, professionally qualified human resources, sound management practices and higher capital base.

b) Further, most of the UCBs face challenges in allocating scarce financial resources for IT which is investment intensive. During the consultations, certain stakeholders like software vendors and smaller UCBs also highlighted that adoption of technology was low due to high CAPEX and OPEX being prohibitive for their scale of operations.

iii) Quality of Human Resources

The quality of human resources is important to be agile enough to respond to the changing dynamics of banking. It has been found difficult by smaller UCBs to attract talent resulting in poorer quality of human resources in relation to their peers in the banking industry. Further, a majority of UCBs tend to recruit staff through a non-standardized process resulting in lower skill levels of their human resources. Further, the lack of training and handholding creates a wide gulf between the skills required to conduct modern day banking and the skills available with the staff of UCBs. UCBs fail to attract desired talent because of far flung locations, low salary structures and not-so-good career prospects. Despite several steps taken by RBI and the sector, for capacity building/trainings/handholding of management and staff of UCBs, the quality of human resources does not stack up to the emerging needs of complex banking operations.

4.6.2.3 Policy Related Constraints Faced by UCBs – As Highlighted by Stakeholders

i) Stakeholders, during their interaction with the Committee, highlighted that the regulatory regime for UCBs as compared to that for UNBs and SFBs has been largely restrictive. The foremost concerns expressed by the stakeholders were the lower group exposure limits, lower exposure limits for housing loans, real estate and commercial real estate, ceilings on total unsecured loans as well as individual unsecured loan and restrictions on bullet repayment on gold loans. It was also highlighted that certain SFB-like provisions, such as priority sector targets, prescription for loan ticket size, etc. have been made applicable to UCBs. These provisions have restricted UCBs' ability to expand their business. It was also highlighted that UCBs are generally excluded from interest subsidy/subvention schemes of Government of India. (In this connection, it could be noted that UCBs are already included in the interest subvention/equalization schemes for MSMEs and export credit.)

ii) The avenues available to UCBs for earning non-interest income have been few because of ceiling on non-SLR investments. The Government (agency) business is not allowed for UCBs.

iii) The restrictive criteria for membership of payment systems, internet/mobile banking facilities, engaging Business Correspondents / Facilitators (BC/BF), etc. have been the constraints in extending digital banking and has led to loss of customers. Further, as against the automatic scheduling for SFBs and UNBs, UCBs are allowed scheduling only above a certain level of deposits, subject to compliance with other criteria including regulatory compliance.

iv) Unlike UNBs and SFBs, UCBs require prior approval of RBI for branch expansion, opening of off-site ATM, shifting of branches, issuance of preference shares, etc. Also, with lack of powers to write-off or settle sticky NPAs, UCBs fail to clean their balance sheets.

4.6.3 Committee's Views

The Committee deliberated on the various factors and issues enumerated above and drew following conclusions.

i) It was agreed that UCBs have a very important role to play in the financial landscape of the country. The Committee noted that the regulatory architecture applied for the UCBs hitherto was in many respects more rigorous, less enabling and hinged on the assumption, perhaps rightly, that many of them did not have the governance and management bandwidth to make sound commercial decisions within a proper risk management framework. This also demonstrated an unwillingness on the part of the regulator to let them grow without too many fetters partly for the above reasons and partly due to concerns arising from lack of any legislative powers and proper avenues for resolution of problem banks. It was the general experience that with growth in the size of the balance sheet, the non-disruptive voluntary resolution was more difficult leaving liquidation as the only available regulatory tool, the disruptive outcome whereof rose with the size of the bank. The Committee also noted that many UCBs too have not done enough to overcome their inherent weaknesses, whether in governance or adoption of technology, enhancing HR skills etc., in many cases due to the scale of their operations not permitting the required investment therein. The Committee thus concluded that the regulatory approach and the inability of the UCBs to scale up their operating methods have contributed to the less than satisfactory performance of the sector.

ii) The Committee observed that the amendments to the BR Act now give an opportunity to RBI to strengthen the lines of defence in UCBs, *viz.* governance and audit. It also gives more avenues to UCBs to strengthen their capital base and additional tools for voluntary and involuntary resolution that could be largely non-disruptive. Therefore, the current regulatory template needs to be and can be reviewed. The RBI has more regulatory comfort arising from the additional powers vested in it and, therefore, could consider giving certain relaxations in business side of the regulations to enable UCBs to grow further.

iii) It was further agreed that the regulatory approach has to be so designed as to provide a framework for the financially strong UCBs to grow while remaining as a co-operative entity. At the same time, considering the fact that the banks are dealing with the public deposits, the principles have to be interpreted in a manner that they support the interests of the larger body of the depositors and the banks are run in an efficient manner for their own stability and in the interest of depositors

iv) While the concerns in respect of smaller UCBs were appreciated, it was felt that in view of their operations being closer to co-operative principles, this strength should be harnessed while at the same time using the instrumentality of the Umbrella Organisation to acquire scale through network and thereby alleviate the concerns and constraints arising from their size.

v) It is in the above background that the recommendations of the Committee as outlined in the following chapters, should be seen.

Chapter 5

International Experience

5.1 Co-operative Banks, also referred to as financial co-operatives (FC), are significant players in the financial system of many countries across the world. Co-operative financial institutions originated in Germany, with first urban credit co-operative founded in 1850. These institutions were designed as self-help institutions based on the principle of mutuality for encouraging the members to pool their financial resources and allow borrowals by the needy. Friedrich Wilhelm Raiffeisen formed the first rural credit co-operative in 1864. The model quickly spread to other countries in Europe, such as Austria, Italy, Switzerland, the Netherlands, Belgium, France, Spain, Finland, Sweden and Great Britain.

5.2 At the beginning of the 20th Century, the financial co-operative concept spread from Europe to North America. The first FC (*caisse populaire*) was established in 1900 in Canada by Alphonse Desjardins who went on to set up a further 150 FCs over the next fifteen years and helped establish the first US credit co- operative in 1908. The model kept on spreading around the world as an alternative to banks in the corporate sector during the remainder of the 20th Century.

5.3 The FCs are assigned different names in different jurisdictions such as Credit Unions or Caisses, Mutuals, Co-operative Banks, Rural Banks or Community Banks. The institutional structure, legal and regulatory status, product offerings and business models vary across countries, especially between advanced and emerging economies. For example, credit unions/*caisse populaires* are not-for-profit entities, and provide services to members. Shinkin banks of Japan are also structured as not-for-profit entities and restrict loans to members while accepting deposits from non-members. In some countries, village level credit societies may neither be regulated nor allowed to seek public deposits. Further, there are employees' thrift and credit co-operatives which are not banks and are not regulated. As at the end of 2019, in Europe there were 2683 co-operative banks operating through 42521 branches with aggregate assets of €7 trillion. Co-operative banks in countries like France, the Netherlands, Germany, Austria, Denmark, and Finland are an important source of funding for small and medium sized enterprises (SMEs).

5.4 The market presence of co-operative banks/ financial co-operatives varies significantly across jurisdictions, marginal to dominant. In some countries, their presence is dominant (e.g., France, the Netherlands), while they are not so dominant in some countries, and in yet others, they are marginal players. For example, the share of co-operatives was less than 1 per cent of the financial systems total assets in South Africa whereas the share of co-operative banks was nearly half the country‘s financial assets in France. Two out of the three co-operative banking groups have been declared as globally systemically important banks (GSIB) in France and the third one as a domestically systemically important bank (DSIB). In Germany, Kenya and the United States, FCs collectively contribute 8-15 per cent of the respective financial system assets. The share of FCs in Australia, Brazil, China and Ireland can be placed at 5 per cent of total banking assets. In Europe, USA and Japan, FCs compete directly with other types of financial institutions in providing financial services to retail customers and small and medium-sized enterprises.

5.5 Till 2007-2008, i.e., the emergence of Global Financial Crisis (GFC), co-operative banks in many countries were not regulated as closely or rigorously as commercial banks. The focus of regulation was limited to Deposit Insurance and Minimum Capital. Post GFC, there is a discernible resurgence of co-operative banks on account of shifting of many customers of commercial banks to co-operatives and increased cooperation among co-operative banks/financial co-operatives, thereby, leading to increased regulation and institutional development of the sector. The derived wisdom from the GFC was that the financial co-operatives showed greater resilience than those in the corporate sector because of their being more customer centric and limited exposure to toxic assets.

5.6 Cross-country experience

Under this section, it is proposed to touch upon the system of FCs in certain major jurisdictions in brief while discussing the same in some detail for four European jurisdictions, *viz.* France, the Netherlands, Italy and Germany, where the FCs hold a major share of the banking business.

5.6.1 Germany

In Germany, there are around 900 local co-operative banks. They hold 12.2 per cent of all assets (USD 1.05 trillion), extend 13.5 per cent of all loans (USD 0.73 trillions) and collect 15.6 per cent of all deposits (USD 0.93 trillion) of the German banking system. Together, they have some 18.5 million members and serve more than 30 million customers. A vast majority of co-operative banks are small. The financial co-operative network in Germany consisted of two central banks viz. DZ Bank and WGZ Bank. The latter was merged into the DZ Bank in 2017 and now it caters to all the local co-operative banks. The German Association of Co-operative Banks (BVR) represents 972 local co-operative banks. These local banks are members of the BVR's institutional protection scheme (IPS). The German Banking Act treats all credit institutions equally. There is no special treatment in the German Banking Act and little room for proportionality for small and non-complex institutions. However, according to the ECB Reporting Regulation, smaller institutions are required to provide lesser financial information as compared to bigger and more complex institutions. Co-operative banks are supervised in the same way as commercial banks. The ECB is the competent authority to grant and withdraw licenses for both commercial banks and co-operative banks based on the German Banking Act. Co-operative banks are subject to the same licensing requirements as commercial banks. The subscribed capital of co-operative banks is made up of member shares which are the only CET1 instruments issued by co-operative banks in Germany. Co-operative banks may issue capital instruments qualifying as Additional Tier 1 capital.

In recent years, there has been a spate of mergers between German co-operative banks with their number reducing from about 7000 in 1970 to about 900 presently.

5.6.2 France

i) The first mutual credit institutions in France were formed towards the end of the 19th century. Co-operative banks – like all other types of licensed credit institutions – are required to belong to a central body that is affiliated with the French Association of Credit Institutions and Investment firms. There are three major co-operative banking groups (Groupe Crédit Agricole, Groupe Banques Populaires-Caisses d'Epargne (BPCE) and Groupe Crédit Mutuel) and four networks (Crédit Agricole, Banques Populaires and Caisses d'Epargne and Crédit Mutuel).

ii) All the three major co-operative banking groups are structured as pyramids wherein the financial co-operatives owned by members at the base of the pyramid own the central institution (or central body) that constitutes the summit. In case of Crédit Agricole and BPCE, the central institution has become a joint stock company. However, only Crédit Agricole SA is publicly listed. In the case of Crédit Mutuel, the central body is a not-for-profit association. Together, the three co-operative groups account for 47 per cent of all assets of the French banking system, 51 per cent of all loans and 47 per cent of deposits. Given their size and the range of their activities, two of the groups are designated as systemically important banking groups (G-SIBs) and all three groups are deemed to be significant banks and subject to the direct supervision of the ECB.

iii) The capital of financial co-operatives essentially includes membership shares (called capital shares) and financial reserves, with the distribution of these being limited by legislation. Membership shares can qualify as CET1 capital subject to meeting the eligibility criteria of articles 28 and 29 of the Capital Requirements Regulation applicable to CET1 instruments and capital instruments issued by co-operatives and savings institutions. Membership shares qualifying as CET1 capital can be redeemed under specific conditions.

iv) Since 1999, commercial and co-operative banks, which were previously part of different deposit protection schemes, belong to a common deposit guarantee scheme (Fonds de Garantie des Dépôts et de Résolution or FGDR). The fund receives mandatory contributions from its members, with such contributions being one of the prerequisites for being licensed as a credit institution. Each co-operative group/network has set up its own liquidity support arrangements and solidarity mechanisms.

5.6.3 The Netherlands

i) In the Dutch economy, co-operative banks play a major role in the agricultural and horticultural sector. In the late 19th century, co-operative banks were founded in rural areas of the Netherlands to provide farmers with cheap loans. They later evolved into local banks and their need for mutual support system led to formation of two central institutions *viz.* Coöperatieve Centrale Raiffeisen-Bank and Coöperatieve Centrale Boerenleenbank. Those two institutions merged in 1972 into Rabobank. Thus, the co-operative banking system in the Netherlands is characterised by a high level of consolidation in the form of the Rabobank Group as apex entity.

ii) Rabobank Group consists of 86 member banks (also co-operatives and each licensed as a credit institution), their central organization Rabobank Nederland (also a co-operative entity and licensed as a credit institution) and their subsidiaries and other affiliated entities. Rabobank Nederland acts as an apex co-operative to the local member banks. The members of the local banks are drawn from customers, but do not make any capital contributions to the banks. The management/supervisory Boards of the local banks are elected from the members. Member banks are geographically organised into 12 Regional Delegate Assemblies (RDAs) and a Central Delegate Assembly (CDA) of the Rabobank is constituted from the RDAs. There are Local Members' Council at the member bank level and a General Members' Council at the Apex level (which is a body made up of delegates of the Members appointed by the Local Members' Councils). The General Members' Council Meetings approve annual financial statements, changes in Articles of Association, elect the Supervisory Board of Rabobank Nederland etc. Voting rights of member banks are in proportion to a formula based on balance sheet totals, Tier-1 banking capital and commercial results. It must be noted here that at the apex level, the co-operative principle of 'one member one vote' does not apply.

iii) Rabobank does not have shareholders, but over two million members and as such dividend payments are not made to members. It has a Bankers' Bank role (regulating the deficits and surpluses of member banks) and a Services role (support in development of products and services, payment systems, advice, legal assistance, knowledge dissemination and co-ordination of policies). In addition to this, it has also a supervisory role with responsibility of monitoring operations, integrity, outsourcing, solvency and liquidity of the member banks), which has been entrusted under law. The appointment of MDs of member banks has to be approved by Rabobank and it can appoint additional director having veto rights on the Board of member banks. The Dutch Central Bank / ECB monitors the Rabobank Nederland's performance of its tasks.

iv) Equity of Rabobank

The Rabobank Annual Report 2020 states that the equity of Rabobank as on December 31, 2020 consisted of the following:

Retained earnings and reserves – 69 per cent

Rabobank Certificates – 19 per cent

Capital Securities[12] – 11 per cent

Other non-controlling interests – 1 per cent

v) Rabobank does not have any equity shares as part of its capital. Rabobank Certificates, which are perpetual, represent participation rights issued by Rabobank *via* the foundation ***Stichting Administratie Kantoor Rabobank Certificaten*** (Stichting AK Rabobank) - which is like an SPV created by Rabobank for the purpose of issuing debt securities for repaying existing credit facilities, refinance indebtedness and for acquisition purposes - and belong to the Common Equity Tier 1 capital of Rabobank. The Rabobank Certificates are listed on Euronext Amsterdam.

vi) Rabobank has issued Rabobank Participations to Stichting AK Rabobank and a corresponding number of Rabobank Certificates (with same nominal value - € 25.00) have been issued by Stichting AK Rabobank to the investors, representing the interests in those Rabobank Participations. As per Rabobank website, Rabobank Certificate is an investment product with the characteristics of deep subordinated bonds.

vii) Neither the Stichting AK Rabobank nor the investors of Rabobank Certificates have any voting rights in or right to attend the General Members' Council of Rabobank. However, Stichting AK Rabobank convenes a meeting of Certificate Holders to give presentations on the performance of Rabobank. Stichting AK Rabobank distributes the payments received by it on Rabobank Participations to the Listing and Paying Agent of the depository to be distributed to the Certificate holders. There are no assured dividend payments on Participations and Certificates. But in the prospectus issued on January 24, 2017 offering the Certificates, the then current payment policy was provided to the investors. During 2020, ECB has put restrictions on payment of returns on the Certificates and Rabobank has issued bonus certificates to compensate the holders.

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[12] The Capital Securities are perpetual securities (classified as Hybrid Tier-1 capital) which have no scheduled repayment date. Holders of Capital Securities have no ability to require the Issuer to redeem their Capital Securities. In addition, Holders have limited enforcement remedies in the case of non-payment as there are no events of default under the Capital Securities or the Coupons. This means that Holders of Capital Securities have no ability to cash in their investment, except: (a) if the Issuer exercises its rights to redeem or purchase the Capital Securities; (b) by selling their Capital Securities; or (c) by claiming for any principal amounts due and not paid in any bankruptcy or dissolution of the Issuer (Offering Circular dated 10 July 2020 < https://www.rabobank.com/en/images/at1-july2020-final-oc-no-canadian-wrapper.pdf>)

5.6.4 Italy

The co-operative banking system in Italy is characterized by presence of two types of banks, viz. Credit Co-operative Banks or Mutual Banks (CCBs), and Banche Popolari (industrial co-operatives). As on December 31, 2020, there were 248 CCBs with 4204 branches and 22 Popolari Banks with 1519 branches. The deposits are covered by an exclusive organization known as Fondo di Garanzia desi Depositanti del Credito Cooperativo.

The Government of Italy had been taking steps to encourage the consolidation process to boost the international competitiveness of the Italian banking sector. The Government had required 10 largest co-operative banks (Banche Popolari) to convert to joint-stock companies. In April 2016, the government required 355 small credit co-operatives (BCCs) to merge into a centralized network with at least €1 billion in capital within 18 months. The reform generated three banking groups (ICRREA, Cassa Centrale Banca and Cassa Centrale Raiffeisen) which currently fall under the supervision of the Bank of Italy and are authorized to become the leaders of three consortia of small co-operative and mutual banks.

5.6.5 United Kingdom

In UK, building societies which were formed for extending loans for construction or purchase of houses eventually developed into general-purpose savings and banking institutions with 'one member one vote' principle. Many of these have been demutualized into conventionally owned banks in the 80's and 90's. The well-known Co-operative Bank of UK, despite its name, is a commercial bank partly owned by a holding entity which is a co-operative. Credit unions in UK are regulated by the Financial Services Authority (FSA) which sets the regulatory standards and approves the appointments at important governance positions in a credit union. All credit unions must have the words 'credit union' in the title.

5.6.6 Ireland

Credit unions in Ireland are governed primarily by the Credit Union Act of 1997, which also established the Credit Union Advisory Committee (CUAC) to advise the Minister of Finance about the improvement of the management of credit unions and the protection of the interests of their members and creditors. Nearly all of the capital of Irish CUs is made up of retained earnings. CUs are not allowed to issue capital instruments. All the capital held by the financial co-operatives must be perpetual and fully available to absorb losses. Therefore, the reserves must be unrestricted, non-distributable, permanent, and rank below all other claims in the event of a liquidation.

5.6.7 Poland

In Poland, there are two broad categories of co-operative banks: (i) those with capital above €5 million and comply with the standards applied to commercial banks to operate nationally as independent entities; (ii) (a) those with minimum capital between €1 and €5 million euro and operate, only regionally and (b) those with capital above €5 million but do not comply with all applicable standards to be treated as independent entities. The supervisory arrangement for co-operative banks is evolving to a 'supplementary' supervision model.

5.6.8 Canada

Co-operative banking in Canada is provided by Credit Unions (Caisse Populaire). These are structurally like banks. Almost 50 percent of the economically active populace of Canada is member of these credit unions. There are around 700 credit unions across Canada and are governed by co-operative members and volunteer directors. As at the end of 2018, these unions had more than 10 million members, held more than $340 billion in assets and employed more than 60,000 people. Most of these credit unions are covered by provincial laws which stipulate as to how they can lend, borrow, and invest.

5.6.9 United States of America

i) In US, co-operative banking is offered by co-operative banks and credit unions. All members have accounts in the union/bank. There were as of December 2018, 5684 credit unions in USA with 112 million members, deposits of US$ 1.17 trillion, Credit of US $0.97 trillion, and total assets of US$ 1.39 trillion. It is reported that this sector had a failure rate of about one-fifth of the failure of commercial banks during the global financial crisis. Credit unions of USA commonly network with two types of second tier facility. The first is the 'Corporate Credit Union' (CCU), a Co-operative Union Network, which helps their member societies to enhance their efficiency through economies of scale. The second network is known as 'Credit Union Service Organizations' (CUSO) which can have inter-institution transactions and offer support. There are also over 490 mutual savings banks in the United States holding total assets of USD 374 billion as of 31 March 2018. Mutual savings banks have no capital stock, as opposed to credit unions. They are operated by trustees solely for the benefit of the depositors, who receive interest as dividends.

ii) Nearly all credit unions' capital is originated through retained earnings since they are generally not allowed to issue capital instruments. Membership shares have small denominations, usually ranging from USD 5 to USD 50. They are treated as regular deposits, including for accounting purposes and are insured so that they do not count as capital. Accordingly, the net worth of CUs is almost entirely made of retained earnings.

5.6.10 Australia

In Australia, all financial firms that take deposits are defined as Authorised Deposit-Taking Institutions (ADIs) and licensed and regulated by the Australian Prudential Regulation Authority (APRA) whether they are companies or mutuals. Member shares, with nominal values of a few dollars, are only a notional contribution of capital. For accounting purposes, they are treated as any other deposit. For regulatory purposes, they are not eligible for inclusion as regulatory capital and are not considered to be deposits for financial claim scheme purposes. They can only be redeemed at their nominal value when a member closes all accounts with the FC and cancels her/his membership.

5.6.11 Kenya

Savings and Credit Co-operative Societies (SACCOs) are the licensed financial co-operatives in Kenya for collecting deposits from their members. The deposits collected by SACCOs fall into two categories: non-withdrawable deposits (or share deposits) and withdrawable or demand deposits. All SACCOs start by collecting share deposits. Where the FC elects to collect demand deposits, it becomes a “deposit-taking savings and credit co-operative society” (DT-SACCO). Member shares and retained earnings are the primary source of capital. The member shares cannot be redeemed unless the DT-SACCO is liquidated and, in an operating co-operative, they can only be transferred to another member.

5.6.12 Brazil

The Brazilian version of a financial co-operative (FC) is called a “credit co-operative”. As of 2017, there were 1,006 co-operatives of different sizes and levels of complexity operating in Brazil. They can only operate with their members and are subject to geographical limitations. FCs in Brazil are classified into three different levels: standalone or single financial co-operative, federations of co-operatives, and confederations, as summarised below. There are 200 standalone credit co-operatives. Forty-nine FCs are organised into five two-level groups under a central facility (federation), and the other 759 entities are distributed throughout four three-level systems, under the control of four confederations. Two of these three-level systems, Sicredi and Sicoob, include a commercial bank. Over the past decade, a significant amount of consolidation has taken place, although most FCs remain small. In December 2008, there were 1,439 operating co-operatives whereas in December 2017 there were slightly more than a thousand FCs. This concentration has helped FCs face increased competition in financial markets through economies of scale.

5.7 Major features of FCs

The major features of the FCs across jurisdictions are summarized in the following paragraphs.

5.7.1 Networking

Co-operatives banks in Europe developed central institutions and formed network associations. The level of integration varies from the centralization of common services viz. strategic advice, basic support services etc. to more complex functions viz. risk and liquidity management, mergers and acquisitions etc. Wherever the FCs are strong and compete with the commercial banks, particularly in respect of small customers, such as in France, the Netherlands, Germany, Italy, Austria, Spain, Finland, they work under highly integrated and centralized systems. Delegation is lesser in case of Austrian and German co-operative banks, while Italian and Spanish co-operative banks are almost entirely decentralized.

In Canada, Desjardins Caisses Populaire operate as a complex federated model. The individual caisse are independent and autonomously incorporated entities, but operate in a structured, standardized and closely inter-connected environment. In US, credit unions have formed Credit Union Services Organizations (CUSOs) which are limited liability companies to facilitate shared services.

5.7.2 Business Model

Business model diversity has been observed within the co-operative financial institutions across the jurisdictions. Canadian credit unions are found to operate on any one of the three models followed in the country of which two are retail-oriented with different levels of diversification (focused retail and diversified retail) and one is investment-oriented which includes trading and derivatives. US credit unions operate retail-oriented business model. Co-operative banks in Europe operate one of five business models. Three of these are characterized as being retail-oriented, a fourth wholesale focused and a fifth investment driven. In Japan, Shinkin banks adopt two forms of business model, which concentrate on the issuance of loans funded by deposits (*traditional*) and the investment and management of large investment portfolios (*new)*. Business model types differ in terms of their risk appetite and profit potential.

5.7.3 Governance

Variations in board constitution observed across some of the jurisdictions are as under:

i) Credit Agricole has a three-tier indirect system of governance. Co-operative banks, at the base level elect directors of the regional banks. Credit Agrocol S.A. at the top is a public limited company owned by the regional banks.

ii) Credit Mutuel in France has an indirect representative system. Individual members through the general body elect/ appoint the Board of Directors of local banks. These boards in turn elect regional boards, who elect the board of the central confederation in the confederal general assembly. This is, reportedly, a very elaborate and expensive process. At the national level there are two bodies: The Central Federation that represents the Group and acts as banking supervisor and inspector, and a Central Bank, which manages liquidity and ensures the financial solidarity of the regional groups.

iii) BVR (Germany) has an indirect, representative system of governance, with a Member Council. Each member bank has one vote each in the Annual General Meeting, where a 50-

member strong council is elected. This council in turn elects a 12-person Administrative Board. BVR also has a smaller three-member committee known as Management Board.

iv) Rabobank in the Netherlands has a direct representative system. Its local banks (divided in to 12 regions) constitute the general assembly and have annual general meeting of Rabobank Nederland. Each region has one member in the Member Council that discusses policy. The general meeting appoints 10 persons as Group's Board of Directors. These are all experienced professionals selected based on their skills rather than their ability to represent a region.

v) The Desjardins of Canada has a similar structure, though with only two tiers. Desjardins Group has a Unitary Board. It has a democratic structure of regional general meetings, councils, and an assembly of representatives.

vi) Raiffeisen ZB in Austria is an investor-owned bank that has the conventional Board of Directors (known as a Supervisory Board) and a Management Board. The Directors are elected at an annual meeting of shareholders, after being proposed by a nominations committee of board members, with proportional voting rights.

5.7.4 Proportionality in Regulation (Differential Regulation)

Proportionality in regulation is considered to be an important factor in the context of sustainability of co-operative banks. Most of the jurisdictions practice some sort of proportionality. The following is a quick review of proportional or differential regulation as it applies to co-operative banks across the jurisdictions.

i) In all countries, the regulatory prescriptions regarding governance, processes and systems are higher with respect to large and more sophisticated financial institutions. The main tool of regulation being capital adequacy, proportionality is often seen in capital and liquidity adequacy ratios. In some countries smaller institutions are given concessions in capital ratio and Liquidity Coverage Ratio (LCR). In France and Germany (and more generally EU countries), Basel III standards apply, in general, to all financial institutions regardless of their size and complexity. Both Basel II and Basel III norms advocate Internal Risk Based Assessment which ultimately leads to proportionality.

ii) Proportionality in prudential regulation usually takes the form of simpler but not necessarily lighter requirements as proportionality does not necessarily mean a lower capital ratio. In Brazil, the minimum CET1 ratio under the simplified prudential approach ranges from 12 per cent to 17 per cent. In some countries, regulators depend solely on a non-risk-weighted metric. In Ireland, Kenya and South Africa, a minimum ratio of retained earnings to total assets in the range of 6 per cent to 10 per cent is applied which incentivises the co-operative banks to avoid an excessive distribution of their annual surpluses and improve retained earnings which is the main, and often the only, source of capital for them. In some countries risk-sensitive capital adequacy ratios are prescribed, but the assessment and calculations are simplified. Also risk weights are commonly calibrated to a higher level to compensate for the fact that several other components of risk are not reckoned.

iii) Several countries exempt small financial institutions from compliance to the LCR and the Net Stable Funding Ratio (NSFR). Instead, they stipulate a simple liquidity requirement at a given percentage to total assets or deposits. In Ireland, co-operative banks are required to maintain a minimum liquidity ratio of 20 per cent of their unattached savings in liquid assets. In Kenya, at least 15 per cent of total savings deposits must be held in the form of liquid assets.

iv) Compliance to regulations has a cost. Therefore, reporting requirements can also be proportional. In Brazil, small financial institutions are exempted from Pillar 3 disclosure (information relating to their risks, capital adequacy, and policies for managing risk with the aim of promoting market discipline) requirements. In South Africa, large FCs are required to submit monthly returns while smaller ones report on a quarterly basis.

v) Provisioning rules are essential part of the prudential regulatory framework in all countries. Given the relative complexity in accounting rules under IRAC norms, some countries have come up with a simplified or automatic approach to provisioning. In Australia, Kenya and South Africa, number of days in default is the main input for determining the provisioning rate. In Ireland under Financial Reporting Standard, co-operative banks need to follow an incurred loss approach to provisioning.

vi) The measurement of capital differs among countries. In Ireland and the United States where capital is mainly made up of retained earnings, member shares are not eligible for regulatory capital because they are redeemable and are therefore considered to be liabilities. In Kenya, member shares may count as regulatory capital, but they cannot be redeemed. If a member wants to leave the co-operative, her share must be transferred to another member. In European Countries, member shares are considered as part of capital. In most of the countries, member share is not transferable and can only be redeemed at face value. A member does not have a right to ask for retained earnings when redeeming the capital.

5.8 Observations

5.8.1 From a brief account of the policies and practices across major jurisdictions as discussed above, the following discourse emerges:

i) Capital has been considered to be a key element of the financial co-operatives undertaking the business of banking, whether with members only or with non-members as well, across the world. It would appear well recognized globally that for a financial co-operative to be on path of stable growth, it has to be adequately capitalized at all times in line with the other types of banks.

ii) Given the peculiarities and constraints of the co-operative structure where share capital is essentially withdrawable and is difficult to raise in view of the 'one member one vote' principle, different jurisdictions have evolved different practices for strengthening of the overall capital.

iii) It would also appear that in order to do so, some of these jurisdictions have veered away considerably from the basic co-operative principles underlining the need for small sacrifice of principles for greater good. In other words, the co-operative principles appear to be evolving.

iv) Some jurisdictions do not consider the share capital as accounting or regulatory capital at all. The share capital is treated as deposits and is freely withdrawable.

v) In many jurisdictions, the capital standards are same for all FCs irrespective of size of the entities.

vi) In some jurisdictions, the withdrawal of share capital is not allowed even though it is transferable from one member to another. In some other jurisdictions, withdrawal of share capital is allowed under certain conditions.

vii) Demutualization has been resorted to in some form or other in many jurisdictions. In some jurisdictions, the federated entity, which works as a full-service universal bank, is a joint stock company. In some other jurisdiction, conversion of a FC into a joint stock company has been allowed, even pursued under a set of reforms.

viii) While proportionate or differential regulation has been allowed in many jurisdictions, it does not mean dilution of the standards of minimum capital or governance required for an FC. The Proportionate Regulation primarily means simpler regulatory prescriptions (such as requirement of capital on Basel I norms) and lesser compliance rigour proportionate to systemic importance of a class of entity.

ix) A UO, as a federated entity which can support its member FCs in the long run, is essential to growth and stability of the FCs.

x) Consolidation has been pursued aggressively in some of the jurisdictions where co-operative banking is rather strong. These have mostly happened voluntarily, while the factors leading to consolidation may vary.

5.8.2 The Committee concluded that global practices with regard to financial co-operatives are varied, but the federated structure was normally used as the instrumentality for dealing with concerns and constraints arising from smaller scale of operations. The apex institution, to be able to provide stability to the federating co-operatives, should be financially strong, be professionally managed and have exemplary risk management practices.

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Chapter 6

REGULATORY FRAMEWORK FOR UCBs

6.1 Background

6.1.1 As observed by the Committee in Chapter 4, effective regulation of UCBs by RBI was constrained, *inter alia*, by two major factors, i.e., lack of adequate regulatory control of RBI over UCBs emanating from statutory limitations and vast heterogeneity amongst the UCBs in terms of size, scale, complexity of business, etc. The extant regulatory framework for UCBs is the outcome of RBI's assessment of how, within these constraints, the UCB sector can be allowed to function without much adverse impact on depositor safety and systemic stability.

6.1.2 The recent amendments to the BR Act took effect in June 2020 for UCBs. As stated in earlier in the report, the provisions of the BR Act applicable to UCBs till then did not include several important areas of their functioning, such as management, share capital, audit, resolution, etc. These areas have been regulated by the State Governments under the provisions of the respective State Co-operative Societies' laws and by the Central Government under the provisions of the Multi-State Co-operative Societies Act, 2002 (for UCBs whose area of operation extends to more than one State). Most of these legislations did not have appropriate provisions for effectively regulating these co-operative societies as banks.

6.1.3 Keeping in view the aforesaid gaps and constraints, there have been efforts in the past to contain the systemic risk in the sector in the event of failure of a large UCB as also with a view to enhancing their aspirations for further growth. The High-Powered Committee (HPC) on UCBs chaired by Shri. R. Gandhi had recommended in 2015 that UCBs with business size of more than ₹20,000 crore may be converted into joint stock banks. Though the HPC did not envisage compulsory conversion of large banks, it suggested restricting the unrestrained growth of large UCBs. The HPC also recommended that there may be an option for other large UCBs to voluntarily convert into SFBs provided they fulfil the eligibility criteria therefor.

6.2 Amendment to the BR Act

6.2.1 The Committee deliberated at length on the provisions of the Banking Regulation (Amendment) Act, 2020, which amended the provisions of the BR Act, as applicable to UCBs. It was observed that most of the provisions of the principal Act, which were otherwise applicable only to banking companies, are now applicable to UCBs (Annex 5). Important provisions of the Act which have now become applicable to UCBs include restriction on whole time directors of UCBs from having substantial interest / employment in other companies/firms, qualification criteria for members of the board, requirement of prior approval for appointment / re-appointment /

termination of appointment of Managing Director (MD) / Whole Time Director (WTD)/Chairman, removal of Chairman / MD / Chief Executive Officer / Directors, supersession of the board of UCBs, issue of share capital and securities by UCBs, regulation of refund of share capital by UCBs, powers to sanction voluntary amalgamations of UCBs, power to prepare scheme for compulsory amalgamation and reconstruction of UCBs and power to approve appointment / removal of statutory auditors.

6.2.2 In the Committee's view, while it was possible that the structural factors arising from the co-operative character underlying the UCBs could still pose some challenges, the amendments to the BR Act address to a large extent the gaps in the legislative framework, which informed the extant approach of the RBI towards regulation and supervision of UCBs. Consequently, since the UCBs have the potential of driving financial inclusion and credit delivery to those with limited means, the regulatory policies can now be more enabling. At the same time, there were divergent views on allowing the UCBs to convert into joint stock companies. One view was that conversion of UCBs into banking companies is against the co-operative principles as the retained earnings in co-operative structure cannot be distributed. A contrary view was that voluntary conversion after a well-informed decision taken by the General Body of the UCB in a democratic manner should not be barred by regulation, particularly where the underlying legislation is not restrictive on the use of retained earnings. Incidentally, it was also observed that a few co-operative laws such as the Multi-State Co-operative Societies Act, 2002 and Maharashtra Co-operative Societies Act, 1960 do facilitate distribution of surplus assets to shareholders during liquidation of the co-operative society. **The Committee, therefore, recommends the continuation of the existing regulatory neutrality in regard to the voluntary conversion of co-operative banks to joint stock companies as per the operating framework in place therefor.**

6.2.3 The Committee also discussed the issue of parallel statutory provisions in the BR Act and the co-operative societies' laws, which was raised by UCBs and their federations during their interaction with the Committee. These are considered more to be administrative challenges rather than legislative conflicts. The Committee **recommends that to obviate difficulties for UCBs due to jurisdictional issues between the RBI and the concerned Registrars of Co-operative Societies (RCS) / Central Registrar of Co-operative Societies (CRCS), RBI may consider clarifying the position appropriately to the concerned authorities.**

6.3 Heterogeneity in the Sector

6.3.1 The Committee observed that the UCBs are highly heterogeneous in terms of the size, scale, complexity of business, etc. As on March 31, 2020, the largest UCB in the sector had deposits of around ₹38,000 crore, whereas the average deposit size of the bottom 100 UCBs was about ₹5 crore. In terms of branch network, as on March 31, 2020, there were about 550 Unit UCBs (having a single office-cum-branch), whereas the largest UCB had 285 branches.

6.3.2 There is also a sizeable difference in the cooperativeness and aspirations of the UCBs in the sector. It has been observed that as the UCBs grow, the commonality amongst the members, which is the cornerstone of co-operative societies, declines and the commercial interests start taking over. The impressionistic understanding was confirmed through a study, wherein it was observed that around 47 per cent of the deposits in the smaller UCBs (deposits up to ₹10 crore) were held by its members, it was only around 30 per cent in the larger UCBs (deposits more than 1000 crore) (Annex 6). The smaller UCBs are more member-oriented and have limited aspirations which is evident from the fact that many of them are single branch banks despite being in existence for a very long time. On the other hand, the larger UCBs expressed their intentions to grow their areas of operation, give larger loans, and undertake activities on par with commercial banks, during the course of the interaction with the Committee.

6.3.3 Recognizing the heterogeneity, the extant regulatory framework classifies UCBs into two tiers[13], *viz.* Tier I and Tier II. The prudential guidelines make a distinction between Tier I and Tier II UCBs in several areas, e.g., provisioning norms[14], area of operation[15], Board of Management (BoM)[16], ceiling on housing loan, etc. The general approach has been to provide a relatively simple but somewhat restrictive prudential framework for Tier I UCBs *vis-à-vis* Tier II UCBs, keeping in view their small size and limited risk management capabilities. In the recent past, RBI has issued instructions for still larger banks for appointing Chief Risk Officers, reporting advances above ₹5 crore to CRILC, system based NPA identification and differential stipulations for cyber security based on digital depth.

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[13] In terms of extant instructions, Tier I UCBs are banks which meet the following criteria:

i. Unit banks i.e. banks having a single branch / Head Office and banks with deposits below ₹100 crore, whose branches are located in a single district.

ii. Banks with deposits below ₹100 crore having branches in more than one district, provided the branches are in contiguous districts and deposits and advances of branches in one district separately constitute at least 95% of the total deposits and advances respectively of the bank.

iii. Banks with deposits below ₹100 crore, whose branches were originally in a single district but subsequently, became multi-district due to reorganization of the district.

All the remaining UCBs are categorised as Tier II UCBs.

[14] Extant instructions on IRAC norms prescribes higher provisioning on standard assets for Tier II UCBs vis-à-vis Tier I UCBs (except for loans granted to agriculture and SME sectors, Commercial Real Estate (CRE) sector, and CRE – Residential Housing Sector).

[15] Single-State Tier II UCBs may extend their area of operation to the entire State of Registration on fulfilling the conditions stipulated for FSWM UCBs. Tier I UCBs may extend their area of operation to the whole of the district of registration and to its adjoining districts within their State of registration subject to satisfying certain norms.

[16] UCBs with a deposit size less than ₹100 crore and Salary Earners' Banks are exempted from constituting BoM.

6.4 Need for Scale-Based / Proportionate Regulation

6.4.1 The questionnaire circulated among all UCBs and their Federations *inter-alia* sought comments on whether it was time to bring in more elaborate differential regulation system based on size of UCBs and provide different levels of operational freedom. The questionnaire returned 700 responses, out of which 92 per cent of the responses were in favour of scale-based differential regulation. Further, 78 per cent of the respondents indicated deposit size as the preferred parameter to categorise banks for the purpose.

6.4.2 One cannot ignore the role of growth for any organization. Growth provides economies of scale and enables the organization to provide a wider range as well as quality/standards of products and services, improved customer service, enhanced employee satisfaction, to mention a few. Growth can happen either organically or inorganically or through a combination of both. The Committee noted that many small/unit UCBs did not appear to have ambition to grow, as many of them did not wish to expand their area of operation or open branches and most were against growth by way of consolidation / mergers. This is why few mergers, other than those warranted on account of resolution of weak UCBs, have so far taken place in the UCB sector. The Committee also noted that, given the competition from other types of banks and new age financial service providers, it was imperative that UCBs have enough growth to sustain their operations, provide better products and services to be able to retain existing customers as also attract future generation, more tech-savvy and tailored product/service-seeking customers.

6.4.3 The Committee also observed that given the heterogeneity in the sector, a tiered regulatory framework with more than two tiers is required to balance the spirit of mutuality and co-operation more prevalent in banks of smaller sizes and those with limited area of operation *vis-à-vis* the growth ambitions of the large sized UCBs to spread their area of operation and undertake more complex business activities on par with commercial banks. The Committee agreed that the deposit size can continue to be the basis for categorising banks into regulatory tiers, as for a normally functioning bank, deposit size can broadly serve as proxy for capital size and net worth. Further, additional tiers could be created to cater to the aspirations of the larger UCBs to undertake business akin to SFBs and UNBs.

6.4.4 The Committee adopted a two-step process to chalk out the proportionate regulatory framework. Initially, the performance of UCBs by categorising them into various buckets based on their deposit size was examined to see the extent of correlation between the UCBs' deposits and their performance. Subsequently, the Committee compared the regulatory framework of UCBs with UNBs and SFBs to identify the functional areas where appropriate distinction could be suggested for the proposed regulatory tiers.

Box 3: Proportionate Regulation

Post-financial crisis, world-wide, the regulatory framework for banks has become more complex due to increase in the compliance and reporting requirements on regulated entities, along with the accompanying costs. The burden of cost of compliance is felt more by the smaller entities. Therefore, there has been an increasing focus on tailoring the regulations corresponding to regulated entities' systemic importance, complexity, and riskiness. The proportionate regulation aims at avoiding excessive cost of compliance on smaller or non-complex entities, which may inadvertently impact their competitive standing.

Applying proportionate regulation for each entity and each variation in size and complexity is impractical. Therefore, appropriate approach is to group the entities into unique or somewhat similar categories and apply proportional regulation. Once the grouping is done, applicable proportional regulation may be made applicable on all entities in that category. The two models often used for establishing proportionality in a regulatory framework are:

a) Categorization approach for proportionality (CAP): Establish categories of entities according to different qualitative and/or quantitative characteristics and apply a precise regulatory regime for each of the categories; and
b) Specific standard approach for proportionality (SSAP): Establish criteria for the application of specific requirements for a subset of prudential standards, such as disclosure requirements, liquidity ratios, market risk etc.

Globally, developed financial markets like USA and Europe have adopted proportionate regulation to various extent. In USA, a few banks with total assets of $250 billion or more or $10 billion or more in total on-balance sheet foreign exposure are subject to Basel III's risk-based capital and leverage requirements, with additional capital requirements applicable to US G-SIBs. In contrast, in the European Union, nearly all banks are subject to Basel III, with a few exceptions for smaller banks.

The regulatory framework for banks in India so far largely followed proportionate regulations based on the type and, to some extent, size of the entities. UCBs are under a differential and simpler regulatory framework as compared to UNBs, e.g., UCBs are governed under Basel I capital framework as against Basel III framework applicable on UNBs. StCBs/ DCCBs, RRBs, SFBs and Payment Banks also have simplified regulatory frameworks. The regulatory approach has been uniform for a particular type of banking entity.

Given the heterogeneity in the sector, it has created a situation of regulatory arbitrage for the larger UCBs where they are under simpler prudential guidelines despite the high level of systemic risk associated with them. However, the larger entities are also unable to grow as much as their commercial bank counterparts, given the idiosyncrasies associated with the co-operative sector. Therefore, a better approach for proportionate regulation within the UCB sector should consider both the sector level idiosyncrasies as well as differences emerging from sizes of the entities.

References:

1. Fernando Restoy, Chairman, Financial Stability Institute, Bank for International Settlements, Speech at the BIS/IMF policy implementation meeting on proportionality in financial regulation and supervision, Basel, Switzerland, May 2019
2. Regulation and sustainability of co-operative banks: a cross country study, International Co-operative Banking Association, International Co-operative Alliance, August 2020
3. Rodrigo Coelho, Jean-Philippe Svoronos, Jose Angelo Mazzillo and Yu Taohua, Regulation and Supervision of Financial Co-operatives, FSI Insights on policy implementation No 15, Bank for International Settlements, January 2019

6.5 Performance of UCBs Based on Deposit Size

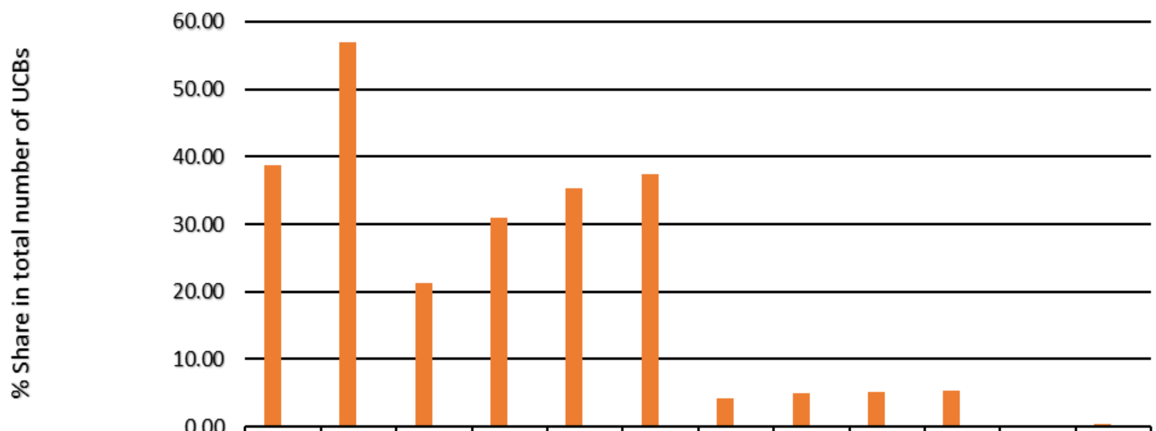
6.5.1 The Committee analysed the performance of the UCBs by categorising them into the following four groups and sub-groups (cumulative) based on their deposits. The analysis was conducted based on the data reported by UCBs for the financial years ended 2018, 2019 and 2020.

1. UCBs with deposits up to ₹100 crore
    a. Deposits up to ₹50 crore
    b. Deposits up to ₹100 crore
2. UCBs with deposits between ₹100 crore and ₹1000 crore
    a. Deposits between ₹100 crore and ₹250 crore
    b. Deposits between ₹100 crore and ₹500 crore
    c. Deposits between ₹100 crore and ₹750 crore
    d. Deposits between ₹100 crore and ₹1000 crore
3. UCBs with deposits between ₹1000 crore and ₹10000 crore
    a. Deposits between ₹1000 crore and ₹2500 crore
    b. Deposits between ₹1000 crore and ₹5000 crore
    c. Deposits between ₹1000 crore and ₹7500 crore
    d. Deposits between ₹1000 crore and ₹10000 crore
4. UCBs with deposits of more than ₹10000 crore
    a. Deposits between ₹10000 crore and ₹15000 crore
    b. Deposits of more than ₹10000 crore

The summary findings are discussed below (All amounts are in ₹ Crore).

6.5.1.1 From the Charts 12, 13 and 14 below, it can be observed that although 57 per cent of the total UCBs fall under Group 1, their share in deposits and loans & advances of the sector is only around 7 per cent and 6 per cent, respectively. On the other hand, UCBs in Group 3 and 4 together comprise 6 per cent of UCBs by number with about 60 per cent of share in deposits and loans & advances of the sector.

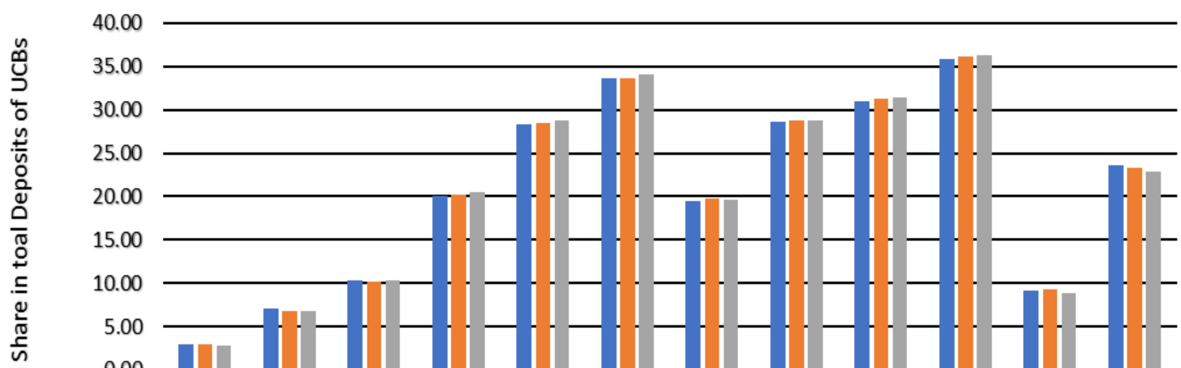
Chart 12: Group-wise number of UCBs and % share (as on March 31, 2020)



	Group 1		Group 2				Group 3				Group 4	
	0 - 50	0 - 100	100 - 250	100 - 500	100 - 750	100 - 1000	1000 - 2500	1000 - 5000	1000 - 7500	1000 - 10000	10000 - 15000	10000 +
% Share in total UCBs	38.79	56.92	21.18	30.86	35.35	37.36	4.09	4.94	5.07	5.26	0.26	0.45
Number of UCBs	597	876	326	475	544	575	63	76	78	81	4	7

Groups of UCB based on total deposits

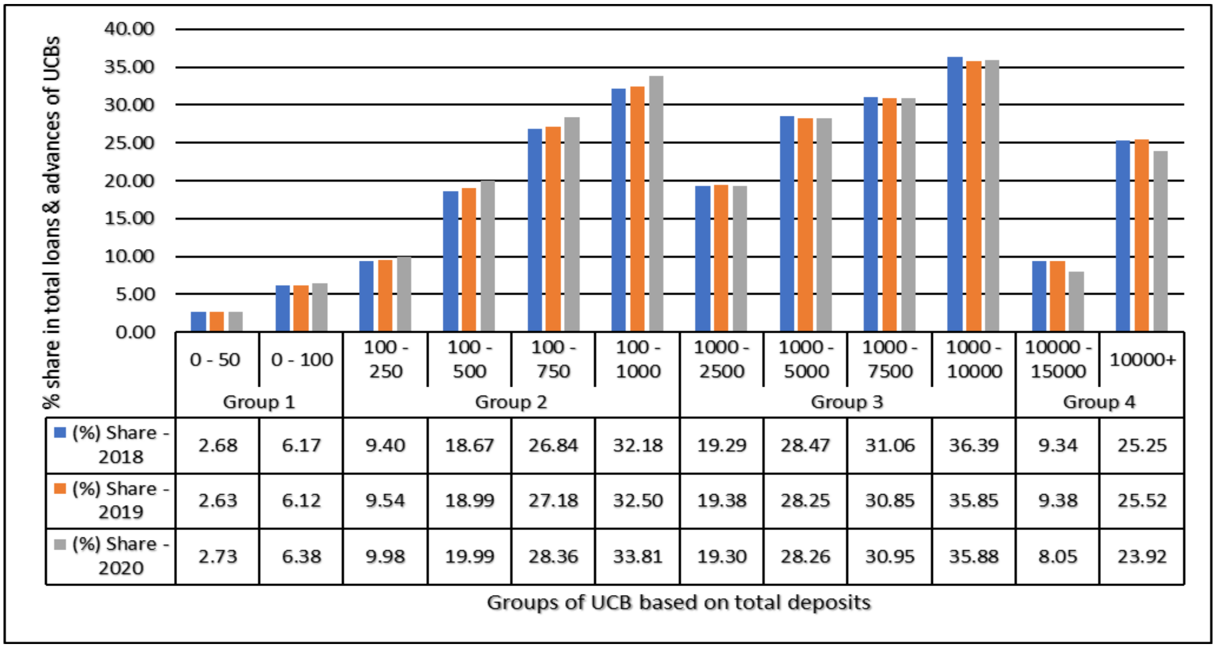
Chart 13: Share in total deposits of UCB Sector (%) – 2018 to 2020



	Group 1		Group 2				Group 3				Group 4	
	0 - 50	0 - 100	100 - 250	100 - 500	100 - 750	100 - 1000	1000 - 2500	1000 - 5000	1000 - 7500	1000 - 10000	10000 - 15000	10000+
(%) Share - 2018	2.99	7.03	10.28	20.04	28.36	33.60	19.47	28.56	30.93	35.80	9.15	23.57
(%) Share - 2019	2.89	6.84	10.22	20.16	28.46	33.71	19.76	28.80	31.34	36.15	9.34	23.30
(%) Share - 2020	2.85	6.80	10.29	20.54	28.81	34.05	19.69	28.82	31.44	36.35	8.87	22.80

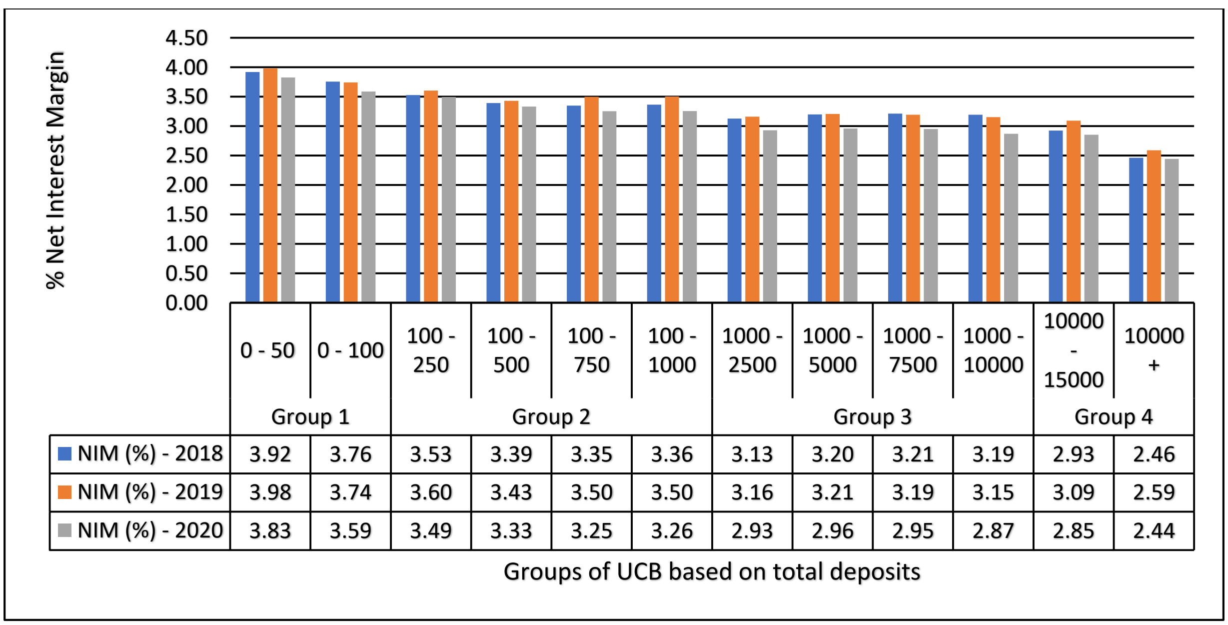
Groups of UCB based on total deposits

Chart 14: Share in total loans & advances of UCB Sector (%) – 2018 to 2020



	Group 1		Group 2				Group 3				Group 4	
	0 - 50	0 - 100	100 - 250	100 - 500	100 - 750	100 - 1000	1000 - 2500	1000 - 5000	1000 - 7500	1000 - 10000	10000 - 15000	10000+
(%) Share - 2018	2.68	6.17	9.40	18.67	26.84	32.18	19.29	28.47	31.06	36.39	9.34	25.25
(%) Share - 2019	2.63	6.12	9.54	18.99	27.18	32.50	19.38	28.25	30.85	35.85	9.38	25.52
(%) Share - 2020	2.73	6.38	9.98	19.99	28.36	33.81	19.30	28.26	30.95	35.88	8.05	23.92

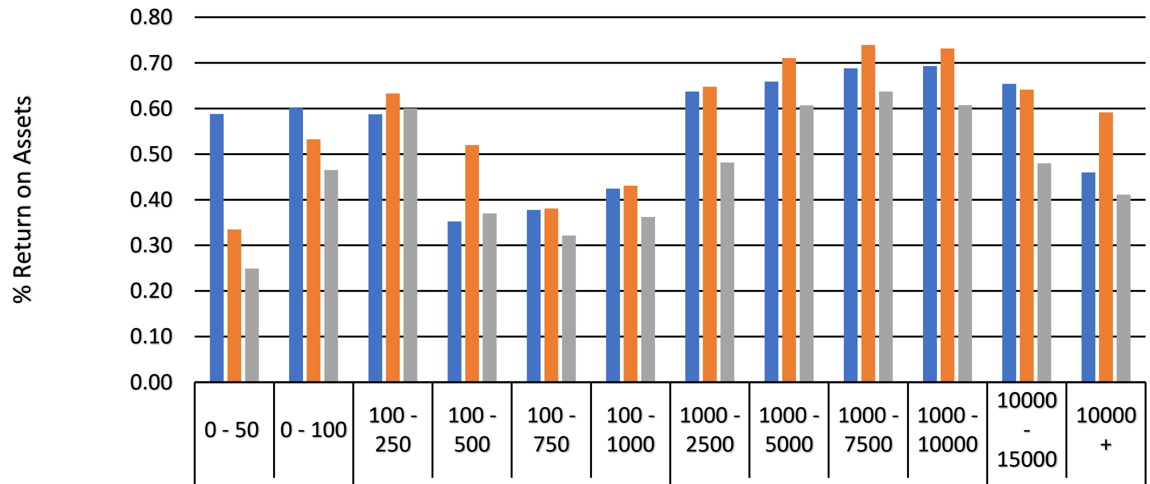
Chart 15[17]: Net Interest Margin (NIM)[18] of UCBs (%) – 2018 to 2020



	Group 1		Group 2				Group 3				Group 4	
	0 - 50	0 - 100	100 - 250	100 - 500	100 - 750	100 - 1000	1000 - 2500	1000 - 5000	1000 - 7500	1000 - 10000	10000 - 15000	10000 +
NIM (%) - 2018	3.92	3.76	3.53	3.39	3.35	3.36	3.13	3.20	3.21	3.19	2.93	2.46
NIM (%) - 2019	3.98	3.74	3.60	3.43	3.50	3.50	3.16	3.21	3.19	3.15	3.09	2.59
NIM (%) - 2020	3.83	3.59	3.49	3.33	3.25	3.26	2.93	2.96	2.95	2.87	2.85	2.44

[17] Chart 15 to 19 exclude data pertaining to two large UCBs under AID.
[18] Net Interest Margin has been calculated as (Net Interest Income / Interest Earning Assets)*100

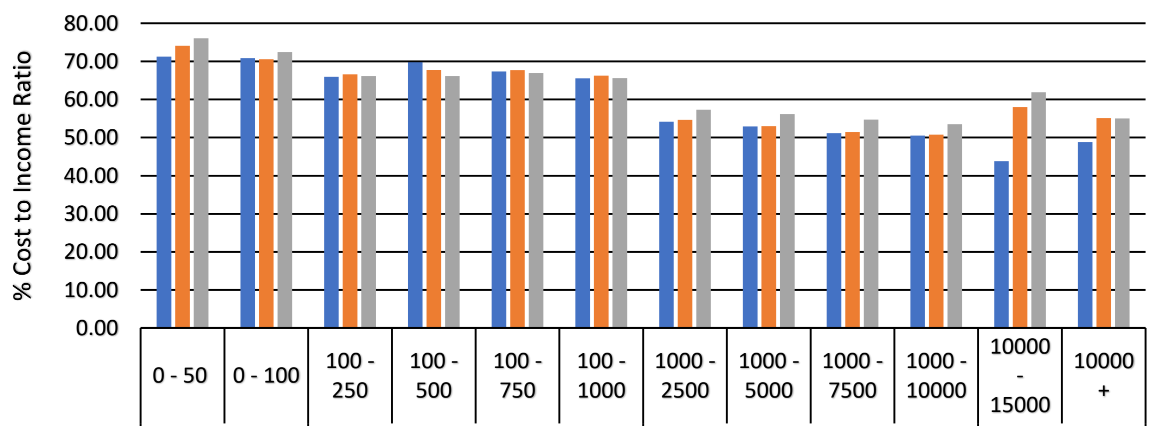
Chart 16: Return on Assets (RoA)[19] of UCBs (%) – 2018 to 2020



	Group 1		Group 2				Group 3				Group 4	
	0 - 50	0 - 100	100 - 250	100 - 500	100 - 750	100 - 1000	1000 - 2500	1000 - 5000	1000 - 7500	1000 - 10000	10000 - 15000	10000 +
RoA (%) - 2018	0.59	0.60	0.59	0.35	0.38	0.42	0.64	0.66	0.69	0.69	0.65	0.46
RoA (%) - 2019	0.33	0.53	0.63	0.52	0.38	0.43	0.65	0.71	0.74	0.73	0.64	0.59
RoA (%) - 2020	0.25	0.47	0.60	0.37	0.32	0.36	0.48	0.61	0.64	0.61	0.48	0.41

Groups of UCB based on total deposits

Chart 17: Cost to Income Ratio[20] of UCBs (%) – 2018 to 2020



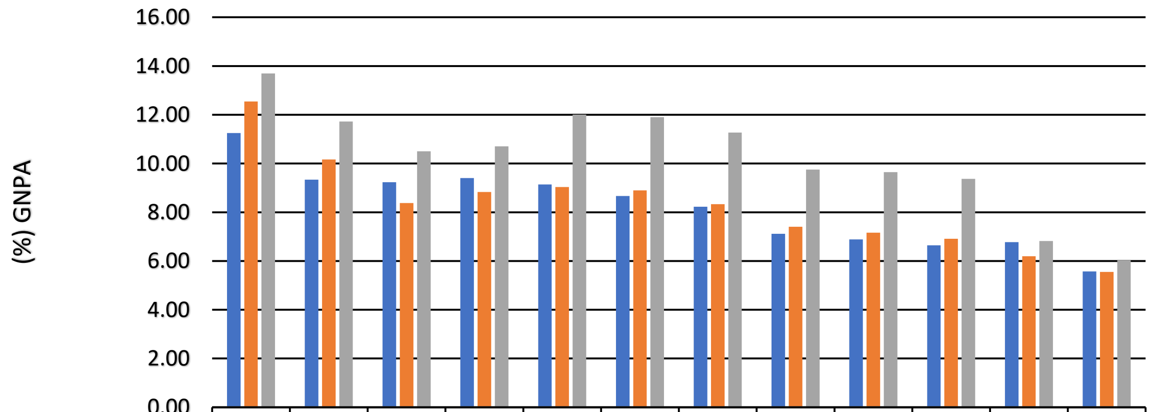
	Group 1		Group 2				Group 3				Group 4	
	0 - 50	0 - 100	100 - 250	100 - 500	100 - 750	100 - 1000	1000 - 2500	1000 - 5000	1000 - 7500	1000 - 10000	10000 - 15000	10000 +
CtoI (%) - 2018	71.24	70.85	65.96	69.76	67.34	65.55	54.19	52.89	51.13	50.53	43.78	48.82
CtoI (%) - 2019	74.09	70.59	66.58	67.76	67.74	66.26	54.66	53.00	51.46	50.75	58.04	55.14
CtoI (%) - 2020	76.09	72.45	66.16	66.18	66.98	65.61	57.32	56.19	54.73	53.48	61.88	54.99

Groups of UCB based on total deposits

[19] Return on Asset has been calculated as (Net Profit or Loss / Total Assets)*100

[20] Cost to Income Ratio has been calculated as (Non-Interest Expenditure / Net Total Income)* 100, where Net Total Income = Total Income – Interest Expenditure

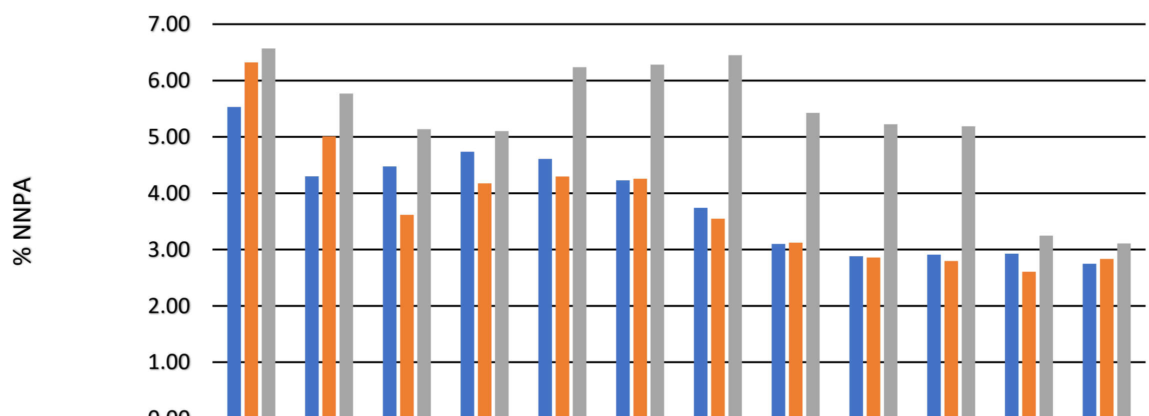
Chart 18: Gross Non-performing Assets Ratio (GNPA) (%) – 2018 to 2020



	0 - 50	0 - 100	100 - 250	100 - 500	100 - 750	100 - 1000	1000 - 2500	1000 - 5000	1000 - 7500	1000 - 10000	10000 - 15000	10000 +
	Group 1		Group 2				Group 3				Group 4	
GNPA (%) - 2018	11.25	9.34	9.23	9.41	9.14	8.67	8.22	7.12	6.89	6.65	6.77	5.58
GNPA (%) - 2019	12.54	10.17	8.38	8.83	9.04	8.90	8.33	7.41	7.16	6.91	6.20	5.55
GNPA (%) - 2020	13.70	11.72	10.50	10.71	12.01	11.90	11.27	9.75	9.65	9.37	6.82	6.04

Groups of UCB based on total deposits

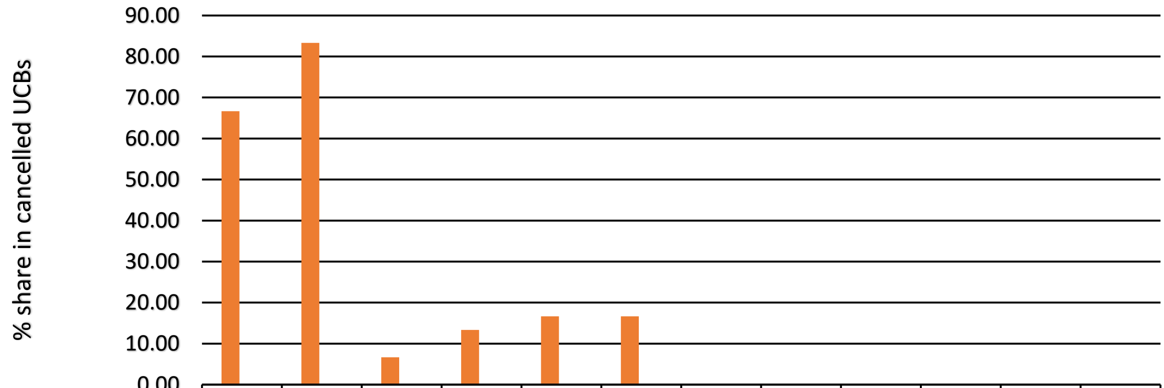
Chart 19: Net Non-performing Assets Ratio (NNPA) (%) – 2018 to 2020



	0 - 50	0 - 100	100 - 250	100 - 500	100 - 750	100 - 1000	1000 - 2500	1000 - 5000	1000 - 7500	1000 - 10000	10000 - 15000	10000 +
	Group 1		Group 2				Group 3				Group 4	
NNPA (%) - 2018	5.53	4.30	4.48	4.74	4.61	4.23	3.74	3.10	2.88	2.91	2.93	2.75
NNPA (%) - 2019	6.32	5.01	3.62	4.17	4.30	4.26	3.55	3.12	2.86	2.80	2.61	2.83
NNPA (%) - 2020	6.57	5.77	5.14	5.10	6.24	6.28	6.45	5.43	5.22	5.19	3.25	3.11

Groups of UCB based on total deposits

Chart 20: UCBs whose licenses have been cancelled (%) – 2015 to 2020



	Group 1		Group 2				Group 3				Group 4	
	0 - 50	0 - 100	100 - 250	100 - 500	100 - 750	100 - 1000	1000 - 2500	1000 - 5000	1000 - 7500	1000 - 10000	10000 - 15000	10000 +
Share (%) - in Cancelled UCBs	66.67	83.33	6.67	13.33	16.67	16.67	0.00	0.00	0.00	0.00	0.00	0.00
Number of Cancelled UCBs	20	25	2	4	5	5	0	0	0	0	0	0

Groups of UCB based on total deposits

6.5.1.2 From the above charts, it can be observed that UCBs in Group 1 had a higher average NIM (≈3.75 per cent), whereas UCBs in Group 4 had a relatively lower average NIM (≈2.50 per cent), thereby indicating a reduction in NIM as UCBs increase in size. However, it can also be observed that the higher NIM in smaller UCBs did not result in a correspondingly higher RoA for them. The key reasons for low RoA in smaller UCBs can be attributed to their higher Cost to Income Ratio and GNPA when compared with larger UCBs. It can be argued that the higher Cost-to-Income ratio and NPA ratios of smaller UCBs were due to their lack of economies of scale and poor credit management, which can ultimately be attributed to their smaller size. Further, it is also observed from the data that once UCBs come under financial stress, smaller UCBs have higher likelihood of failing to improve themselves, leading to cancellation of their license.

6.5.1.3 The Committee further observed that UCBs with deposits of less than ₹100 crores have largely homogeneous characteristics. These UCBs are relatively more attached to co-operative principles, are more member centric, lack economies of scale, have limited area of operation, and are not very ambitious. The Committee also observed that all Unit Banks can be considered as part of this group. The Salary Earner Banks, irrespective of their deposit size, can also be included in this group because of the larger degree of simplicity in their operations and lesser risks in the operations. The Committee agreed that these banks have lower systemic and resolution-related risks due to their small size. Given their limited ability to raise capital, manage liquidity, hire capable human resources, augment infrastructure and compete with other lenders, it will be highly conducive for their growth and sustained competitiveness if they get networked as has been the experience of many other jurisdictions where co-operative banks are highly successful. Such support, it was observed, could come from the UO which has proposed to provide *inter-alia* technological and fund-based support to its members once it starts its operations. Thus, the Committee was of the view that for UCBs falling in Group 1, membership of the UO would be a game-changer for their growth and survival, and therefore, the regulatory framework should take cognisance of this.

Box 4: Umbrella Organization

In many countries where co-operatives are successful in the financial sector, a federated structure with a strong apex entity has been generally prevalent. The apex entity should be able to operate on scale, have access to adequate financial resources and be resilient to instil confidence in the federating co-operative entities and those transacting business with the federating entities. In many jurisdictions, such apex entity is a joint stock company. The joint stock company does not face constraints of raising capital which an entity organised as a co-operative society faces, so long as it has a credible business model.

The idea of an umbrella organisation for UCBs in India was first mooted by the Working Group to Examine the Issue of Share Capital of UCBs (Chair: Shri N S Vishwanathan, 2006). The matter was further examined in detail by the Working Group on Umbrella Organization (UO) and Constitution of Revival Fund for Urban Co-operative Banks (Chair: Shri V S Das, 2009). The report suggested that Reserve Bank can play an important role in setting up of a UO at the national level and Emergency Fund Facility Trusts at the state level. The recommendations of the V S Das Committee were further examined by the Expert Committee on Licensing of New UCBs (Chair: Shri Y H Malegam, 2011). It was suggested by the Malegam Committee that there should be two separate UOs *viz.* a national level organization which provides payments and settlement services and other services normally provided by central banks as also liquidity support to its members; and one or more organizations which provide the management, IT, training and other services which the UCB sector needs. After examining the various options, the RBI gave an in-principle approval to NAFCUB to set up an Umbrella Organisation as a NBFC. The RBI has, *inter alia,* allowed investment by UCBs in the share capital of the UO and capital contribution by UCBs to be excluded for the purpose of evaluating compliance with the limit on non-SLR investments. Broadly, the UO is expected to provide support with regard to IT infrastructure, capital, liquidity, training, etc. to its member UCBs.

6.5.1.4 The Committee also deliberated in detail on whether there should be a prescription for minimum capital and reserve (net worth) requirement for UCBs irrespective of CRAR. In this regard, views of the members were divergent. There was one view which favoured the *status quo* arguing that the smaller UCBs have a long history of surviving and serving their customers, despite their small size. They observed that there are around 300 UCBs with deposits of less than ₹25 crores, which would find it difficult to augment their capital and reserves beyond a point. Holders of the other view, however, observed that there has been a quantum shift in the financial services industry where there is emphasis on technology-enabled delivery of services to reduce cost and time as also to have skilled manpower to provide customer-comfort. A sustained growth in business is necessary to survive and remain relevant, even survive, in the medium term. UCBs are competing with various other types of lenders which have bigger size/scale and state of the art technological infrastructure to provide banking services. Most of these new players are focussing on segments which traditionally have been the clientele of UCBs. In this environment, small size of the UCBs itself could become a threat to their survival as is evident from the existence of financial stress in a large number of small UCBs. Therefore, if the *status quo* is allowed, then a large number of small UCBs could perish in the medium to long term, which would not be in the interest of the depositors and other stakeholders. This will also be detrimental for the UCB sector as cancellation of license of even a small UCB impacts the perception of the public about the sector. **The Committee finally agreed that a minimum capital and reserve (net worth) with a reasonable time period to achieve the same could be suggested.**

6.6 Comparison of Regulatory Frameworks for UCBs, UNBs, SFBs and RRBs

6.6.1 The Committee looked at the extant regulatory framework for UCBs, UNBs, SFBs and Regional Rural Banks (RRBs) (Annex 7). Comparative position with regard to a few major areas of the regulatory framework is outlined below for quick reference.

Table 4: Major regulatory provisions for UCBs, UNBs, SFBs and RRBs

Prudential Norm / Regulatory Approval	UCBs	UNBs	SFBs	RRBs
Capital Adequacy	Under Basel I norms, capital to be maintained only on credit risk. AD Category-I UCBs have to maintain capital on credit risk as well as market risk.	Under Basel III norms. Capital to be maintained on credit risk, market risk and operational risk.	Under Basel II norms, but capital to be maintained only on credit risk.	Under Basel I
Opening of Branches, Extension Counter	Prior approval of RBI is required.	Under automatic approval route, subject to conditions	Under automatic approval route, subject to conditions	Under automatic approval route, subject to conditions

Prudential Norm / Regulatory Approval	UCBs	UNBs	SFBs	RRBs
	Only UCBs satisfying FSWM criteria[21] are eligible to apply. Requirement of Board of Management for UCBs having deposits of ₹100 crore and above.			
Extension of area of operation	Under prior approval route FSWM UCBs having a net worth of at least ₹50 crore are eligible to apply.	Not applicable. Area of operation extends to the entire country.	Not applicable. Area of operation extends to the entire country.	Area of operation of RRBs is fixed.
Priority Sector Lending targets	75 per cent of Adjusted Net Bank Credit (ANBC), to be achieved by March 31, 2024.	40 per cent of ANBC	75 per cent of ANBC	75 per cent of ANBC
Individual Housing Loan limits	• Tier I UCB – ₹30 lakh • Tier II UCB – ₹70 lakh	No regulatory exposure limits	No regulatory exposure limits	No regulatory exposure limits
Gold Loan on bullet repayment terms	Maximum ₹2 lakhs, subject to conditions	No regulatory restriction on amount	No regulatory restriction on amount	Maximum ₹2 lakhs, subject to conditions
Unsecured loans	• Maximum individual unsecured loans – ₹0.25 lakh to ₹5 lacs, depending on CRAR and DTL of UCBs. • Maximum aggregate unsecured loans - 10 per cent of total assets (up to 35 per cent, subject to conditions)	No regulatory exposure limits	No regulatory exposure limits	No specific instructions

[21] FSWM or "Financially Sound and Well Managed" criteria for UCBs are as under:

(a) CRAR of not less than 10 per cent;

(b) Gross NPA of less than 7 % and Net NPAs of not more than 3%;

(c) Net profit for at least three out of the preceding four years subject to it not having incurred a net loss in the immediately preceding year.

(d) No default in the maintenance of CRR / SLR during the preceding financial year;

(e) Sound internal control system with at least two professional directors on the Board;

(f) Core Banking Solution (CBS) fully implemented; and,

(g) Regulatory Comfort based on, *inter alia*, record of compliance to the provisions of Banking Regulation Act, 1949 (AACS), Reserve Bank of India Act, 1934 and the instructions / directions issued by RBI from time to time, i.e., the bank should have track record of regulatory compliance and no monetary penalty should have been imposed on the bank on account of violation of RBI directives / guidelines during the last two financial years.

Prudential Norm / Regulatory Approval	UCBs	UNBs	SFBs	RRBs
Inclusion under Second Schedule to RBI Act, 1934	Prior approval route UCBs fulfilling prescribed criteria are eligible to apply.	Prior approval route All new SCBs after commencement of operations are eligible to apply.	Prior approval route All new SFBs after commencement of operations are eligible to apply.	Prior approval route Newly amalgamated RRBs are Scheduled by RBI on the basis of certificate issued by NABARD.

6.6.2 The Committee observed that while UNBs and SFBs have considerable freedom to undertake their business activities and decide their own sectoral exposure limits, the lack of even elementary risk management capability in majority of the UCBs does not allow RBI to adopt a similar regulatory approach for UCBs. At the same time, lack of investor interest emanating from the absence of proportionate voting rights is a major constraint faced by RBI in resolution of financially distressed UCBs. Seemingly due to the above reasons, RBI adopts a calibrated regulatory approach for mitigating various risks in case of UCBs by prescribing sectoral limits / monetary ceilings for different categories of loans, as also requirement of prior approval for expansion of branches and area of operation. The Committee felt that a liberal regulatory approach may be adopted for UCBs that meet a certain minimum level of capital and reserves (net worth) and CRAR requirements. Further, membership of the UO might also provide an extra comfort to the regulator as the smaller UCBs would benefit from the products and services provided by the UO. It was felt that UCBs meeting the criteria specified for UNBs or SFBs and having comparable risk management abilities may be regulated on the lines of UNBs or SFBs, as the case may be. At the same time, the Committee was of the opinion that comparison of UCBs with RRBs may not be justifiable given that the latter primarily operates in rural areas and have little scope for expansion of area of operation.

6.6.3 With regard to the existing regulatory approach of prescribing sectoral limits / monetary ceilings for UCBs, the Committee believed that given the heterogeneity in the sector, the monetary ceilings on different categories of loans may be dispensed, particularly for the larger UCBs. Instead, the Committee felt, the regulatory ceilings may be defined as a percentage of Tier I capital of the bank, with appropriate monetary ceilings for smaller UCBs having inadequate risk management and risk bearing capacity. For larger UCBs, the monetary ceilings may be decided by their Boards, within the prescribed general exposure limits (for single/group borrowers).

6.6.4 At the same time, the Committee recognized the need for UCBs to be well capitalized in proportion to their risk weighted assets. It was noted that the UCBs are presently regulated under Basel I with the CRAR of 9 per cent on credit risk alone unlike Basel III where the CRAR is on credit, market and operational risks. It further observed that in the jurisdictions where co-operative banks are strong, they are regulated under Basel III capital framework. The Committee felt that in line with the principles of proportionate regulation, it may not be desirable to expect smaller UCBs to switch over to Basel III which is complicated and require higher technical competence and skills. However, a higher level of CRAR needs to be prescribed to take care of the market and operational risks, particularly if operational freedom has to be enhanced. While doing so, the Committee also considered that membership of UO, once it becomes operational, would mitigate these risks for UCBs in lower tiers to a certain extent and, therefore, the CRAR requirement can be brought down. However, a glide path should be provided to UCBs to achieve the higher CRAR.

6.7 Recommendations

6.7.1 Scale-Based Differential Regulation

6.7.1.1 Categories of UCBs

Based on the ‘cooperativeness’ of the banks, availability of capital and other factors, UCBs may be categorised into following four tiers for regulatory purposes:

- Tier 1 - All unit UCBs and salary earner’s UCBs (irrespective of deposit size), and all other UCBs having deposits up to ₹100 crore
- Tier 2 - UCBs with deposits more than ₹100 crore and up to ₹1000 crore
- Tier 3 - UCBs with deposits more than ₹1000 crore and up to ₹10,000 crore
- Tier 4 - UCBs with deposits more than ₹10,000 crore

6.7.1.2 Prescriptions for Tier 1 UCBs

i) Tier 1 banks having area of operation within a district should have a minimum capital and reserves (net worth) of ₹2 crore and other Tier 1 banks should have a minimum capital and reserves (net worth) of ₹5 crore.

ii) A suitable glide path may be provided for achieving the target minimum net worth, provided the banks meet the CRAR requirement.

iii) The minimum CRAR stipulation for Tier 1 banks may be as under:

Sr. No.	Condition	Minimum required CRAR (%)
1.	Meets the minimum net worth criteria of ₹2 crore / ₹5 crore and is a member of UO	9.0

2.	Meets the minimum net worth criteria of ₹2 crore / ₹5 crore but is not a member of UO	11.5
3.	Does not meet the minimum net worth criteria of ₹2 crore / ₹5 crore but is a member of UO	11.5
4.	Does not meet the minimum net worth criteria of ₹2 crore / ₹5 crore and is also not a member of UO	14.0

iv) There may be no differentiated risk weights.

v) Banks meeting the minimum net worth and CRAR criteria may be given general permission to open, during a financial year, branches up to 10 per cent of the number of branches at the end of the previous financial year, subject to a minimum of one branch. The new branch(es) should be opened in an unbanked area within the district of operation of the banks requiring minimum capital of ₹2 crore, and in current districts of operation or adjoining districts in case of banks requiring a minimum capital of ₹5 crore. The branch in the unbanked area should be front loaded wherever the number of branches to be opened by the bank is less than 4. The extant regulations with regard to capital headroom should continue.

vi) All other regulatory prescriptions may be in line with the present regulatory guidelines for UCBs, as amended from time to time and subject to the other recommendations of this Committee.

vii) As already prescribed for all UCBs by the RBI, 75 per cent of the ANBC/CEOBSE of banks in this tier shall meet PSL criteria and 50 per cent of their credit portfolio should consist of loans of ticket size up to ₹25 lakh. The time given to these banks till March 31, 2024 to get their loan book in conformity with these stipulations is reasonable.

6.7.1.3 Prescriptions for Tier 2 UCBs

i) Minimum CRAR of 15 per cent[22] on credit risk. The minimum CRAR requirement may be reduced by 1 per cent point upon the bank becoming a member of the UO.

ii) Additional timeframe (say two years) and glide path may be provided in case a UCB has to achieve the required minimum CRAR for tier-2 category, on transitioning from tier-1 to tier-2 category on account of size of deposits.

iii) Banks meeting the CRAR requirements may be allowed to open branches in existing districts or contiguous districts (in the state where the bank has its head office) up to 10 per cent of the existing number of branches (subject to minimum one and maximum five) every year under automatic route with a prescription of opening at least 25 per cent of the branches in

[22] Tier 2 UCBs being larger in size and having aspirations to grow further, there is a need for them being adequately capitalized to compensate for market and operational risks.

unbanked areas, subject to headroom capital availability and reporting to RBI. The branch(es) in the unbanked area should be front loaded wherever the number of branches to be opened by the bank in a year is less than four.

iv) All other regulatory prescriptions may be in line with the present regulatory guidelines for UCBs, as amended from time to time and subject to the other recommendations of this Committee.

v) As already prescribed by RBI for all UCBs, at least 75 per cent of the ANBC/CEOBSE of the UCBs in this tier shall meet PSL criteria and 50 per cent of their credit portfolio should consist of loans of ticket size up to ₹25 lakh. It was noticed that the banks are required to bring their loan book in conformity with these regulations by March 31, 2024. The Committee observed that where they are not already in conformity, the banks could meet this stipulation only in one of the two ways. First, by writing a large quantity of new loans that meet the twin-criteria, such that their weight in the aggregate loan book conforms to the prescribed criteria. This will, in turn, require them to raise substantial amount of capital and deposits to expand the balance sheet in conformity with the stipulated CRAR. This will be extremely difficult for UCBs and as such they will be forced to resort to the second option, namely sell off a part of their loans that do not conform to the stipulations so that the residual loan book meets the stipulation. In the Committee's view, this could be extremely disruptive and may create liquidity and solvency problems in the short-term. In view of this, the Committee recommends that the hard timeline be replaced with a stipulation that 95 per cent of the incremental portfolio of these banks should be corresponding to the aforesaid prescriptions till the overall loan book conforms to the stipulated composition.

6.7.1.4 Prescriptions for Tier 3 UCBs

i) Minimum CRAR of 15 per cent as applicable to SFBs

ii) A Tier 3 UCB which meets both the entry point capital and the CRAR[23] requirements applicable to SFBs may, on RBI being satisfied that it meets the financial requirements and has a fit and proper Board and CEO, be allowed to function on the lines of an SFB. Such UCBs may be eligible for the following:

a) Deemed area of operation across the country and, consequently, deemed permission / NOC from RBI to become a multi-state bank, if it is not already one.

b) Branch expansion throughout the country through automatic route, subject to a prescription of opening at least 25 per cent of the branches in unbanked areas and

[23] Presently, ₹200 crore and 15% respectively

reporting to RBI. The branch(es) in the unbanked area should be front loaded wherever the number of branches to be opened by the bank is less than four.

c) Automatic inclusion in second Schedule to the RBI Act
d) AD licensing regime on par with SFBs
e) Any other regulatory permissions normally granted to SFBs
f) Tier 3 UCBs not fulfilling the conditions as at (ii) above may have operational freedom on par with tier-2 UCBs.

iii) The loan portfolio of all UCBs in Tier 3 shall conform to the stipulations made for SFBs as per instructions already in place. For the reasons outlined in case of Tier 2 UCBs above, the Committee recommends that the hard timeline be replaced with a stipulation that 95 per cent of the incremental portfolio of these banks should be corresponding to the aforesaid prescriptions till the overall loan book conforms to the stipulated composition.

iv) There may, however, be no sub-target for agriculture under PSL.

v) While there will be no regulatory imperative for UCBs in Tier 3 to become members of the UO, since the latter intends to emerge as an all-encompassing entity in the UCB sector, if UCBs find value in becoming its member, they can do so.

6.7.1.5 Prescriptions for Tier 4 UCBs

i) Minimum CRAR as per Basel III prescriptions as applicable to UNBs.

ii) A Tier 4 UCB which meets both the entry point capital[24] and CRAR requirements applicable to UNBs as also the leverage may, on RBI being satisfied that it meets the financial requirements and has a fit and proper Board and CEO, be allowed to function on the lines of a universal bank.

iii) Tier 4 UCBs fulfilling the conditions at (ii) above may have all the operational freedom, including for branch expansion (including the obligation to open 25 per cent of the branches in unbanked areas subject to reporting), scheduling, AD license, etc. on par with UNBs.

iv) Any bank which is in Tier 4 by virtue of its deposit size but found ineligible to be authorised to function as a universal bank may be provided operational freedom as applicable to Tier 2 UCBs while their regulatory requirements will continue to be as applicable to banks in Tier 4. The loan portfolio of such UCBs shall conform to the stipulations made for SFBs as per instructions already in place. For the reasons outlined in case of Tier 2 banks above, the Committee recommends that the hard timeline be replaced with a stipulation that 95 per cent

[24] Presently, ₹500 crore

of the incremental portfolio of these banks should be corresponding to the aforesaid prescriptions till the overall loan book conforms to the stipulated composition.

v) While there will be no regulatory imperative for UCBs in tier 4 to become members of the UO, since the latter intends to emerge as an all-encompassing entity in the UCB sector, if UCBs find value in becoming its member, they can do so.

6.7.2 Recommendations on Sectoral Exposure Ceilings

As already mentioned, regulation of UCBs in Tier 3 and Tier 4 will be largely on par with SFBs and UNBs, respectively. For Tier 1 and Tier 2 banks, the following modifications are recommended to give more operational freedom to these banks, subject to banks meeting the suggested regulatory requirement of CRAR and net worth:

6.7.2.1 Housing Loan

i) The maximum limit on housing loans may be prescribed as a percentage of Tier 1 capital, subject to RBI prescribed ceiling for Tier 1 UCBs (but higher than the present ceiling) and respective Board of Directors-approved ceiling for Tier 2 UCBs.

ii) For Tier 2 UCBs, the risk weight on housing loans may be prescribed based on size of the loan and loan-to-value (LTV) ratio, in line with SCBs.

6.7.2.2 Loan against Gold Ornaments with Bullet Repayment Option

i) The maximum limit on loan against gold ornaments extended on bullet repayment terms may be prescribed as a percentage of Tier 1 capital, subject to suitable LTV ratio.

ii) There may be an RBI prescribed ceiling (higher than the present ceiling) for Tier 1 UCBs and respective Board of Directors-approved ceiling for Tier 2 UCBs.

6.7.2.3 Unsecured Advances

i) For banks in Tier 1 and 2, the maximum limit on individual unsecured loans may be linked to Tier I capital, subject to a suitable upper cap for Tier 1 banks. Tier 2 banks may have a Board-approved ceiling.

ii) The present aggregate limit on unsecured advances, i.e., 10 per cent of total assets may continue. However, the UCBs may be allowed to have a higher limit with the approval of their Boards and subject to the condition that the loans exceeding the aforesaid 10 per cent limit must qualify to be classified as PSL.

6.7.2.4 For UCBs in Tier 2, the limit on exposure to various sectors may be removed on par with other banks. However, to mitigate the concentration risk (coupled with geographical concentration risk), additional standard asset provisioning may be imposed on exposure to a single sector beyond a specified percentage of the loan portfolio (say 20 percent).

6.7.3 Other Recommendations

6.7.3.1 Board of Management

Since the recent amendments to the BR Act largely addresses the issues related to management and governance in UCBs with powers to RBI for prescribing ‘fit and proper criteria’ for directors and MD/CEO and requirement for minimum of 51 per cent of the directors having special qualification or experience, the extant guidelines related to constitution of Board of Management may be withdrawn. RBI should strictly enforce the new provisions of the BR Act with regard to Governance. A toolkit of appropriate regulatory responses besides enforcement action may be put in place. Details regarding the Board of Management have been discussed in Annex 8.

6.7.3.2 Computation of Tier I Capital

Revaluation Reserve may be considered for inclusion in Tier I capital, subject to applicable discount on the lines of scheduled commercial banks.

6.7.3.3 Inclusion of UCBs in Government sponsored schemes

The Committee recommends that the UCBs should be included as eligible banks under the Government Schemes such as MUDRA, interest subvention/ subsidy scheme. UCBs should also be allowed to undertake Government business subject to them meeting the prescribed criteria.

6.7.4 Umbrella Organization (UO)

i) RBI granted an ‘in-principle’ approval to NAFCUB in June 2019 to set up a UO in the form of a non-deposit taking NBFC. Necessary regulatory forbearance has also been provided, such as those related to investment in shares and ceiling on non-SLR investments by UCBs to enable them to buy shares in the UO.

ii) As per the model presented to the Committee, the UO would provide HR, IT and financial support to its federating members and, in due course, it will service the member UCBs on the client side and provide interface to the world of mainstream finance. The UO is also expected to provide all value-added services like those related to treasury, forex, international remittances, credit and debit cards, insurance, social-security and pension products, etc. which are desired by the customers, but smaller UCBs are not able to provide the same due to their limited scale / ability. The UCBs will also be able to leverage the technological prowess of the UO as they are expected to link up to the shared computing and technology services on cloud which will be managed by the UO. Any change in technological infrastructure in future due to business or regulatory requirements would also be easier to manage at the UO level at a lower unit cost to UCBs.

iii) While the UO is envisaged as the provider of scale through network to the smaller UCBs and the proposed reduction in capital requirements on becoming a member of the UOs shall incentivise them to acquire the UO membership, there should be no bar on the larger cooperative banks voluntarily joining the UO to derive the benefit of branding. The membership of the UO could also be opened to all types of co-operatives. While financial co-operatives would use most of the services of the UO, the non-financial co-operatives could use certain specific services provided by it, such as wallet services, cash management services and restricted/regulated access to payments and remittance systems. The contribution that the members make to the UO may, *inter alia*, be in the nature of share capital which will be permanently with the UO. It will have incremental membership with new members joining the UO, possibly at a premium that may be decided from time to time.

iv) The UO is expected to play a crucial role. For that, it must be a financially strong organization with adequate capital and a viable business plan.

v) The minimum capital for the UO should be ₹300 crore with regulatory stipulations including in respect of governance and prudential framework akin to those for the NBFCs in the highest regulatory tier.

vi) Once the UO stabilizes, it may explore the possibilities of converting into universal bank and offer value added services on behalf of its member banks. With suitable structural flexibility to operate as a bank, the UO can be owned by the co-operative institutions even if it is a joint stock company, which may encourage the smaller UCBs to become an extended arm of such a bank.

vii) In the medium term, the UO may also take up the role of a Self-Regulatory Organization (SRO) for its member UCBs. For this, the UO could run an independent audit/inspection and supervisory division that may conduct both offsite and onsite supervision. In this context, the UO should be evaluated for quality of internal controls to enable it to play this role.

viii) The UO can emerge as the focal point for identifying training needs of the staff and directors of its member banks. It will need to train the persons working in the front end of the member banks and also on other aspects of their banking business.

ix) The UO is expected to mobilize necessary capital from its promoters and others to be able to get Certificate of Registration from the RBI. Once the COR is issued and the UO commences its business, RBI could consider providing a one-time grant to the UO for a specific objective, tied to providing IT support to its member banks. Since aggregation of IT services will be a financial inclusion enabler and can also contribute to system-stability through standardisation of the IT interface, RBI's financial support to the UO would be justifiable.

Chapter 7

CAPITAL AUGMENTATION FRAMEWORK FOR UCBs

7.1 Banking, unlike other businesses, is a highly leveraged business involving acceptance of deposits from the public without any security. Debt-Equity ratio of banks can be as high as 15:1 or even more, as against other businesses where it generally does not exceed 3:1. While it is for these reasons that banking is among the most regulated businesses globally, the availability of capital in conformity with the regulatory requirements and ability to augment it as and when needed is critical for idiosyncratic and system stability. The regulatory capital requirement is articulated through the global standards set by the Basel Committee on Banking Supervision and enshrined in the legislative framework.

7.2 Empirical evidence suggests that banks seldom get into financial troubles if they are run prudently, within a well-articulated and executed risk management framework with proper strategies, policies, systems and processes in place, except in the face of a major systemic event. The regulatory capital framework looks to ensure idiosyncratic solvency in the event of unknown risks under normal circumstances manifesting. Further, in the case of black swan events like the COVID pandemic, it is the banks that are well capitalized, and seen to have the potential to infuse additional capital, which show greater resilience.

7.3 Capital is needed for sustenance as well as growth. A bank having very low level of capital may not be able to mobilize deposits beyond a certain point. As a result, its growth will be affected. On the other hand, if it somehow continues to mobilize deposits without commensurate increase in its capital, it exposes the depositors to a higher degree of risk and adversely affects the degree of regulatory comfort as well. Adequate level of capital provides enhanced ability to bear shocks from financial stress. A small amount of capital can be easily eroded in case of a severe financial stress, whereas a higher level of capital enables a bank to absorb unforeseen losses and still continue to grow its business.

7.4 Capital is also needed for adoption of modern banking technology. Merely having CBS is no longer adequate for a bank. Banks need to invest in or have the capacity to acquire superior technologies, e.g., for CTS, ATM, Debit/Credit Cards, ever evolving Payment System Infrastructure, Data Analytics, MIS, etc. All these are capital intensive investments. A bank having low level of capital, even as it may be meeting the minimum CRAR requirement, may not be able to invest adequately on these assets, thereby lagging behind in customer services as well as risk management.

7.5 Minimum Capital Requirement

7.5.1 The bare minimum capital (paid-up capital and reserves having real and exchangeable value) that is required to be maintained for making a co-operative bank eligible to commence and carry on the banking business has also been prescribed in the BR Act[25]. This bare minimum capital of rupees one lakh was prescribed in the year 1965 when the provisions of the Act were made applicable to co-operative societies. With the passage of more than five and a half decades, this amount has lost its significance. The position is similar in the case of banking companies as well, wherein the maximum capital (paid-up capital plus reserves) has been fixed at rupees ten lakhs for a banking company registered in India. However, in addition to the above requirement, every bank licensed under the BR Act (including a co-operative bank) is required[26] to have adequate capital structure on an ongoing basis as one of the conditions for getting as well as holding a banking license. RBI has prescribed entry point capital requirements and CRAR requirements for banks to ensure fulfilment of this condition.

7.5.2 As per the extant policy of RBI, while the capital requirement as per the entry point norms (EPN) for universal commercial banks is ₹500 crore, and that for small finance banks is ₹200 crore, for a general category UCB at an ‘A’ centre (> 10 lakh population), the initial capital requirement is only ₹4 crore. This requirement is ₹2 crore for a ‘B’ centre (population 5-10 lakh), ₹1 crore for a ‘C’ centre (population 1-5 lakh) and ₹25 lakh for a ‘D’ centre (population < 1 lakh population). For specialised UCBs (viz., banks organised as unit banks, banks organised by Mahilas/SC/STs and banks organised in less developed states/North Eastern states/Tribal regions), the entry point capital ranges between ₹8.33 lakh to ₹3 crore depending on the population of the centre. These norms were prescribed 21 years ago. Since then, though the deposits of UCBs have grown multifold, no revision in the minimum entry point capital requirements has been made.

7.5.3 In the year 2011, i.e., about a decade ago, Malegam Committee had recommended EPN capital ranging from ₹50 lakh to ₹5 crore based on centre / area of operation, whereas in the year 2015, HPC (Gandhi Committee) recommended EPN capital of ₹25 crore to ₹100 crore for various categories of UCBs. Traditionally, the EPNs have been based on population of the centre from where the banks were supposed to start operations. Also, different levels of entry point capital were prescribed for banks for women/SC/ST or those in North-East Region. For a bank which runs under the same set of regulations with the same set of objectives and challenges, the aforesaid differential capital requirement is fundamentally flawed as it seeks to bring in developmental objectives to the fore at the cost of the basic soundness of the banking institution.

[25] Section 11 read with Section 56 of BR Act

[26] Clause (d) of Sub-section (3) of Section 22 of BR Act

Irrespective of the geographical area where the bank is based or the constitution of its membership, capital requirements should be designed to ensure that the bank can withstand the risks faced in the banking business. Differentiation in this regard should only be based on the size of operations of the bank.

7.6 CRAR Requirement

7.6.1 Apart from the minimum capital requirements as entry point norms, RBI has prescribed minimum CRAR for UCBs, which currently stands at 9 per cent of the risk-weighted assets. Presently, CRAR is calculated taking into account the credit risk of UCBs, as Basel I norms have been applied to UCBs, irrespective of their size of operations, except for AD Category-I UCBs which have to maintain capital for market risk as well. As on March 31, 2020, there were about 80 UCBs which did not have even the minimum CRAR prescribed.

7.6.2 As discussed earlier in the report, the UCBs were constrained in their ability to raise capital because of co-operative character and absence of enabling statutory provisions. The amendments to the BR Act provide additional avenues for UCBs to augment their capital. Considering these aspects, the Committee has found it appropriate to recommend minimum capital (net worth) and CRAR requirements for different tiers of UCBs in Chapter 6 and consequently also recommended to allow more operational freedom to enable them to grow. This chapter discusses the impact of the amendments to the BR Act insofar as they relate to enhancement of the ability of the UCBs to raise capital and recommendations of the Committee in this regard.

7.7 Changes made under the BR Act

The Banking Regulation (Amendment) Act, 2020 has brought in a new provision[27] for enabling co-operative banks to raise capital and quasi-capital funds by way of public issue or private placement to any member of the co-operative bank or any person residing within its area of operation. The amendment has also enabled co-operative banks to raise capital at premium. Both these ways of raising capital are at present alien to co-operative sector, where the main sources of capital have been through membership (including share-linkage to borrowing) and retained earnings. Considering that the aforesaid amendment has provided overriding effect to the provisions of BR Act over the co-operative laws governing these banks, it is expected that the UCBs would be able to utilise these provisions to raise capital through the specified means irrespective of the position under the respective co-operative acts. This has obviated some of the

[27] Section 12 read with section 56 of the BR Act

bottlenecks in the law for raising capital as discussed in the Report of the Working Group to Examine Issues Concerning Raising of Capital by Primary (Urban) Co-operative Banks (2006)[28].

7.8 Present Position on Share Issues by UCBs

7.8.1 Most of the co-operative banks are organised based on community or regional or ethnic affiliations and the membership with voting rights are held on those lines. The byelaws accordingly provide for the class of persons who are eligible to become shareholders of a co-operative bank. Therefore, the main source of share capital is through membership / share linkage. Borrowers who subscribe to shares of the UCB as a part of share-linkage tend to surrender the shares and seek refund once the loan is repaid, as they do not have any long- term interest in investing in the co-operative bank. As such, capital raising through share-linkage may not be a feasible way of having sustainable and resilient share capital.

7.8.2 Nevertheless, there have been instances, howsoever rare, where certain individuals/groups have invested in the shares of co-operative banks on the appeal of the members of the society to tide over their capital adequacy requirements. Further, investments in shares by senior citizens who are attracted by the high dividends paid by some of the co-operative banks has also been an important source of capital for UCBs.

7.9 Public Issue and Listing

7.9.1 In the case of companies, any issue of securities to public through issue of prospectus is considered as a “public offer”[29]. Further, private placement of any security to more than 200 persons (excluding placements to Qualified Institutional Buyers and through ESOPs) in aggregate in a financial year is deemed to be a public offer[30]. SEBI has come out with the requirements that need to be fulfilled by companies for making public issue of securities[31]. SEBI derives the power to regulate issue of securities by companies and corporations from the Companies Act, 2013 and the Securities Contracts (Regulation) Act, 1956 (SCRA) read with the Securities and Exchange Board of India Act, 1992. As the Companies Act, 2013 is not applicable to co-operative societies and the issue/listing of securities (both shares as well as debt instruments) by co-operative societies are not governed by SCRA[32] and SEBI Act, SEBI’s jurisdiction does not extend to issue

[28] The restriction on types of securities that are permitted to be issued, issuing shares at premium and modes of issuance (public issue or private placement). However, even under Section 12 of BR Act, securities can be issued only to any member or person residing within its area of operation. There is no restriction in co-operative banks borrowing by way of bonds or debentures even from persons outside the area of operation, to the extent permitted by the applicable co-operative law.

[29] Section 23 of the Companies Act, 2013

[30] Section 42(11) of the Companies Act, 2013

[31] Securities and Exchange Board of India (Issue of Capital and Disclosure Requirements) Regulations, 2018

[32] In Section 2(h)(i) of SCRA, “securities” is defined to include “shares, scrips, stocks, bonds, debentures, debenture stock or other marketable securities of a like nature in or of any incorporated company or other body corporate”. The word “body corporate” is not defined in SCRA. However, section 2A of SCRA provides that words and expressions used in that Act, but not defined, shall have the meanings assigned to the under the Companies Act, 1956, SEBI Act or Depositories Act, 1996. The expression “body

of securities by co-operative banks. In view of the above, listing of securities issued by co-operative banks on recognised stock exchanges under SCRA would not be legally possible[33] at this stage. Further, there is no scope of value appreciation of shares of co-operative banks through price discovery in the secondary market. The listing of a security provides a secondary market for the investors. This, in turn, leads to greater liquidity and the potential investors would then not be limited to only those who may want to hold the securities till maturity or for perpetuity.

7.9.2 The Committee is of the view that the recent amendments to the BR Act need to be supplemented by legislative enablement for listing of certain securities issued by the UCBs. As there is no corresponding law in the co-operative realm, it is difficult to categorise the issuance of securities made by co-operative banks into "public offers" and "private placements" in the manner these are known in case of companies. However, going by the principles of the Companies Act, such issuances can be categorised based on the intention of the issuer, that is, whether it is intended to be open for subscription by any person eligible under the co-operative law to subscribe to the shares of the co-operative society or whether it is intended to be subscribed by only those persons to whom the shares have been offered privately. Furthermore, considering the restrictions relating to area of operation, such public issues/private placements, though could be at premium, can only be made to persons residing within the area of operation of the bank.

7.9.3 The Committee examined the various options for legislative enablement to facilitate listing of securities issued by UCBs. It noted that any amendment to the SCRA and the SEBI Act to include securities issued by co-operative banks may pose significant unintended negative consequences. Such an amendment may lead to all issues of shares and debt instruments by all co-operative banks in India being governed by SCRA and regulated by SEBI. As a majority of the co-operative banks (which are small in size and operation) may not be in a position to issue such securities to the public and considering the fact that the main avenue today for raising capital is through share linkage at the time of lending, bringing in such compulsory requirements for all issue of securities may put further hurdles in the attempts of UCBs in garnering resources.

7.9.4 Considering the need for listing the securities issued by co-operative banks and given the constraints discussed above, **a suitable amendment could be made in the BR Act, enabling RBI, being the regulator and supervisor of the sector, to notify certain securities (shares or debenture or bonds) issued by any co-operative bank or class of co-operative banks as**

corporate" is defined under the Companies Act, 2013 (which is a re-enactment of the Companies Act, 1956) specifically excludes "a co-operative society registered under any law relating to co-operative societies" from its purview. Companies Act, 1956 also had a similar exclusion.

[33] Though under Section 2(iia) of SCRA, "securities" include "such other instruments as may be declared by the Central Government to be securities" also, considering the specific exclusion applicable to co-operative societies as mentioned hereinabove, and also the use of the words "such other" in this provision, notifying instruments issued by co-operative societies under this clause, may not be feasible.

“securities” for the purpose of SCRA and SEBI Act. This would ensure that not all securities issued by a co-operative bank is required to comply with SEBI regulations and limit compliance with SCRA and SEBI Act provisions to the securities notified by RBI.

7.10 Valuation of Shares

While the statute[34] governing multi-state co-operative banks require that redemption of shares have to be at face value, that statute does not impose such restrictions on transfer of shares from a member to another person. The valuation of shares, when made by a member to another member duly admitted by the society, are in some states governed by the rules framed by the state government[35], which takes into account the valuation based on the financial position of the society. However, there are certain states which have prescribed that such transfers have only to be at face value[36].

7.11 Challenges

While the BR Act does allow issue of shares at a premium, the lack of economic incentives for an investor poses a real challenge for its implementation on the ground. The normal economic incentives that drive investment in shares of any entity are ‘control’ and ‘returns’, the latter both in the form of dividend and appreciation of the share value. The former is not possible in a system involving ‘one man one vote’ principle, especially when a large number of shares are issued. Appreciation of the share value is also difficult to realise even if the intrinsic enterprise value goes up because the bank cannot redeem shares at a premium and there is no secondary market. The legal constraints in listing the shares of a co-operative entity on a recognised stock exchange would accentuate this difficulty.

7.12 Other Capital Instruments

7.12.1 UCBs are now permitted to issue the following instruments for augmenting their capital requirements:

Tier I Capital

- Perpetual Non-Cumulative Preference Shares (PNCPS),
- Innovative Perpetual Debt Instruments (IPDI) (for financial restructuring of weak UCBs)

Tier II Capital

- Perpetual Cumulative Preference Shares (PCPS),

[34] Section 35(2) of the Multi-State Co-operative Societies Act, 2002

[35] Though the Maharashtra Co-operative Societies Act, 1960 does not impose any restriction on value of transfer, rule 23 (3) of the Maharashtra Co-operative Societies Rules, 1961 mandates that the transferee shall not be required to pay anything in excess of the amount arrived at by a valuation based on the financial position of the society as shown in the last audited balance sheet preceding the cessation of membership

[36] Rule 82(2) of the Uttar Pradesh Co-operative Societies Rules, 1968 (accessed from http://www.bareactslive.com/ALL/UP317.HTM#0)

- Redeemable Non-Cumulative Preference Shares (RNCPS),
- Redeemable Cumulative Preference Shares (RCPS), and
- Long Term (Subordinated) Deposits (LTD)

7.12.2 Though the above options are available to UCBs for raising capital for the last several years, there has not been much capital raising through these routes with a few exceptions, mainly in the form of some banks accessing funds in the form of LTDs. Non-availability of a clear legal framework could be attributed as one of the reasons for these instruments not getting the desired level of acceptance. It is expected that with the provisions of the BR Act and consequent issue of exhaustive guidelines from the RBI would reduce the above constraint significantly.

7.13 Recommendations

7.13.1 Share Capital

Issue of shares to the public and at premium has been allowed after the recent amendments to the BR Act, which should, in the future, be supported by amendments to the BR Act to facilitate listing of shares, thereby enabling transparent discovery of price and bringing in requisite transparency. However, till such amendments are in place, RBI may consider allowing larger banks in Tier 3 and 4, having the necessary technology and wherewithal, to issue shares at premium to person residing in their areas of operation.

Accordingly, the recommendations of the Committee are as under:

i) Amendments to the BR Act for enabling RBI to notify through a Gazette Notification the classes of instruments as "securities" for the purpose of SCRA and SEBI Acts, to enable their listing and trading on stock exchanges.

ii) Till such amendment comes into force, banks may be allowed to have a system on their websites facilitating buyers and sellers of shares to indicate their interests to buy / sell securities at book value, subject to the bank ensuring that the prospective buyer is eligible to be admitted as a member.

iii) RBI may provide the broad mechanism for guidance of the banks to determine the valuation (book value) based on their last audited financial statement.

iv) The statutory auditor of the bank may be required to certify the book value of the shares as per RBI's directions.

v) Eligible banks may be required to publish their financial statements more frequently (say, quarterly/half-yearly) for transparency. The banks may also be required to carry out valuation of their shares with certification by the auditors at quarterly/ half yearly intervals. The valuation of the shares should be disclosed by banks on their websites.

vi) The banks should disclose the price / volume and other important data with respect to all buy / sell transactions on their website for the guidance of other prospective investors.

vii) Banks should not be allowed to issue fresh shares at less than the book value certified by the Statutory Auditors. However, the transactions between members may happen at the price negotiated by the buyers / sellers.

viii) Redemption of the shares with the bank may only be as per the provisions of the concerned Co-operative Societies' laws. Where legislations permit redemption at higher than face value, redemption value may not be more than the price paid at the time of the primary issuance of the share and in any case not higher than the book value at the time of redemption.

ix) UCBs should be required to disclose other important information like divergences identified by the RBI, penalties imposed by the regulators, etc. on their websites for the benefit of the investors.

7.13.2 Perpetual Non-cumulative Preference Shares (PNCPS)

Currently, apart from regular members, UCBs are allowed to grant loans to nominal members. Nominal members do not have a vote. The current regulations prescribe a monetary ceiling of rupees one lakh on the amount of loan that can be granted to nominal members and restrict the number of such borrowers to 20 per cent of the regular members. The general shareholders' incentive to invest in shares of UCBs is that it enables them to borrow from the bank. The current tepid interest to invest in PNCPS can, to some extent, be overcome if such investors are allowed to borrow from the UCB. The UCBs and their federations sought a relaxation in the regulations with regard to lending to nominal members. Taking this into consideration as also to create an enabling environment for potential investors in PNCPS, the Committee recommends that UCBs may be permitted to grant advances to subscribers of PCNPS subject to the amount of loan being a limited multiple of the PNCPS subscribed to by the investor. The number of such borrowers and other nominal members having credit facility shall not exceed 20 percent of the total borrowing members of the UCB. In other words, the PNCPS subscribers who have borrowed from the bank will be akin to nominal members except that there shall not be a monetary ceiling of ₹1 lakh on the loans in their case but a limit in the form of a multiple of their subscription to PNCPS.

7.13.3 Treatment of donations, grant-in aids and other contributions of charitable nature

i) The issue of permitting UCBs to raise capital funds through donations / grants-in-aid / contribution from NGOs, Corporates, Co-operative entities, etc. was deliberated by the Committee. One view was to treat such contributions as paid-up capital, as these funds will be permanent and without any encumbrance / obligation to repay in future. Such contributing persons can become sympathiser members without voting rights as provided under Section 27 of the Maharashtra Co-operative Societies Act, 1960. Admission of such persons as members will also resolve the issue of KYC verification which is carried out at the time of admission of members.

ii) However, there was a counterview that the amount of donation/ grants-in-aids / contributions is required to be credited to Profit and Loss Account as per the accepted accounting practices. Consequently, after paying income tax on such income, certain portion of the profit gets transferred to reserves as per the legal provisions, which anyway is considered for net worth. Furthermore, only persons of eminence are generally admitted as sympathiser members who are not expected to contribute to share capital in the normal course. If such members contribute to the capital, they will have to be assigned the same rights as ordinary members according to the co-operative laws. The Committee recommends that for providing an avenue for persons to contribute to capital in the form of donations / grants-in-aid / contribution without accompanying voting rights, feasibility of issuing an alternate instrument, possibly in the form of Redeemable Preference Shares with very low coupon rate and maturity of 20 years could be considered.

Chapter 8

RESOLUTION AND CONSOLIDATION OF UCBs

8.1 As discussed earlier in the report, with the amendments to the BR Act in the year 1966, a large number of primary credit societies which were hitherto carrying on the business of banking among the closed section of its members were made eligible for approaching RBI for a bank licence. Over the years that followed, a large number of such small co-operative societies emerged as UCBs. However, licensing of such large number of entities with a nominal capital requirement and lack of professionalism led to proliferation of weak UCBs. Thus, highly liberalized licensing policy for UCBs in comparison to that in place for other banks ultimately gave rise to concerns associated with the future of UCBs. The frailties of co-operative society as the business organisation undertaking banking business came to the fore whenever the sector witnessed a crisis.

8.2. Crisis in the Co-operative Banking Sector

8.2.1 The first major crisis in the sector was witnessed at the turn of the current millennium, caused by the failure of Madhavpura Mercantile Co-operative Bank (MMCB), an Ahmedabad headquartered multi-state UCB. MMCB had a branch in Mumbai, Maharashtra, besides branches in the state of Gujarat. It was a classic case of the effects of a bank moving out of its co-operative moorings both in terms of its business model and asset allocation. MMCB became like a bank to other co-operative banks and raised deposits from them. It used the liabilities to lend large sums to a stockbroker whose default not only put the retail depositors of MMCB in jeopardy but created a systemic risk to the smaller UCBs whose funds were placed with it. The news of MMCB's large exposure to a stockbroker facing default triggered a run on the UCB and on the other smaller UCBs that had exposure to it. There was a similar problem in the then undivided Andhra Pradesh, where the failure of a relatively large bank based out of that state (not a multi-state bank) due to high NPAs triggered a panic in the UCB sector in the state.

8.2.2 It is instructive to note that while a commercial bank that ran into difficulty around the same time could be resolved without loss to the depositors, both the aforesaid co-operative banks had to be eventually taken into liquidation with losses to their depositors as also to the depositors of some of the other banks which had placed funds with them. These episodes had a series of ripple effects on the UCB sector. Nearly one-third of the newly licensed UCBs, became financially unsound within a short period. The market share of UCBs declined from about 6.3 per cent to about 5.8 per cent immediately after the MMCB crisis. Taking cognizance of the crisis, RBI took a series of measures including coming out with a vision document and creation of a forum *viz.* Task Force for Co-operative Urban Banks (TAFCUB) for tripartite consultation between the RBI, the State/Central Government and the UCB sector representatives through a Memorandum of Understanding with the State/Central Governments. The emphasis was on strengthening the weak UCBs and facilitating the non-disruptive exit of the irretrievably unviable banks.

8.2.3 Given that the ability of the measures to reduce occasions for liquidation of unviable banks hinged on voluntary actions by the UCB sector participants in particular, the success of these options petered over a period of time for various reasons. Consequently, the fragility of the UCB sector keeps getting exposed with a disconcerting regularity, weaning away current and potential customers. The larger the deposits of a bank, the more difficult its non-disruptive resolution becomes, which constrains the regulator from pursuing an entity growth-friendly policy.

8.2.4 This historical perspective highlights the importance of an effective resolution framework that results in minimal, if not zero, loss to depositors of a bank to maintain depositor confidence in the co-operative banking system. Despite the history of the RBI in resolving commercial banks' issues without loss to depositors, panic run on them at the hint of a problem does occur. A run on a bank which is solvent or whose solvency can be restored will no doubt lead to a liquidity problem, but the consequent preferential payments are at best temporal. In contrast, a run on a bank that is irreversibly insolvent or approaching irretrievable insolvency results in preferential payments that are non-temporal in nature and hence detrimental, *inter se*, to other depositors of the bank and the public interest at large.

8.3 Supervisory Action Framework

8.3.1 To instil confidence in the depositors and arrest deterioration in the financial position of UCBs by initiating early supervisory interventions, RBI adopted, in the year 2003, a system of categorizing banks into four grades based on objective parameters comprising capital adequacy, asset quality, earnings, compliance with CRR/SLR requirements and adherence to RBI guidelines / directives. While Grade I represented banks with no major supervisory concerns, the other three grades indicated supervisory concerns in varying degree, thereby developing a graded supervisory action (GSA) framework.

8.3.2 With the transition to 'CAMELS' model for supervisory rating from the then existing grading system, the framework of supervisory action, too, had to be realigned. Accordingly, a Supervisory Action Framework (SAF) was prescribed by RBI in March 2012 which replaced the then GSA framework. Under SAF, RBI specified regulatory trigger points in terms of five financial parameters, *viz.*, CRAR, Gross NPA, concentration of deposits, profitability, and CD ratio for initiating structured and discretionary action in respect of banks hitting such trigger points. SAF was subsequently revisited in the years 2014 and 2020 to rationalize the triggers and partly overcome the limitations of a delayed resolution process.

8.3.3 Supervisory Action Framework, which, to a certain extent, resonates with Prompt Corrective Action framework for commercial banks, envisages early corrective action by UCBs themselves as well as appropriate regulatory/supervisory intervention by RBI to arrest further deterioration of the financial health of a UCB with an overall objective of protection of depositors' interest. When the weak financial position of a UCB culminates in negative net worth and erosion of deposits, the framework envisages issue of Directions including "All-Inclusive Directions (AID)" under Section 35A of the BR Act (AACS). Directions can also be issued on occurrence of other exceptional circumstances like run on a bank, reports of severe liquidity crunch, complaints of non-payment or preferential payment of deposits, market information regarding problems related to management, etc. Once AID is imposed on a bank, it has two alternatives – either to revive by way of fresh capital infusion and/ or by improving recoveries thereby improving its financial position or exit in a non-disruptive manner by voluntary merger with a stronger bank or conversion into a non-banking society. In case none of the options work, the bank has to be taken into liquidation after cancellation of licence.

8.4 Non-Disruptive Exit

Exit through voluntary merger is discussed in greater detail in the subsequent paragraphs of this chapter. Voluntary conversion of weak UCBs into a non-banking society can be resorted to by payment of deposits of non-members or for making provision for such payments in a manner acceptable to RBI. The option is suitable for smaller UCBs which have a large amount of member deposits. Although the RBI guidelines are in place for many years, it has failed to elicit desired response from the UCBs concerned.

8.5 The existing SAF framework and its effectiveness

8.5.1 The approach for the SAF envisaged in the year 2012 by RBI has seen substantial modifications by the year 2020. Efforts have been made by RBI to reduce the number of indicators (which used to be CRAR, GNPA, Incremental NPA, CD Ratio, Net Worth, Profitability), modify their form, rationalize the trigger thresholds and reduce the number of stages for implementation of various regulatory/supervisory action. The present SAF with only three major indicators, namely CRAR, Net NPA and profitability, is relatively more focused, and less cumbersome to implement and monitor. However, a majority of the UCBs being very small, an elevated level of deterioration in the asset quality often quickly triggers erosion of capital making their resolution difficult. The smaller UCBs are loath to pursuing voluntary mergers when they still have a positive net worth and when they are ready, they often cease to be target of interest to acquiring banks.

8.5.2 The Committee noted that even though the present SAF aims to start the resolution process early, close to one third of all UCBs consistently remain under the SAF over the years. This raises concerns about their functioning as also the efficacy of the resolution process.

8.5.3 The Committee further noted that licenses of about 40 UCBs have been cancelled in the last five years and they have been taken into liquidation/voluntary merger/conversion into non-banking society. The following table broadly depicts the health of the weak UCBs over the last six years:

Table 5: Movement in the number of weak UCBs since 2014

Particulars	March 2014	March 2015	March 2016	March 2017	March 2018	March 2019	March 2020
No. of UCBs	1589	1579	1575	1561	1551	1544	1539
Negative NW UCBs	55	51	44	37	32	46	59
C/D rated UCBs	419	353	356	343	327	337	364

8.5.4 One of the objectives of the SAF has been to eliminate negative net worth UCBs which has yet not been achieved due to fresh slippages. The Committee feels that achieving the objective in its totality is difficult due to the following reasons:

i) Given the presence of a large number of UCBs in the country, most of which are small, one or the other UCB keeps slipping into negative net worth territory and these fresh slippages offset or even exceed the reduction in the number of negative net worth UCBs.

ii) Inability of UCBs to swiftly raise capital as and when necessitated does not help them to come out of the red.

iii) Delay in resolution of weak UCBs when they are still solvent is also identified as a reason as resolution of a negative net worth UCB becomes far more difficult.

8.6 The Proposed SAF – Twin-Indicator Approach

8.6.1 The Committee feels that the "multiple indicators - multiple stages" approach of the existing SAF mechanism needs a relook. If a UCB remains under more stringent stages of SAF for a prolonged period, it may have an adverse effect on its operations and may further erode its financial position. Delay in initiating the resolution process causes inconvenience to the depositors/customers and further lead to erosion in the enterprise value including deposits. Therefore, the Committee, after an extensive deliberation, recommends that **the framework may contain twin indicator only, viz. CRAR and Net NPA, with an emphasis on reducing the time spent by a UCB under SAF**. Key benefits arising out of the proposed approach will be as under:

i) It will help in reducing the number of weak UCBs by advancing supervisory actions and expediting the resolution process.

ii) It will make the framework more focused and less cumbersome to implement and monitor.

iii) Time element for implementation of stricter action will be easy to understand for UCBs, enabling them to plan accordingly.

8.6.2 The Committee also finds it appropriate that the **additional provisioning suggested by the Inspecting Officers (IOs) should be adjusted from GNPA to arrive at assessed NNPA similar to the adjustments in Tier I capital done to arrive at assessed CRAR**. **TAFCUB intervention may also be envisaged if the divergence is large leading to significant increase in NNPA and reduction in CRAR. Such banks may be flagged for discussions TAFCUB and early intervention.**

8.6.3 Recommendations on SAF

8.6.3.1 Ideally, the SAF should be based on the single indicator of solvency, namely CRAR. However, at different levels of provision coverage ratio, CRAR as a single indicator for supervisory interventions can result in inconsistencies. An alternative to this could be the use of Derived CRAR (See Box 5). While a single indicator-based SAF could be thought of as a medium-term goal, the SAF for now should follow a twin-indicator approach, i.e., it should consider only asset quality and capital measured through NNPA and CRAR. The objective of the SAF should be to find a time-bound remedy to the financial stress of a bank.

8.6.3.2 As hitherto, actions under the SAF may continue to be segregated into mandatory and discretionary. The action based on the suggested twin indicators may be taken by the RBI without reference to TAFCUB. However, there could be banks with other supervisory concerns like stress in profitability, governance related concerns, etc., all of which call for further corrective action on the part of the banks. These may be considered for discretionary action in consultation with TAFCUB for banks in Tiers 1 and 2.

8.6.3.3 All-inclusive Directions should be treated on par with moratorium under Section 45 of BR Act and, if imposed, a bank should not continue thereunder beyond the time permitted to keep a bank under moratorium *viz.*, three months extendable by a maximum of another three months. As discussed earlier, resolution of weak UCBs has been a long-drawn process. UCBs continue to remain under AID for extended periods during which often their financial position deteriorates further and non-disruptive resolution becomes even more difficult. Liquidation of such banks results in considerable hardships to all depositors and haircuts for large depositors (those having deposits in excess of DICGC cover). To mitigate the difficulties, among other things, it is recommended that at some stage, the weak banks should be visited with a regulatory nudge to explore the possibility of voluntary merger or conversion into a non-banking society at an early stage with the clear understanding that in the absence thereof, the powers for mandatory resolution would be employed.

8.6.3.4 Further, in view of the powers derived from the recent amendment, RBI may strive to begin the mandatory resolution process including reconstruction or compulsory merger as soon as a UCB reaches Stage III under the SAF. RBI may also consider superseding the Board if the bank fails to submit voluntary merger / conversion proposal within the prescribed timeframe and take necessary steps to avoid undue flight of deposits once the news becomes public.

8.6.3.5 Accordingly, **the following broad structure is recommended for SAF**:

Stage	**Indicator / threshold*** **(Action to be initiated if any or both indicators breach the thresholds)**		**Recommended Action**
I	CRAR < 9% but ≥ 6% **and/or**	NNPA > 6% but ≤ 9%	Besides other supervisory actions under the SAF, it is recommended as under: • Bank to be advised to recoup CRAR and reduce NNPA within a given time frame, say within six months to one year. • It may be clearly emphasized at this stage that if situation does not improve within a year or deteriorates further, resolution process may start from Stage II. • Branch expansion should not be allowed.
II	CRAR < 6% but ≥ 4.5% **and/or**	NNPA > 9% but ≤ 12%	• Bank to submit an action plan within one month of being placed under Stage II of SAF for increasing CRAR and reducing NNPA to, at least, Stage I levels within a time frame of one year. • Total time under Stage I and II together should not be more than one year. • If proposal to improve CRAR and reduce NNPA is not feasible, bank may submit proposal for voluntary merger or for conversion into a non-banking society within six months of coming into Stage II. RBI may strive to approve the merger proposal within two months. • Emphasis should be on time spent under SAF irrespective of the stage/s. Once a year elapses since the imposition of SAF, exit through voluntary merger, and not improvement in financial position, should be the objective. • Branch expansion should not be allowed in Stage II • Once in Stage II, RBI should put supervisory restrictions in terms of the exposure ceilings, exposure to sensitive areas, governance measures, restrictions on expenditure, etc. based on circumstances of each case.
III	CRAR < 4.5% **and/or**	NNPA > 12%	• If a bank directly falls under Stage III of SAF, it should submit an action plan within one month of being placed under SAF for either enhancing the CRAR to the prescribed level or for voluntary merger or for conversion into a non-banking society within six

			months to one year. Other restrictions to follow as given under Stage I and II. • Emphasis should be on time spent under SAF irrespective of the stage. Once a year has elapsed since the imposition of SAF, voluntary merger and then mandatory resolution should be the objective and not improvement in financial position. • If a bank slips from Stage I or II to Stage III, once a year has elapsed since imposition of SAF, RBI may directly initiate action for mandatory resolution. • Imposition of AID may be considered at this stage but only for a brief period as discussed above, till the resolution is finalized. • If no resolution is found possible within 6 months, the process of cancellation of license may be started and completed within 6 months.

***The thresholds/slabs of CRAR reckoned for now are based on the extant minimum regulatory requirement. As and when the minimum CRAR requirement is reviewed in the light of this Committee's recommendations, the CRAR thresholds/slabs may be recalibrated accordingly.**

8.7 Amendments to the BR Act - Resolution

8.7.1 The Committee deliberated upon the amendments to the BR Act relevant to resolution and observed that some of the important areas where RBI now has regulatory powers are as under:

i) Section 44A (read with Section 56) gives power to RBI to sanction schemes of amalgamation of UCBs which would become binding on the bank and its stakeholders. The transfer of properties, assets and liabilities of the amalgamating bank would get transferred to, and vest in the acquiring bank based on the sanction accorded by RBI and Sub-sections (6A) and (6B) empowers RBI to dissolve the amalgamating bank by a further order and forward the same to the Registrar before whom that bank is registered, who on receipt of the same is required to strike off the name of the amalgamating bank from the register.

ii) Under Section 45 of the BR Act, read with Section 56 thereof, RBI can prepare scheme of compulsory amalgamation or reconstruction of UCBs, like banking companies. This action may be envisaged when the required voluntary actions are not forthcoming or giving desired results.

8.7.2 The action, other than voluntary, may, *inter alia*, provide for one or more of the following:

i) Compulsory amalgamation with another banking institution or a transfer of assets and liabilities to another financial institution. In such cases, the existing members of the transferor UCB may be disenfranchised for a period of five years.

ii) Reconstruction through reconstitution of the capital, assets, powers, rights, interests, privileges, liabilities, duties and obligations, change in Board of Directors, alteration of byelaws, etc. for giving effect to reconstruction.

iii) The amalgamation or reconstruction scheme may include reduction in the rights of creditors, including depositors and members of the bank; or payment in cash or in other manner to depositors/creditors in respect of their entire claims or reduced claims, as the case may be.

iv) The Section also offers flexibility to allot shares/long term debt instruments of the transferee bank (acquiring bank) to the depositors/creditors/members without reducing their claims.

Box 5: Derived CRAR

The Supervisory Action Framework (SAF) for UCBs put in place by RBI is intended to make supervisory intervention and take corrective measures in a timely manner in respect of UCBs which are suffering from financial stress, so as to restore their financial health by limiting further deterioration and preserving/improving their capital levels. The framework, in many respects, is akin to the Prompt Corrective Action (PCA) framework for commercial banks with the exception that the PCA also takes into account Leverage Ratio of banks.

The financial parameters relevant for the purpose of SAF for UCBs include capital (CRAR), asset quality (Net NPA) and profitability (Losses). While capital is the backbone of a financial entity as it ensures its solvency, asset quality and profitability also assume significance as these determine the extent of accretion to or erosion in the capital. Nevertheless, a bank may not fail even if its non-performing assets are high, or profitability is low/negative as long as it has adequate capital to bear the resultant losses.

International experience[37] suggests that the formal early intervention regimes differ across jurisdictions. For instance, with regard to the indicators used to trigger early interventions, PCA framework in the United States relies solely on capital triggers whereas the early Intervention Measures (EIM) regime of the European Union considers composite indicators, such as supervisory ratings and events deemed significant by the supervisory authority. Regimes in Japan, Peru, the Philippines and other countries, including India, have features that lie somewhere between these two examples. There are trade-offs to consider when setting the triggers for a formal intervention framework. Capital-based triggers are based on relatively simple, transparent, and harmonized bank solvency indicators. Such triggers are explicit and make for an internally consistent framework. However, capital is often a backward-looking indicator of bank weaknesses. At the same time, other, more forward looking, indicators may lead to more timely action but are less transparent and objective. While formal intervention

[37] Reference: Jean-Philippe Svoronos (April 2018), Early Intervention Regime for Weak Banks, FSI Insights on Policy Implementation No.6, Bank for International Settlements.

regimes cannot replace discretionary interventions based on regular supervisory powers, they provide useful backstops.

The single indicator regime in USA is feasible apparently because of relatively high provision coverage ratio (PCR) of banks in that country. However, keeping in view the relatively low PCR in most UCBs, a single SAF indicator such as CRAR may not work in isolation even though it might be a preferred choice on account of it being objective, transparent, equitable and easy to administer. Therefore, adequacy of capital for the purpose will have to be assessed after taking into account the weakness in the other parameters, particularly Net NPA, as losses are already factored in CRAR, whereas NPA is factored only to the extent it has been provided for by the bank. Thus, for banks having high Net NPA, say, more than 6 per cent (which is the current SAF threshold), it will be desirable to ascertain the amount of capital erosion that will take place if banks make enough provision to bring down the Net NPA from its actual level to a uniform level of 6 per cent and calculate the CRAR after accounting for such erosion. In other words, the amount of additional provision required to bring down the Net NPA of the bank to 6 per cent may be reckoned for computing CRAR and the CRAR thus arrived at, say "Derived CRAR", may be considered as the sole indicator under the SAF. Such Derived CRAR will be a uniform indicator across banks by pegging their Net NPAs at 6 per cent and as long as a bank continues to have Derived CRAR more than the prescribed minimum CRAR, it may not call for supervisory action under the SAF, notwithstanding the actual Net NPAs or losses. CRAR being the sole indicator will ensure that a well-capitalized bank will not be placed under SAF due to weakness in other parameters.

Relying on CRAR without normalizing it for a given net NPA level could result in the CRAR becoming backward looking and delay supervisory intervention in case of banks that have a high level of un-provided NPAs. The more stringent actions are invariably linked to solvency and so long as a bank is solvent and is potentially solvent, the other deficiencies can be addressed outside the SAF through discretionary measures targeted at addressing the specific shortcoming(s).

8.8 Role of TAFCUB

8.8.1 The Vision Document (year 2005) for Urban Co-operative Banks, *inter alia*, had proposed a strong working arrangement between RBI and the state governments / CRCS to address the difficulties associated with the sector. Unlike commercial banks, the joint forum with state government and other stakeholders was required given that UCBs have been under dual control. In the aftermath, Task Force on Urban Co-operative Banks (TAFCUB) was formed in all states as well as one for the multi-state UCBs by entering into Memoranda of Understanding (MoUs) with the state/Central Governments. The TAFCUB comprising the Regional Director (RD) of the RBI and the Registrar of Co-operative Societies of the state concerned and a representative each from NAFCUB and the State Federation of the UCBs has been instrumental for more than a decade in identifying potentially viable / non-viable UCBs and suggesting a revival path for viable UCBs and an appropriate exit route for non-viable UCBs.

8.8.2 In the light of the recent amendments to the BR Act, the Committee had asked the stakeholders (UCBs and Federations) to review the efficacy of the existing agenda of the TAFCUB. Of the total responses received, approximately 75 per cent suggested that the current agenda of TAFCUB was satisfactory. However, some UCBs suggested, *inter alia,* that TAFCUB should have a forum to study early warning signals of UCBs heading towards imposition of SAF. This will ensure that with the guidance from TAFCUB and the regulator, and with supportive involvement of the UO, wherever found commercially feasible, the bank does not reach the stage of invocation of the SAF. Concerns have also been expressed over the limited role of TAFCUB after introduction of SAF by RBI while some banks have also mentioned that the regulatory action taken by Regional Offices of RBI should be in consonance with decisions of TAFCUB.

8.8.3 The Committee deliberated at length over the role of the TAFCUB during or after a UCB is placed under SAF. However, given that the recommended structure of the SAF includes a set of objective criterion for mandatory action under the SAF, the Committee felt that **while the mandatory action based on objective criterion under the SAF should be taken by RBI, discretionary actions to address the deficiencies of other financial or non-financial nature, such as high GNPA, losses, governance issues, inefficiencies, weakness in systems and controls etc. in case of Tier 1 and 2 banks may be deliberated and appropriate supervisory action may be recommended by the TAFCUB.**

8.9 Consolidation

8.9.1 RBI's Vision Document, 2005 put a brake on the liberal licensing policy while envisaging a multi-layered regulatory and supervisory strategy aimed at shoring up the viability of UCBs. Leveraging the TAFCUB mechanism, it focused on resolution of weak UCBs through merger of weak UCBs with stronger ones and closure of the unviable ones. The RBI introduced a scheme for merger within the UCB sector in 2005. The intention was to encourage mergers through a system of incentives for acquiring banks, in a legal framework that allowed only voluntary amalgamations. The incentives included shifting/relocating/closing down the loss-making branches of transferor bank and permitting licenses to open new branches in lieu thereof. The RBI rolled out separate guidelines for transfer of assets and liabilities of weak UCBs to commercial banks in the year 2010. In 2014, these guidelines were modified to the effect that large value depositors, i.e., those having deposits more than the insurance ceiling, had to make sacrifices in proportion to the deposit erosion of the transferor bank. The policy of encouraging mergers brought about a consolidation in the sector to a certain degree.

8.9.2 Trends in Merger / Consolidation

8.9.2.1 Since 2003, licenses of 385 UCBs have been cancelled and they have been taken to liquidation or merged with stronger banks. Despite the fall in the number of UCBs, their combined asset size has continuously increased. Further, beginning 2004-05 till March 2020, UCBs have undergone 136 mergers, with Maharashtra accounting for more than half of them, closely followed by Gujarat. Data related to merger of UCBs since 2005 juxtaposed with the prevailing regulatory policy at the time is given in the following table:

Table 6: Mergers in the UCB sector since 2005

Period	Regulatory Policy	No. of mergers	Average per year
2005-08	In 2007, only well managed and financially sound UCBs registered in states which had signed MoUs with RBI were allowed to open branches with prior approval of RBI. In 2008, licensed UCBs classified as Grade I were permitted to extend their area of operation to the whole of the district of registration and to its adjoining districts. Extension beyond the adjoining districts or the state of registration was not permitted.	46	15.3
2008-10	In 2009, Tier II UCBs were permitted to extend their area of operation to the entire state of registration. Extension beyond the state of registration, or extension of area of operation of multi-state UCBs, was not permitted.	35	17.5
2010-20	FSWM UCBs having assessed net worth of ₹50 crore permitted to extend their area of operation beyond the state of registration as also to any other state/s	55	5.50

8.9.2.2 As may be observed, in the first five years after the issuance of the merger guidelines, 81 mergers took place, i.e., an average of 16.2 mergers per year; whereas in the next ten years, the number came down to 55, i.e. an average of 5.5 mergers per year. The Committee observed that more mergers during the initial years could mainly be attributed to the incentives for the acquiring bank in the form of extended area of operation and permission for opening more branches. However, with the issue of the liberalised norms on extension of area of operation and branch expansion in 2010, the number of mergers came down considerably, as potential amalgamating UCBs were apparently keen to grow organically rather than by merging weak UCBs with themselves. This suggests that there is a strong negative correlation between liberal regulation related to expansion of area of operation / branch network and mergers.

8.9.2.3 Until the recent amendments to the BR Act, RBI was not empowered to formulate or approve a scheme for mergers/amalgamation of UCBs, as the same was under the domain of the respective Registrars of Co-operative Societies. The state governments had, however, incorporated in the respective Co-operative Societies' laws a provision for obtaining prior sanction, in writing from RBI for an order, *inter alia*, for sanctioning a scheme of amalgamation. RBI's examination of the proposals emanating from UCBs has been mainly confined to financial aspects, such as the interests of depositors as well as the stability of the financial system. The above arrangement made the resolution powers of RBI pertaining to UCBs inconsistent with those for commercial banks.

8.9.2.4 As banking becomes more complex and the competition intense, the need for adequately skilled workforce increases, IT infrastructure needs to be enhanced and the cost of compliance goes up. The Committee felt that due to the heterogeneity, the sector needs some consolidation to achieve scale and remain relevant in the medium term. It further felt that the management of smaller UCBs should have long term vision and consider consolidation even as they may appear to be currently viable. Emergence of weak UCBs as reflected in the number of banks under SAF and AID is undermining the potential of the UCB sector to grow.

8.9.2.5 The Committee noted that subsequent to the amendments in the BR Act, Master Direction has been issued by RBI in March 2021 for voluntary amalgamation of UCBs. With full powers for sanctioning mergers having come to RBI, unlike in the past when mergers had to be approved by both RBI and RCS, it is expected that the merger process will be smoother and faster.

8.9.3 Recommendation

The Committee feels that **RBI should be largely neutral to voluntary consolidation except where it is suggested as a supervisory action**. In general, the default approach to voluntary merger, more particularly where it is not in response to a regulatory nudge, should be to examine from the financial position of the consolidated entity, governance, and whether it is resulting in an entity that is systemically disconcerting. The Committee found that the smaller UCBs do embrace co-operative principles and with a prescription for a minimum capital, certain size is embedded in the recommendations. Further, the UO is seen as the alternative to consolidation, whereby the small UCBs will be able to harness the advantages of a co-operative entity without excessive concerns on individual bank's viability. However, the **RBI should not hesitate to use the route of mandatory merger to resolve UCBs that do not meet the prudential requirements**.

Annex 1

MEETINGS OF THE COMMITTEE

<table>
<tr><th>Sr. No.</th><th>Date/s of the meeting</th><th>Participants</th></tr>
<tr><td>1.</td><td>March 8, 2021</td><td rowspan="4">1. Shri N S Vishwanathan, Chairman
2. Shri H K Bhanwala, Member
3. Shri M. M. Chitale, Member
4. Shri N C Muniyappa, Member
5. Shri R N Joshi, Member
6. Shri M S Sriram, Member
7. Shri Jyotindra M Mehta, Member
8. Shri Neeraj Nigam, Convenor</td></tr>
<tr><td>2.</td><td>March 16, 2021</td></tr>
<tr><td>3.</td><td>March 30, 2021</td></tr>
<tr><td>4.</td><td>April 13, 2021</td></tr>
<tr><td>5.</td><td>May 11, 2021</td><td>Chairman, all Members and Convenor, as at (1) above, and
Special invitees
1. Shri Krishna Damarla, Consultant for UO
2. Shri Raja Debnath, Consultant for UO
3. Shri Shantanu Ambedkar, Consultant for UO</td></tr>
<tr><td>6.</td><td>May 19, 2021</td><td>Chairman, all Members and Convenor, as at (1) above</td></tr>
<tr><td>7.</td><td>May 25, 2021</td><td>Chairman, all Members (except Shri R N Joshi), and Convenor, as at (1) above, and
Special Invitees
1. Shri Krishna Damarla, Consultant for UO
2. Shri Raja Debnath, Consultant for UO
3. Shri Shantanu Ambedkar, Consultant for UO</td></tr>
<tr><td>8.</td><td>June 8, 2021</td><td>Chairman, all Members and Convenor, as at (1) above, and
Special Invitees
1. Shri M Rajeshwar Rao, Deputy Governor, RBI
2. Shri Saurav Sinha, Executive Director, RBI
3. Shri J. K. Dash, Executive Director, RBI</td></tr>
<tr><td>9.</td><td>June 15, 2021</td><td>Chairman, all Members and Convenor, as at (1) above</td></tr>
</table>

10.	June 22, 2021	Chairman, all Members and Convenor, as at (1) above
11.	July 6, 2021	Chairman, all Members and Convenor, as at (1) above
12.	July 13, 2021	Chairman, all Members and Convenor, as at (1) above
13.	July 22, 2021	Chairman, all Members and Convenor, as at (1) above
14.	July 28, 2021	Chairman, all Members and Convenor, as at (1) above

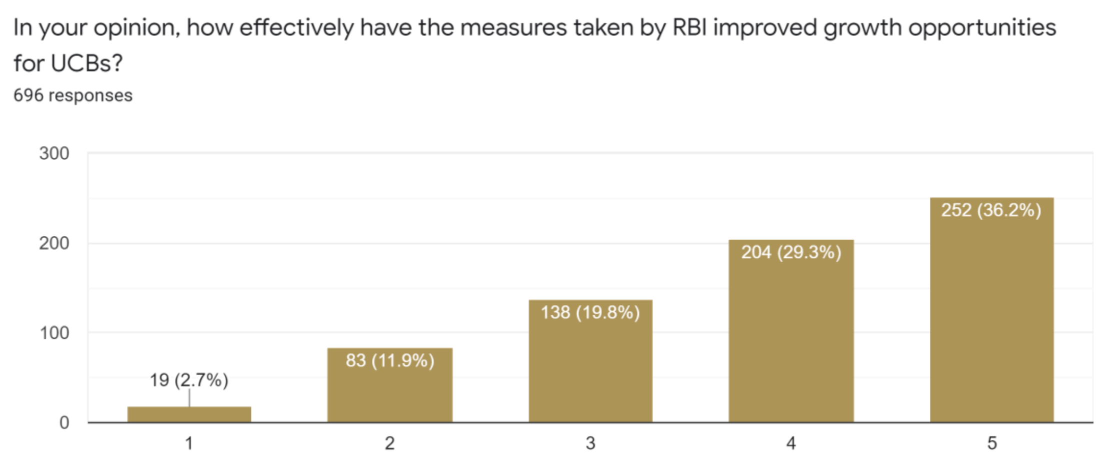
Annex 2

FEEDBACK FROM THE STAKEHOLDERS

A questionnaire designed based on various terms of reference was circulated among all Urban Co-operative Banks and Federations of UCBs for eliciting their feedback. The Committee received an overwhelming response from 654 UCBs and nine Federations. The UCBs, *inter alia,* included 318 unit banks and 40 multi-state UCBs. The responses have been consolidated and presented in nine major segments, *viz.* measures for augmenting business growth, risk mitigation measure, TAFCUB mechanism, role of UO, raising of fresh capital by UCBs, differential regulation, minimum net worth requirement for UCBs and consolidation / merger.

Section I - Measures for augmenting business growth

2. In the last decade or so, RBI has allowed certain dispensations to UCBs such as permission for offering e-banking facilities like ATM/debit cards, credit cards, prepaid instruments, NEFT/RTGS etc., permission to enter new lines of activities, like forex business (AD category I & II), online trading for demat account holders, marketing mutual funds, etc. In this backdrop, stakeholders were requested to rate the efficacy of the existing RBI instructions and suggestions were sought for furtherance of the growth objectives. A majority of the stakeholders have opined that the measures taken so far by RBI are satisfactory.



3. The following suggestions in general were received from stakeholders for improving growth prospects of the sector.

i) Digital Banking services to customers at par with the commercial banks, need for a robust technical infrastructure and technical support in terms of technically skilled staff and training to the existing staff.

ii) Allow new licenses to banks, liberalise conditions for opening of new branches and extending area of operations.

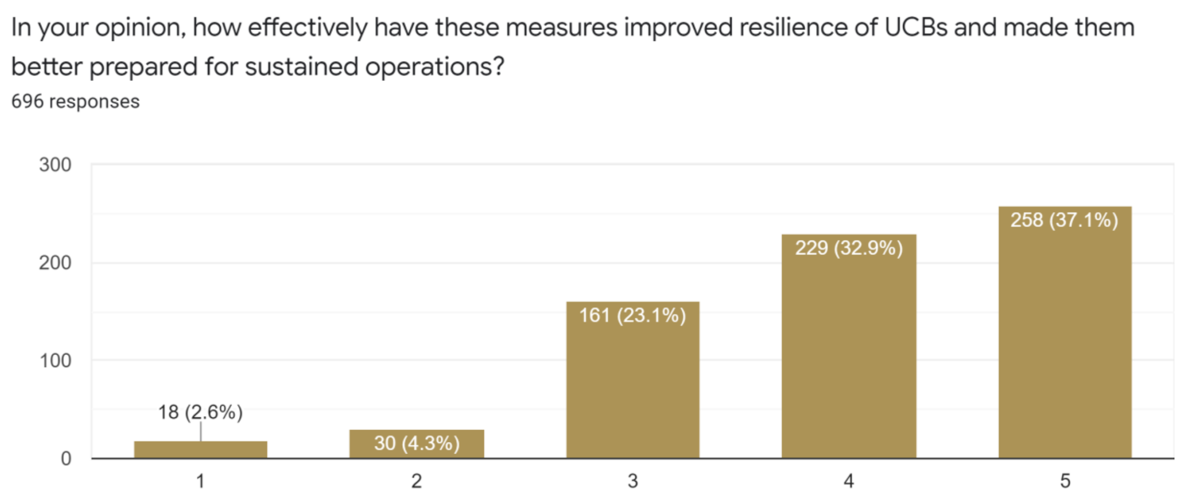
iii) Relaxation in clearing house membership norms, permission for government business and various interest subsidy/subvention schemes being run by the government.

iv) Relaxation in the limits for loans and advances like housing loans, loans to nominal members, gold loans and liberalised exposure norms.

v) Broadly, Federations suggested to allow new licenses to banks, relax prudential norms for internet banking and liberalise conditions for opening of new branches and extension of area of operation.

Section II - Risk Mitigation Measures

4. The Reserve Bank introduced various risk mitigating measures in the past to improve the resilience of the sector. With a view to allowing growth and expanding the range of product offerings, the concept of FSWM UCB was introduced to speed up the grant of regulatory approvals under the automatic route. Further, a slew of measures like sector and borrower-wise exposure norms, priority sectors lending targets, supervisory action framework to help weaker banks to rehabilitate themselves, infusing professionalism at the Board level, professionalizing the executive management by introducing BOM, etc. were also taken. In addition, measures were taken to improve the liquidity position of the UCBs, e.g., MSF for Scheduled UCBs. A majority of the respondents opined that these risks mitigation measure have been effective in improving the resilience of the sector to a large extent. The graphical representation of the opinion received is as under:



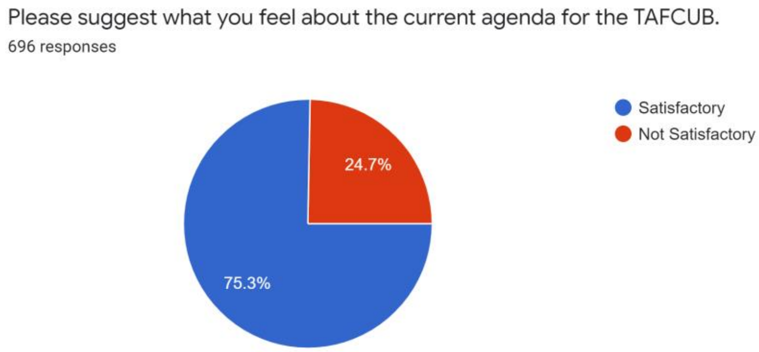
5. Some of the respondents opined that while the measures were effective, certain UCBs with lower financial strength could not get operational freedom in the areas of branch licensing,

scheduling, etc. There was an opinion that overall ceilings in respect of exposure limits, particularly to the housing sector, bullet repayment gold loan limits, etc. need to be enhanced. It was stated that increasing the priority sector lending target for UCBs from 40% of ANBC to 75% was unreasonable. The supervisory action framework needs to be more flexible as long as the bank meets required CRAR and liquidity. Certain UCBs opined that the infusion of two professional directors did not yield the required level of professionalism at the Board level. It was also opined that the introduction of BOM had added an extra layer to the already existing layers with an overlap of functions.

6. The respondents suggested that the thresholds of the financial parameters such as NPA and CRAR may be relaxed which will allow them to offer a better range of digital products.
7. The respondents also suggested instead of a separate mechanism like board of management, the professionalization of the Board itself was a better way to improve the governance standards.
8. Extending MSF to all UCBs, irrespective of scheduled status, issuance of guidelines on audit related functions, providing a cost-effective technology platform, strengthening of off-site surveillance, capital / re-capitalisation support, etc. by the RBI were some of the other suggestions from the participants.
9. It was also suggested to prescribe qualifications for the Directors on the Board and that the voting rights should be in accordance with the proportion of shareholding at the Board level.

Section III - TAFCUB Mechanism

10. The State Level Task Force on Co-operative Urban Banks (TAFCUB) comprising the Regional Director (RD) of the RBI for the concerned state, Registrar of Co-operative Societies, a representative each from NAFCUB and the State Federation of the UCBs, etc. has been instrumental in identifying potentially viable and non-viable UCBs and suggesting revival path / non-disruptive exit routes for more than a decade. Unlike in case of commercial banks, the joint forum with the state governments and other stakeholders was required as UCBs are under dual control of the RBI as well as the respective states with whom they are registered. In the light of the recent amendments to the BR Act, the stakeholders were asked to express their views on the efficacy of the existing agenda of the TAFCUB and offer suggestions for further improvement. Out of the total responses received, approximately 75% of the UCBs (please see chart below) suggested that the current agenda of TAFCUB was satisfactory.



11. Concerns were expressed by some UCBs regarding the reduced role of the TAFCUB after introduction of supervisory action framework. It was opined that any regulatory action by the RBI should be first discussed in the TAFCUB. For improving the functioning and efficacy of TAFCUB mechanism, it was suggested that identification of incipient weaknesses at an early stage, even before the UCB is likely to come under the supervisory action framework, and discussing the same in the TAFCUB can be one of most proactive steps that can improve the efficacy of the mechanism. At this stage, the intervention of the regulator and support from the proposed UO would go a long way in improving the resilience of the sector though the TAFCUB mechanism. Frequent meetings and inclusion of experts therein would also help improve the efficacy.

Section IV – Umbrella Organization

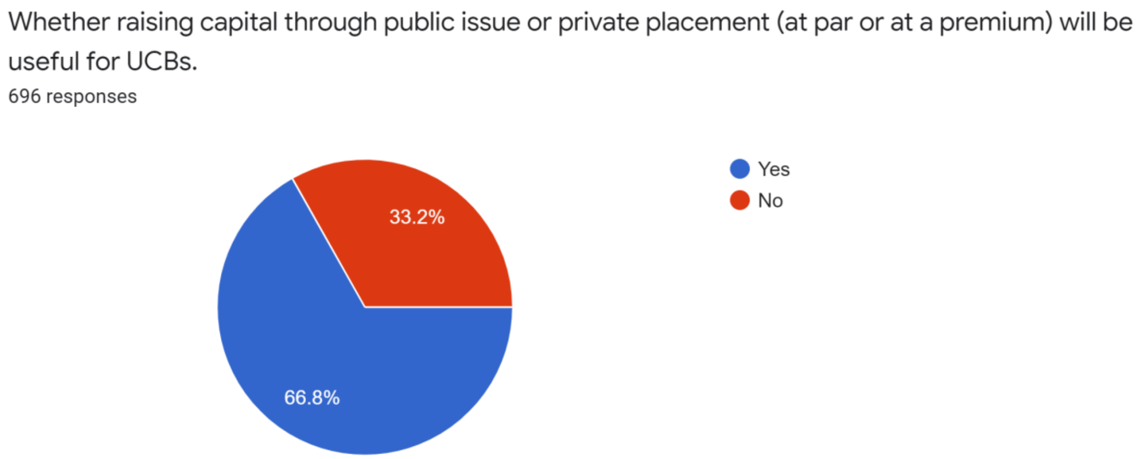
12. In many countries, where cooperatives in the financial sector are successful, a federated structure with a strong apex entity has been generally prevalent. The apex entity should be able to operate on scale, have access to adequate financial resources and be resilient to instil confidence in the federating cooperative entities and those transacting business with the federating entities. In many jurisdictions, the UO, apart from extending liquidity and capital support to its member UCBs, would also be expected to set up Information Technology (IT) infrastructure for shared use of members to enable them to widen their range of services in the wake of advances in information and communication technology at a relatively lower cost. The UO can also offer fund management and other consultancy services. The capital of the UO will be contributed by the member UCBs and from the market. The RBI has already given ‘in-principle’ approval to NAFCUB for setting up the UO. In this regard, feedback was sought from the stakeholders on the role that may be played by the UO.
13. Most of the UCBs welcomed the RBI’s initiative in creating a UO for UCBs. In general, banks suggested that regulatory incentives need to be offered by the RBI to banks for them to

participate vigorously in the promotion of the UO. It was also suggested that the UO should have representatives from the concerned State Government, UCBs, the RBI and the Central Government. A majority of the UCBs suggested that the UO should have its branches at regional level so as to better understand the requirements of the UCBs in a particular region based on the regional situation.

14. UCBs, particularly smaller ones, expected a low-cost technological platform, consultative services, short-term liquidity support, capacity building, etc. from the UO.
15. UCBs, in general, suggested that the proposed UO should accept deposits from both scheduled and non-scheduled UCBs and pay market related interest rates. Further, it should also provide short term liquidity support at low cost against government securities.
16. Some UCBs raised concerns regarding the efficacy of UO as UCBs are geographically scattered and catering to different communities. A few UCBs also mentioned that the larger UCBs might be commandeering the UO at the cost of the smaller UCBs. It was also apprehended that the UO might take unintended form and add an extra layer as another regulator.
17. Federations, while drawing reference to the Vishwanathan Committee formed in 2006, suggested to treat deposits / shareholding of UCBs in the UO as eligible assets for Statutory Liquidity Ratio (SLR) requirement.

Section V – Raising of fresh capital by UCBs

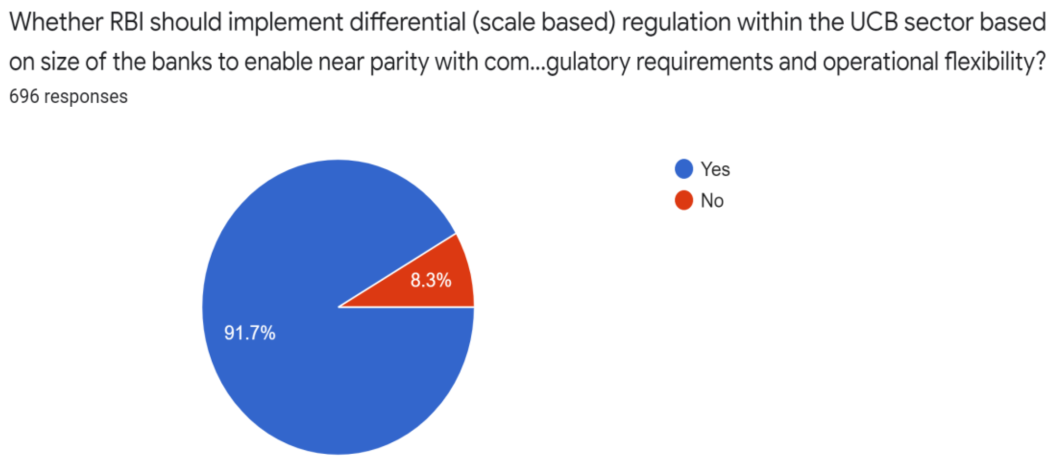
18. Capital raising avenues available to commercial banks, being banking companies, are far more diverse than those available to UCBs (being co-operative societies). Even the existing instruments for raising capital, like PNCPS and LTD, have been used only by a few UCBs, given the lack of enthusiasm among investors, absence of a secondary market for trading in these instruments, etc. Keeping in view the recent amendments to the BR Act, RBI can permit UCBs to raise capital through alternative mechanisms, such as public issue and private placement (at par or at a premium), for raising stable and long-term funds (equity or quasi-equity in nature). In this backdrop, almost two-thirds of the respondents have opined that raising capital through public issue or private placement will be beneficial (please see the chart below).



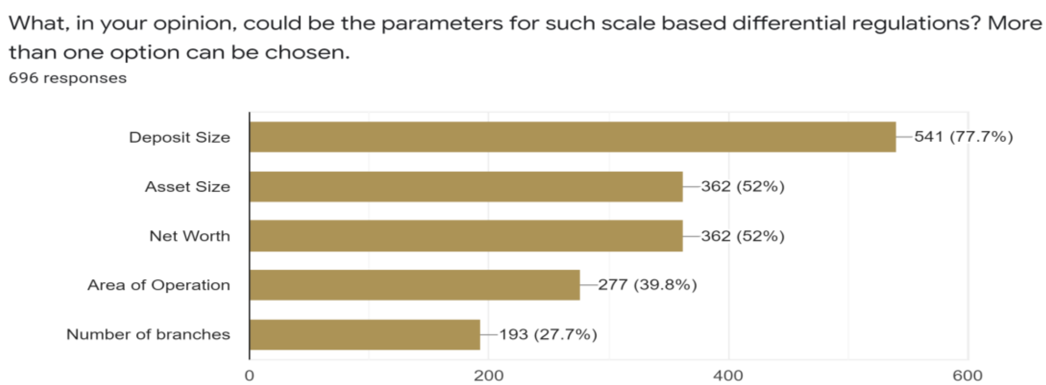
19. Suggestions to introduce a few new instruments like non-voting and non-convertible preference share on private placement basis, public issue of shares at premium, quasi equity shares with differential voting rights, tradable perpetual bonds which can be later converted into shares with voting rights, etc. were also received.
20. As regards attracting new investors, it was suggested that proportionate voting rights, issue of shares at premium, providing secondary market mechanism for UCBs, etc. would go a long way in this regard. While these suggestions have a flavour of joint stock companies, a majority of the respondents, however, intended to stay back under co-operative fold as they believe in the very concept of co-operative structure and its fundamentals.

Section VI – Differential Regulation

21. Heterogeneity is a unique character of the UCB sector. There are some UCBs which are larger than smaller commercial banks, while most of the other UCBs have much less capital than that prescribed even for SFBs. Under the existing norms, UCBs have been segregated into tier I & tier II based on the amount of deposits held by them. However, the regulatory / supervisory landscape for them is uniform (with a few exceptions) across the sector, particularly in terms of prudential norms, governance, area of operation, product offerings, etc. In this backdrop, an absolute majority of stakeholders (92%, see the chart below) were in favor of scale-based differential regulation to enable near parity with commercial banks with regard to regulatory requirements and operational flexibility.



22. On the issue of appropriate differentiator for scale-based regulation, a majority of the respondents suggested deposits (78%) as the parameter, followed by asset size. Some of the UCBs suggested area of operation as the differentiator. The responses are indicated in the chart below.



23. As regards the suggestions on ways to effectively implement the differential regulation structure, respondents suggested, in essence, that the larger the size of the bank the broader the regulatory approach.

Section VII – Minimum net worth requirement for UCBs

24. Entry point norms (EPN) represent minimum net worth/capital requirement for UCB licensing based on the category of centre based on population (A, B, C & D). Presently, it ranges from ₹400 lakh to ₹25 lakh for a general category UCB based on population centre, with suitable relaxations for special category UCBs and those established in the north-eastern region of the country. The Report of the High-Powered Committee on Urban Co-operative Banks (UCBs)

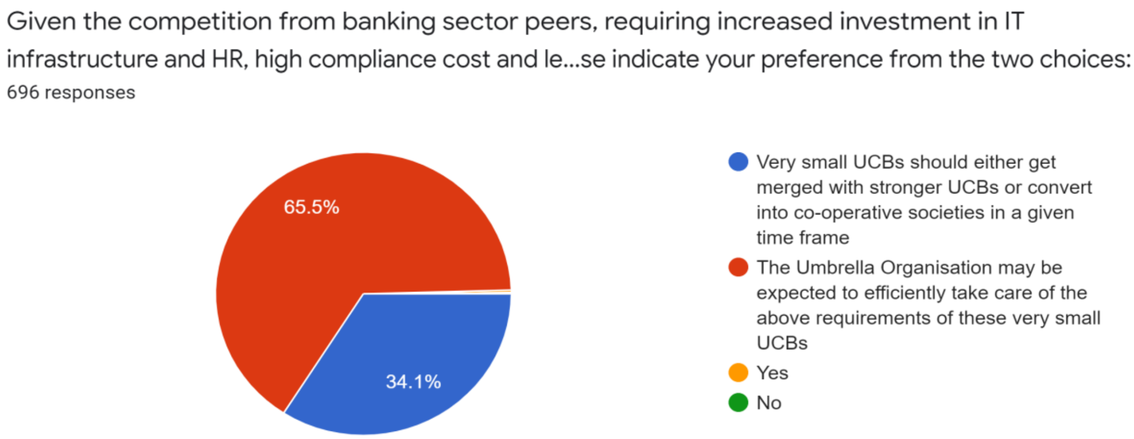
(Chairman: Shri R. Gandhi) was published in the year 2015. It reviewed the EPN requirement and suggested the following revised EPNs in terms of net worth of UCBs:

a. To operate as a Multi-State Urban Co-operative Bank - ₹ 100 crore;

b. To operate beyond two districts and as a state level UCB - ₹ 50 crore;

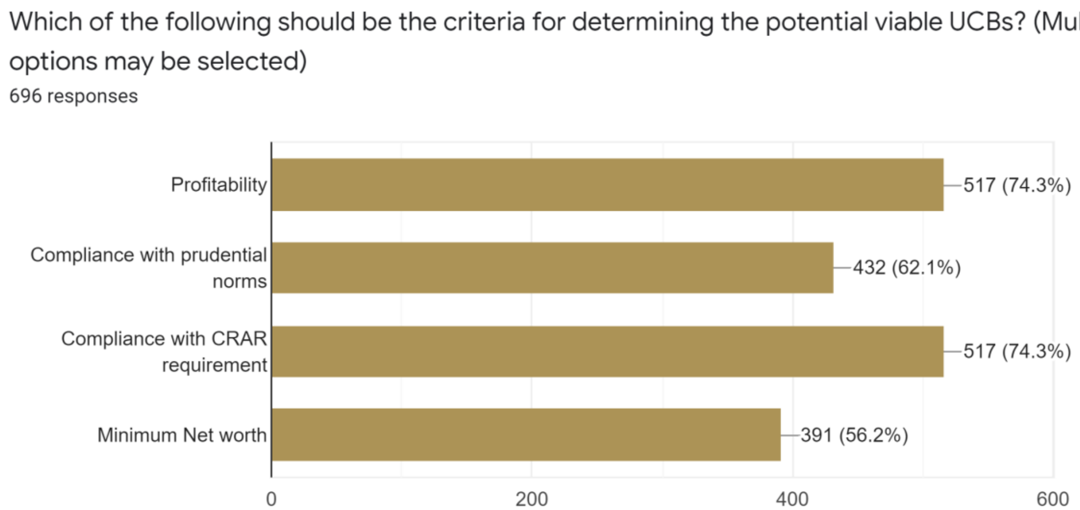
c. To operate as district level UCB (up to two districts) - ₹ 25 crore.

In the above backdrop, and keeping in view the competition from the banking sector peers requiring increased investment in IT infrastructure and HR, high compliance cost and lesser ability of very small UCBs to absorb shocks due to low capital base, stakeholders were requested to indicate their preference out of the two choices.



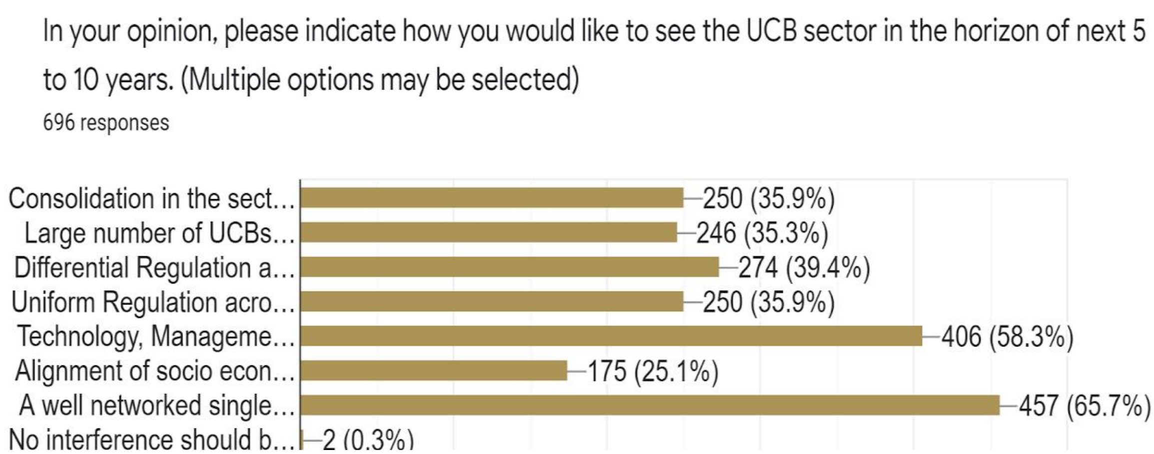
25. Of the two preferences given, about 65% UCBs chose support from UO instead of merger/conversion, while 35% were in favor of merger with another bank / conversion into societies**.** UCBs generally wanted to remain community-oriented with an identity instead of being merged with another UCB. The other UCBs believed that there were strong signals of non-viability in the near future on account of smaller size, stiff competition, ever-increasing costs, etc. and, therefore, opined to either convert into a credit society instead of continuing as a banking institution or get merged with another bank. A majority of the UCBs were not in favor of compulsory mergers in the sector.

26. A majority of the UCBs opined that strong financials in respect of CRAR, profitability, net worth and adherence to prudential norms are pre-requisites for sustained variability (please see the chart below).



Section VIII – Miscellaneous

27. Stakeholders were requested to offer their suggestions on the future roadmap for the sector over a horizon of the next ten years with various alternatives like consolidation in the sector, parity with commercial banks, support from UO, etc. The chart below depicts the options chosen.



Annex 3

LIST OF FEDERATIONS OF UCBs, WHICH RESPONDED TO THE QUESTIONNAIRE

Sr. No.	Name of the Federation
1	The Kolhapur District Urban Co-operative Banks Association
2	Andhra Pradesh State Co-operative Urban Banks and Credit Societies Federation
3	Telangana State Co-operative Urban Banks Federation Ltd.
4	Gujarat Urban Co-operative Banks Federation
5	State Federation of UCBs and Credit Societies Ltd.
6	The Maharashtra State Co-operative Banks' Association Ltd.
7	The Maharashtra Urban Co-operative Banks' Federation
8	The Rajasthan Urban Co-operative Banks Federation Ltd.
9	Uttar Bharat Urban Co-operative Banks Federation Limited, UP

Annex 4

STAKEHOLDER INTERACTION

1. Interaction with Software Vendors / IT Service Providers in the field of Co-operative Banking – April 16, 2021

Participants	Designation / Organisation
Shri Mukund M Chitale	Member, Expert Committee
Shri N C Muniyappa	Member, Expert Committee
Prof M S Sriram	Member, Expert Committee
Shri T V Rao	General Manager, RBI (On behalf of Convenor)
Shri Rajesh Mirjankar	MD & CEO, Infrasoft Technologies Pvt. Ltd.
Shri Chirag Patel	CEO, Acute Informatics Pvt. Ltd.
Shri Guru Murthy	CEO, Processware Systems Pvt. Ltd.
Shri Santosh Mohile	IT Head, SVC Co-operative Bank
Shri Ashish Varun	Head, Sales/Marketing, NELITO Systems Ltd, Mumbai
Shri Devdatta Chandgadkar	CEO, Saraswat Infotech Ltd
Shri Suhas Patil	Chief Engagement Director – UCBs, Edgeverve Systems Ltd. (A subsidiary of Infosys Ltd.)

2. Interaction with select Scheduled UCBs – April 19, 2021

Participants	Designation / Organisation
Shri Harsh Kumar Bhanwala	Member, Expert Committee
Shri R N Joshi	Member, Expert Committee
Shri Neeraj Nigam	Convenor, Expert Committee
Shri Gautam Thakur	Chairman, Saraswat Co-op Bank Ltd.
Shri Udaykumar P Gurkar	Vice-Chairman, SVC Co-op Bank Ltd.
Shri Ajit E Venugopalan	Managing Director, SVC Co-op Bank Ltd.
Shri P F Bharucha	Managing Director, The Kalupur CCB Ltd.
Shri V G Dadlani	General Manager & CEO, The Kalupur CCB Ltd.
Shri Madhav Ramkrishna Mate	Chairman, Janata Sahakari Bank Ltd. Pune
Shri Jayant Kashinath Kakatkar	CEO, Janata Sahakari Bank Ltd. Pune
Shri Umesh Chand Asawa	MD & CEO, AP Mahesh CUB Ltd.

3. Interaction with Experts in the Co-operative Banking Field – April 20, 2021

Participants	Designation / Organisation
Shri Mukund M Chitale	Member, Expert Committee

Shri N C Muniyappa	Member, Expert Committee
Prof M S Sriram	Member, Expert Committee
Shri T V Rao	General Manager, RBI (On behalf of Convenor)
Shri D N Thakur	Former DMD, NCDC and National VP, Sahakar Bharati
Dr Amit Basak	Associate Professor, Susil Kar College, West Bengal
Shri Krishna Damarla	Ex-Chief Executive, NAFCUB
Shri Navin Surya	Chairman Emeritus, Payments Council of India
Dr N Ramu	Professor, Annamalai University

4. Interaction with State UCB Federations – April 21, 2021

Participants	Designation / Organisation
Shri N S Vishwanathan	Chairman, Expert Committee
Shri Jyotindra Mehta	Member, Expert Committee
Shri Neeraj Nigam	Convenor, Expert Committee
Shri H K Patil	President, Karnataka State UCB Federation Ltd.
Smt Mallamma Yalawar	Director, Karnataka State UCB Federation Ltd.
Shri G Rama Moorthy	Hon Chairman, Telangana State CUB Federation Ltd.
Shri G Madana Gopala Swamy	Working President, Telangana State CUB Federation Ltd.
Ms T Vanitha	Joint Registrar (State Monitoring Officer), Tamil Nadu UCB Federation Ltd.
Shri S Raman	General Manager, Tamil Nadu UCB Federation Ltd.
Shri Pratap Narayan Paria	Chief Executive, Federation of West Bengal UCB and Credit Societies Ltd.
Shri Ch Raghavendra Rao	Director, Andhra Pradesh CUB & Credit Societies Federation Ltd.
Shri M Venkata Ratnam	Secretary, Andhra Pradesh CUB & Credit Societies Federation Ltd.
Shri Sitaram Adsul	Director, Maharashtra UCB Federation Ltd.
Smt Sayali Bhoir	CEO, Maharashtra UCB Federation Ltd.
Shri Kanjibhai Bhalala	Director, Gujarat UCB Federation Ltd.
Shri J V Shah	CEO, Gujarat UCB Federation Ltd.
Shri Narendra Singh Dabi	Director, Rajasthan UCB Federation Ltd.
Shri M L Sharma	Chief Executive, Rajasthan UCB Federation Ltd.
Shri Anurag Srivastava	Chief Executive, Uttar Bharat Co-operative Bank & Credit Societies Federation Ltd.

5. Interaction with select Tier-II UCBs – April 24, 2021

Participants	Designation / Organisation
Shri N S Vishwanathan	Chairman, Expert Committee
Shri Jyotindra Mehta	Member, Expert Committee
Shri T V Rao	General Manager, RBI (On behalf of Convenor)
Ms Chetna Sinha	Chairperson, Manndeshi Mahila Sahakari Bank Ltd
Smt Rekhatai Sunil Kulkarni	CEO, Manndeshi Mahila Sahakari Bank Ltd
Shri Subhra Jyoti Bharali	MD, Industrial Co-operative Bank Ltd.
Smt Jayshreeben Vyas	MD, Shri Mahila Sewa Sahakari Bank Ltd, Ahmedabad
Shri Rajesh Tandon	MD, Citizens' Co-operative Bank Limited, Jammu
Shri P V Sarma	CEO, Agrasen CUB Limited, Hyderabad
Shri S P Kashyap	CEO, Bareily Urban Co-operative Bank Ltd.
Shri Mohit Maski	Chairman, SUCO Souharda Sahakari Bank Ltd, Bellary
Shri Parimalacharya Agnihotri	MD, SUCO Souharda Sahakari Bank Limited, Bellary
Shri K K Sharma	Chairman, The Citizens UCB Ltd., Jalandhar
Shri Dileepkumar T K	CEO, Irinjalakuda Town Co-operative Bank Limited

6. Interaction with select Unit UCBs – April 26, 2021

Participants	Designation / Organisation
Dr Harsh Kumar Bhanwala	Member, Expert Committee
Shri R N Joshi	Member, Expert Committee
Shri T V Rao	General Manager, RBI (On behalf of Convenor)
Shri Charegaonkar Shekar Suresh	Chairman, Yashwant Co-op Bank Ltd.
Shri Deepak Munot	Chairman, Shri Mahaveer Urban Co-op Bank Ltd.
Shri Vinod kumar Richhariya	CEO, Rani Laxmi Bai Urban Co-op Bank Ltd.
Shri Chiradeep Adhikari	Member, Board of Administrator, Dhakuria Co-op Bank Ltd.
Shri Sanjay Shantaram Bait	CEO, Shri Ganesh Sahakari Bank Ltd.
Shri Sunil Kumar	GM-i-C, Gandhidham Mercantile Co-op Bank Ltd.
Shri N. Arumugasamy	GM-i-C, Sivakasi Co-op Urban Bank Ltd.

7. Interaction with CA-COB (Chartered Accountants in Co-operative Banking) – May 29, 2021

Participants	Designation / Organisation
Shri N S Vishwanathan	Chairman, Expert Committee

Shri Harsh Kumar Bhanwala	Member, Expert Committee
Shri Mukund M Chitale	Member, Expert Committee
Shri N C Muniyappa	Member, Expert Committee
Shri R N Joshi	Member, Expert Committee
Prof M S Sriram	Member, Expert Committee
Shri Jyotindra Mehta	Member, Expert Committee
Shri Neeraj Nigam	Convenor, Expert Committee
CA Suresh Prabhu	Chartered Accountant & Hon'ble Member of Parliament
CA Dr S B Zaware	Chartered Accountant
CA Milind Kale	Chartered Accountant
CA Pradeep	Chartered Accountant
CA Dr Rewati Paithankar	Chartered Accountant
CA Yashwant Kasar	Chartered Accountant

8. Interaction with the Representatives of Sahakar Bharati - June 1, 2021

Participants	Designation / Organisation
Shri N S Vishwanathan	Chairman, Expert Committee
Shri Mukund M Chitale	Member, Expert Committee
Shri N C Muniyappa	Member, Expert Committee
Shri Jyotindra Mehta	Member, Expert Committee
Shri Neeraj Nigam	Convenor, Expert Committee
Dr Uday Joshi	National General Secretary, Sahakar Bharati
CA Shekhar Desai	Chairman, Jalgaon Janata Sahakari Bank Ltd & Representative, Sahakar Bharati
CA Anil Rao	CEO, Thane Bharat Sahakari Bank Ltd & Representative, Sahakar Bharati

9. Interaction with Central Registrar Co-operative Societies and select state Registrars of Co-operative Societies – June 21, 2021

Participants	Designation / Organisation
Shri N S Vishwanathan	Chairman, Expert Committee
Shri Jyotindra Mehta	Member, Expert Committee
Shri Neeraj Nigam	Convenor, Expert Committee
Shri Vivek Aggarwal	Central Registrar for Co-operative Societies
Shri Anil Kawade	Registrar of Co-operative Societies, Maharashtra

Shri D P Desai	Registrar of Co-operative Societies, Gujarat
Shri Veerabhramhaih	Registrar of Co-operative Societies, Telangana
Shri A Babu	Additional Registrar of Co-operative Societies, Andhra Pradesh
Dr N Vilvasekaran	Additional Registrar of Co-operative Societies, Tamil Nadu

Annex 5

LEGAL FRAMEWORK FOR REGULATION OF UCBs

1. Earlier Position

Before the recent amendments, only those provisions of BR Act that were directly connected with banking business like licensing requirement, opening of new places of business, permitted businesses and prohibitions on undertaking other businesses, minimum capital/net worth requirement, requirements for maintenance of CRR/SLR, prohibitions on certain loans and advances to directors/entities or persons in which they are concerned, direction making provisions relating to banking business, on-site and off-site supervision related provisions and nomination on deposits and other services related provisions, were only made applicable to co-operative banks, including UCBs.

The other provisions of the BR Act relating to mainly shareholding, management, audit, amalgamations/reconstruction and liquidation were not made applicable. Accordingly, the regulation and supervision of the RBI on UCBs were focused on the banking business aspects of UCBs and not on the other aspects enumerated above.

2. Legal Framework after the recent amendments

The Banking Regulation (Amendment) Act, 2020 (Amendment Act) has made significant changes to the regulatory landscape of UCBs. The Statement of Objects and Reasons pertaining to the amendment indicates that such amendments were considered necessary "to provide for better management and proper regulation of co-operative banks and to ensure that the affairs of the co-operative banks are conducted in a manner that protects the interests of the depositors, by increasing professionalism, enabling access to capital, improving governance and ensuring sound banking through the RBI". The amendments have brought legal parity between the regulation/supervision of co-operative banks with that of banking companies, under BR Act.

Unlike a co-operative society which collects resources from its members to be put to use for the benefit of those members, a co-operative bank's main and substantial source of funds are public deposits. Therefore, the focus of the regulation and supervision of these banks under the BR Act has been envisioned for protecting the interests of the depositors. The interests of shareholders/members of the co-operative banks would be subservient to the interests of depositors.

The amendment made through the Amendment Act has attributed primacy to the provisions of BR Act *vis-à-vis* co-operative laws, by expressly providing that the provisions of BR Act shall apply "notwithstanding anything contained in any other law for the time being in force". Accordingly, in the case of UCBs, whenever a provision of BR Act is in conflict with or inconsistent with any of the provisions of the co-operative law, the latter would become inapplicable. Wherever the requirements under the co-operative law are in addition to or not inconsistent with those under BR Act, both laws would apply harmoniously.

The Amendment Act has impacted, mainly, four major areas of functioning of UCBs, *viz*., management, audit, amalgamation and winding up. The impact on each of these areas are discussed below in detail.

2.1 Management

i) Whole-time Chairman or Managing Director

UCBs are required to have a whole-time Chairman (WTC) or Managing Director (MD) (who has special knowledge and practical experience in banking or in financial, business or economic administration) to whom the management of the whole of the affairs of the co-operative bank would be entrusted to, subject to the superintendence, control and direction of the Board of Directions. This would mean that the position of the Chief Executive Officer, by whatever name called, should be at the Board level. The appointment of a WTC/MD can only be for a period of five years at a time, though they are eligible for being re-appointed. While appointing a WTC or MD, the co-operative bank should ensure that this person does not have any of the disqualifications mentioned in Section 10B(4) or Section 10(1) of BR Act. In terms of Section 10C of BR Act, the person appointed as WTC/MD need not be a shareholder/member of the UCB, which would enable professionals unconnected with the UCB also being appointed to such positions. RBI has been empowered to exempt any co-operative bank or class of co-operative banks from the requirement of having a WTC/MD.

RBI has already come out with a circular on appointment of professionals as WTC/MD, laying down the qualifications and disqualifications (including the statutory requirements) of the persons who occupy those positions, that needs to be considered by UCBs before appointing them.
In effect, since the co-operative structure and law provides for an elected Chairman who is part-time, creation of position of a Managing Director in UCBs will become a must.

ii) Requirement for Professional Directors & Disqualifications for Directors

At least 51 per cent of the Board members of UCBs are required to have the special knowledge or practical experience specified under Section 10A(2)(a) of BR Act. RBI has been empowered to exempt any co-operative bank or class of co-operative banks from this requirement. Additionally, 51 per cent of the Board members of a UCB should not have substantial interest in or be connected with (as employee or manager) any company or firm, which carries on any trade, commerce or industry (other than a small-scale industrial concern) or be proprietors of trading, commercial or industrial concerns (other than small-scale industrial concerns). UCBs are required to re-constitute their Boards for meeting the above requirements, failing which RBI is empowered to remove members (by lots drawn) and appoint suitable persons in their place. The directors (other than Chairman/whole-time directors) are also not permitted to hold office continuously for a period exceeding eight years.

iii) Removal of Directors/Employees

RBI is empowered to remove directors/employees of UCBs from office, after following the due procedure specified in section 36AA of BR Act. This would empower RBI to take direct action against delinquent directors who engage in activities that are detrimental to the interest of the bank/its depositors.

iv) Director-related Loans

Section 20 which lays down the prohibitions relating to loans/advances to directors and the borrowers in whom there are interested has been made similar to those that were applicable to banking companies. However, in practice, this amendment may not bring in substantially new provisions as most of these prohibitions were already put in place through directions in 2003 based on JPC recommendations.

The data available on the website of RBI[38], indicate that since September 2019, RBI has imposed monetary penalties under BR Act, on sixteen (16) UCBs for charges relating to director related lending.

v) Common Directorship

The provision prohibiting common directorship among banks has now been made applicable to co-operative banks[39].

2.2 Capital

The Banking Regulation (Amendment) Act, 2020 has brought in a new provision[40] for enabling co-operative banks to raise capital and quasi-capital funds by way of public issue or private placement to any member of the co-operative bank or any person residing within its area of

[38] Under the head 'Press Releases'
[39] Section 16 of BR Act
[40] Section 12 read with section 56 of BR Act

operation. The amendment has also enabled co-operative banks to raise capital at premium. Both these ways of raising capital are at present alien to co-operative sector, where the main sources of capital is through share-linkage while disbursing loans and retained earnings. Considering that the aforesaid amendment has provided overriding effect to the provisions of BR Act over the co-operative laws governing these banks, they would be able to utilise this provision to raise capital through these means irrespective of the position under the respective co-operative laws.

2.3 Audit

Every appointment, re-appointment or termination of an auditor of a UCB would require the previous approval of RBI[41]. Certain state co-operative laws provide that auditors of co-operative societies should be appointed from a panel approved by the state government/an authority authorised by the state government in this behalf. A harmonious reading of the above provision with the BR Act would require the co-operative banks to comply with the requirements of both the laws. In other words, co-operative banks may have to appoint an auditor from the panel prepared by the state government, or the authority authorised by the state government after obtaining the previous approval of the RBI.

For ensuring the quality of audit, RBI can now prescribe that UCBs have to be audited by qualified professionals (Chartered Accountants) and the eligibility criteria, including the cooling periods, disqualifications etc., for the auditors.

2.4 Amalgamation

BR Act provides for the RBI sanctioning the voluntary amalgamation between two UCBs[42] in accordance with the procedure specified thereunder. The RBI has issued the RBI (Amalgamation of Urban Co-operative Banks) Directions, 2020 containing the policy and procedure for voluntary amalgamations of UCBs under section 44A. Section 44A is a code in itself and no further approval under the co-operative law is required for vesting of the assets and liabilities and shall be legally binding. Proposals for voluntary amalgamations by UCBs would now be considered by the RBI in accordance with these Directions.

Apart from the above, the Central Government is empowered to sanction and notify a scheme for amalgamation or reconstruction framed of a UCB with any other bank, framed by the RBI under section 45 of BR Act. These schemes may contain provisions for writing off/writing down interests or rights of shareholders, creditors etc.

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[41] Section 30 of BR Act
[42] Section 44A of BR Act

2.5 Winding up

RBI has been empowered to file winding up before the competent High Court having jurisdiction for winding up a UCB. This winding up would be under the supervision of the High Court.

3. Conclusion

The future regulatory and supervisory measures of the RBI will have to be in accordance with the amended framework of BR Act. The Committee has considered these recent amendments and its impact on the role of the RBI, while considering various issues and making recommendations.

Annex 6

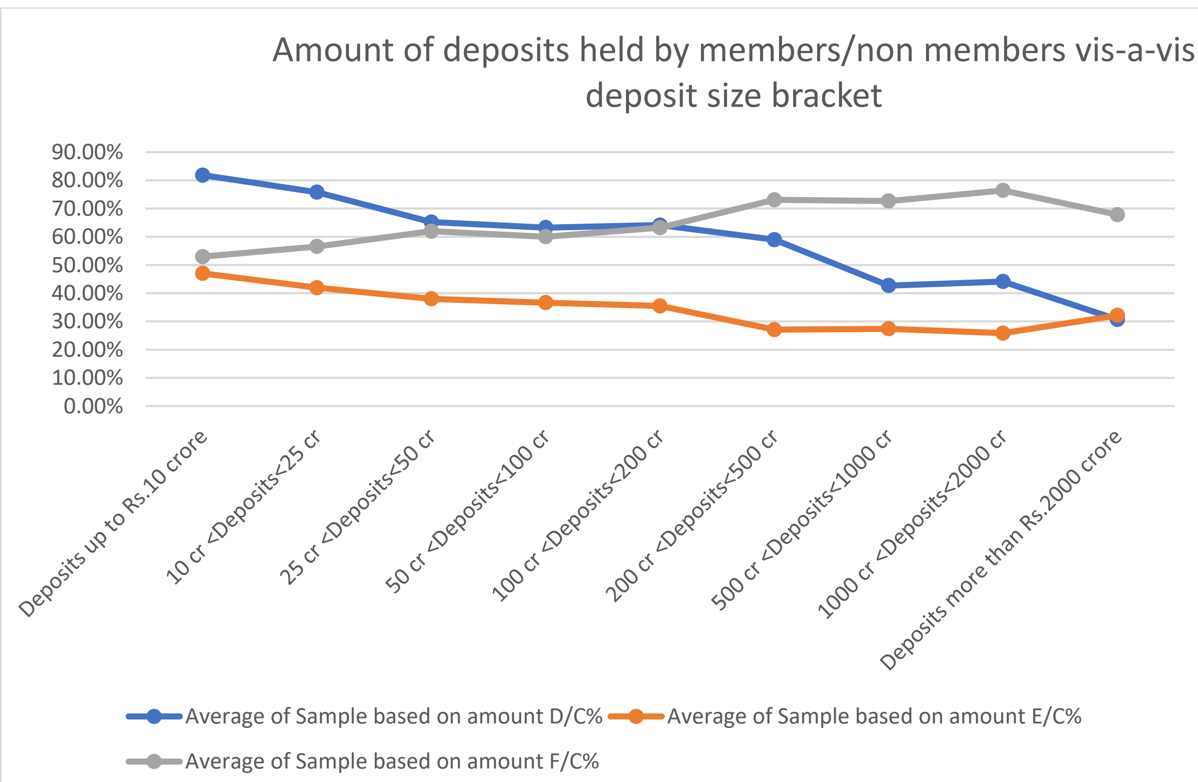
SAMPLE STUDY OF MEMBER AND NON-MEMBER DEPOSITS

Based on a diversified sample of 216 UCBs, an analysis was carried out to ascertain the amount of deposits held by members and non-members. The findings of the study are as under:

Table 1 - Amount of deposits held by members and non-members

Deposit-size wise distribution of UCBs	Average of the Sample		
	D/C%*	E/C%**	F/C%***
Deposits up to ₹10 crore	81.82	47.01	52.95
10 cr <Deposits<25 cr	75.79	41.95	56.56
25 cr <Deposits<50 cr	65.22	38.02	61.98
50 cr <Deposits<100 cr	63.25	36.64	60.03
100 cr <Deposits<200 cr	64.14	35.47	63.24
200 cr <Deposits<500 cr	58.96	27.10	73.11
500 cr <Deposits<1000 cr	42.72	27.40	72.67
1000 cr <Deposits<2000 cr	44.14	25.85	76.42
Deposits more than ₹2000 crore	30.68	32.18	67.82

**D/C% - Ratio of deposits up to ₹5 lakh to total deposits, **E/C% - Ratio of deposits held by members to total deposits, ***F/C% - Ratio of deposits held by non-members to total deposits*

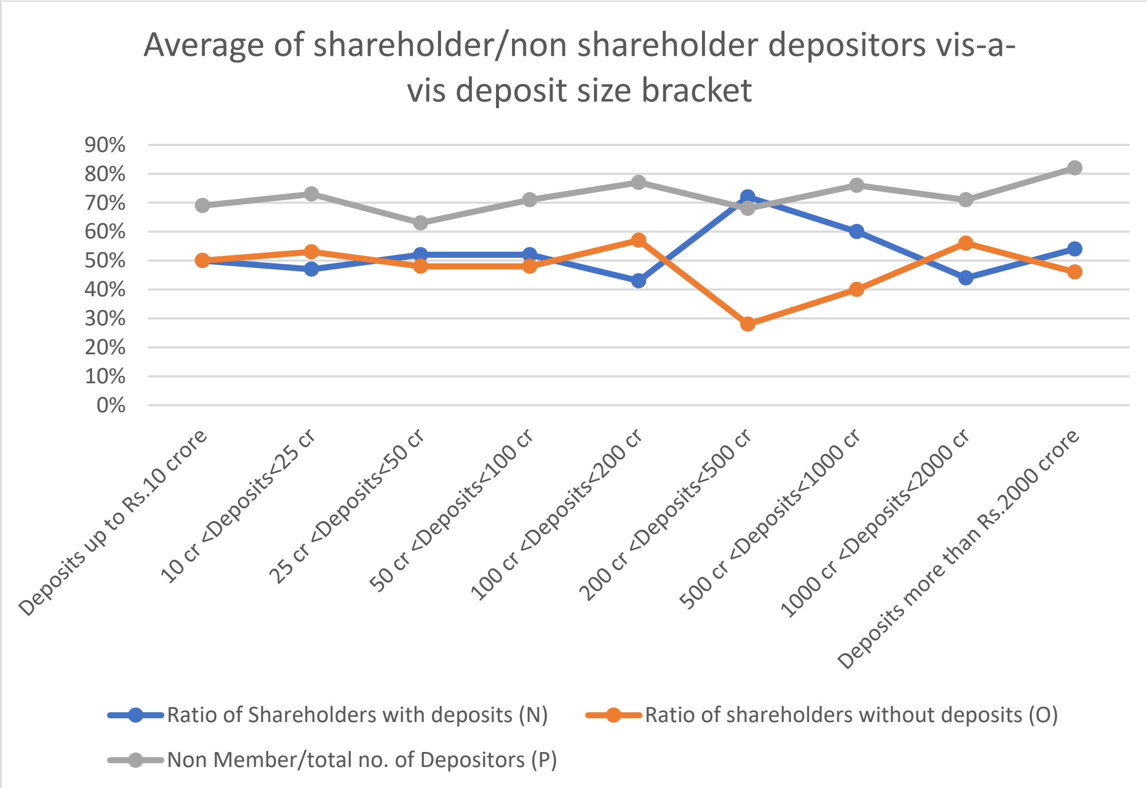


Inference 1: Ratio of deposits up to ₹5 lakh to total deposits (D/C%) showed an inverse relation with the amount of deposits held by UCBs*. Further, for UCBs having deposits below ₹100 crore, about 30 per cent of the deposits were not covered under DICGC insurance.*

Inference 2: Ratio of deposits held by members to total deposits held by the bank (E/C%) was less than 50 per cent across the sample and generally had an inverse relation with the amount of deposits held by UCBs.

Table 2 – Proportion of Members Holding / Not Holding Deposits to Total Members, and Non-Members Holding Deposits to Total Depositors

Distribution of UCBs based on amount of deposits held	Average of sample based on number of members / non-members		
	Ratio of Members with deposits (N%)	Ratio of Members without deposits (O%)	Ratio of Non-Member Depositors to total Depositors (P%)
Deposits up to ₹10 crore	50	50	69
10 cr <Deposits<25 cr	47	53	73
25 cr <Deposits<50 cr	52	48	63
50 cr <Deposits<100 cr	52	48	71
100 cr <Deposits<200 cr	43	57	77
200 cr <Deposits<500 cr	72	28	68
500 cr <Deposits<1000 cr	60	40	76
1000 cr <Deposits<2000 cr	44	56	71
Deposits more than ₹2000 crore	54	46	82



Inference: The proportion of member depositors was much lower than the non-member depositors. Further, data in column "O" indicates that generally less than half of the members chose to keep deposits with the UCBs.

Annex 7

Regulatory Frameworks for UCBs, UNBs, SFBs and RRBs

A. Prudential Norms

S. No.	Function-al area	Sub-area	Prudential Norms			
			UCBs	**UNBs**	**SFBs**	**RRBs**
1	Capital Adequacy	Basel Norms	Under Basel I (with some exceptions, as under)	Under Basel III	Under Basel II but can issue instruments qualifying under Basel III norms viz. AT-1 bonds	Under Basel I
		Capital Charge	• Capital charge for credit risk only, with the following exceptions: - AD Category-I UCBs have to maintain capital for market risk as well. • For other UCBs, an additional risk weight of 2.5 per cent points has been prescribed for market risk. • No capital charge for operational risk	Capital charge for credit risk, market risk, and operational risk	Basel II Standardized Approach for credit risk. No separate capital charge for market and operational risks.	• Capital charge for credit risk only, Market risk on Open Positions only, no capital charge for operational risk.
		Capital Augmentation Instruments	Can issue debt capital instruments in the form of Innovative Perpetual Debt Instruments (IPDI)	Debt capital instruments issued as bond and debentures meeting stipulated criteria are eligible for inclusion in Tier I capital and Tier II capital	Same as SCBs	Can issue debt capital instruments in the form of Innovative Perpetual Debt Instruments (IPDI)

<table>
<tr><th rowspan="2">S. No.</th><th rowspan="2">Function-al area</th><th rowspan="2">Sub-area</th><th colspan="4">Prudential Norms</th></tr>
<tr><th>UCBs</th><th>UNBs</th><th>SFBs</th><th>RRBs</th></tr>
<tr><td rowspan="2">2</td><td rowspan="2">IRAC Norms</td><td>NPA classification</td><td>System based asset classification to be done by select large UCBs with effect from June 2021.</td><td>Automated IT based system (System) for asset classification, upgradation, and provisioning processes.</td><td>Same as SCBs</td><td>Automated asset classification to be done by all RRBs latest by September 30, 2021.</td></tr>
<tr><td>Provisioning</td><td>Agri / SME advances – 0.25 per cent
CRE advances – 1.00 per cent
CRE-RH advances – 0.75 per cent
Other advances – 0.40 per cent (Tier-II UCBs)
Other advances – 0.25 per cent (Tier-I UCBs)
No separate provisions for teaser home loans and restructured advances
Loss asset – 100 per cent
Doubtful Assets - 100 per cent for the unsecured portion.
For secured portion, as under:</td><td>Standard Assets
Agri / SME advances – 0.25 per cent
CRE advances – 1.00 per cent
CRE-RH advances – 0.75 per cent
Teaser rate home loans – 2.00 per cent
Other advances – 0.40 per cent
Restructured advances – 5.00 per cent (for moratorium period + 2 years)
Loss asset – 100 per cent
Doubtful Assets - 100 per cent for the unsecured portion</td><td>Same as SCBs</td><td>Standard Assets
Agri / SME advances – 0.25 per cent
CRE advances – 1.00 per cent
Other advances – 0.40 per cent
Loss asset – 100 per cent
Doubtful Assets - 100 per cent for the unsecured portion
For secured portion, as under:
<table><tr><th>Remained 'doubtful' for</th><th>Provision (%)</th></tr><tr><td>Up to one year</td><td>20</td></tr><tr><td>One to three years</td><td>30</td></tr></table></td></tr>
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<tr><td>Remained 'doubtful' for</td><td>Provision (%)</td></tr>
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<tr><td>One to three years</td><td>30</td></tr>
<tr><td>More than three years</td><td>100</td></tr>
</table>
Substandard Asset (Secured or unsecured) - 10 per cent</td>
<td>For secured portion, as under:
<table>
<tr><td>Remained 'doubtful' for</td><td>Provision (%)</td></tr>
<tr><td>Up to one year</td><td>25</td></tr>
<tr><td>One to three years</td><td>40</td></tr>
<tr><td>More than three years</td><td>100</td></tr>
</table>
Substandard Asset
- For secured – 15 per cent
- For unsecured - 25 per cent</td>
<td></td>
<td><table>
<tr><td>More than three years</td><td>100</td></tr>
</table>
Substandard Asset (Secured or unsecured) - 10 per cent</td></tr>
<tr><td>3</td><td>Loans & Advances</td><td>Priority Sector Lending</td>
<td>PSL target:
Existing - 40 per cent
By March 31, 2024 - 75 per cent

• No target for Agriculture

• Contribution to RIDF or other Funds against shortfall in PSL lending made applicable w.e.f</td>
<td>Total PSL target - 40 per cent of its Adjusted Net Bank Credit (ANBC)

• Targets given for Agriculture, MSME and weaker sections

• Shortfall in PSL lending is allocated for</td>
<td>75 per cent of its Adjusted Net Bank Credit (ANBC) to the sectors eligible for classification as priority sector lending (PSL) by RBI.

Targets given for Agriculture, MSME and weaker sections.</td>
<td>Total PSL target - 75 per cent

• Targets given for Agriculture, MSME and weaker sections.

• Contribution to RIDF or other Funds against shortfall in PSL lending</td></tr>
</table>

S. No.	Function-al area	Sub-area	Prudential Norms			
			UCBs	**UNBs**	**SFBs**	**RRBs**
			March 31, 2020 • UCBs are not members of SLBC and DCC	RIDF (with NABARD) and other Funds with NABARD/NHB/SIDBI/ MUDRA Ltd. • All SCBs are members of SLBC and DCC	40 per cent of its ANBC - different sub-sectors under PSL balance 35 per cent - any one or more sub-sectors under the PSL	made applicable w.e.f March 31, 2020.
		Collection and dissemination of information on Wilful Defaulters	Only Scheduled UCBs are required to report cases of wilful defaults quarterly. (Revised instructions pertaining to monthly reporting to CICs not issued).	All SCBs and AIFIs are required to report cases of wilful default above ₹25 lakh to CICs monthly (since revised MC issued in 2015).	Same as SCBs	-
		CRILC reporting	UCBs having assets > ₹500 crore are now required to report to CRILC, but no sharing of data with banks due to legal impediments	SCBs are required to report to and have access to CRILC database maintained with RBI.	Same as SCBs	-
		NPA Management - Recovery	• Benefit of RDB Act not available. • Benefit of SARFAESI Act is available • Matters related to recovery and write-off are also dealt with in the Co-operative Societies Acts (co-operative courts).	Benefits of RDB Act, SARFAESI Act, etc. are available	Same as SCBs	• Benefit of RDB Act not available. • Benefit of SARFAESI Act is available

S. No.	Function-al area	Sub-area	Prudential Norms			
			UCBs	UNBs	SFBs	RRBs
		Director related loans	After the recent amendments in the BR Act through the BR (Amendment) Act 2020, the principal section 20 now applies to UCBs (earlier a modified version thereof applied to them). However, UCBs are totally prohibited (by issuing a directive u/s 35A of the BR Act in 2003) from giving any loans and advances to director or related persons/entities (except loans against FDR and Insurance Policies).	• Section 20 of the B R Act, 1949 imposes restrictions on loans and advances granted to directors / firm in which director is interested / company in which director is interested / individual of whom any director is partner or guarantor. • SCBs are prohibited from granting loans and advances to or on behalf of any of its directors, or any firm in which any of its directors is interested, or any company or the subsidiary or the holding company where the director is interested; or any individual of whom the director is a partner or guarantor. • Subject to certain exceptions, loans above ₹25 lakh to relatives of directors of the SCB or to directors	Same as SCBs	-

S. No.	Function-al area	Sub-area	Prudential Norms			
			UCBs	**UNBs**	**SFBs**	**RRBs**
				of other banks or to relatives of directors of other banks or to firms / company in which they are interested as partner / guarantor / director / hold substantial interest, should be sanctioned by Board of directors / Management Committee of the SCB. Loans below ₹25 lakh can be sanctioned by appropriate authority under reporting to the board.		
		Gold Loan on bullet repayment	UCBs can grant Gold Loan on bullet repayment upto ₹2 lakh subject to stipulated conditions.	No restriction on amount of Gold Loan on bullet repayment which can be granted by SCBs.	Same as SCBs	RRBs can grant Gold Loan on bullet repayment up to ₹2 lakh subject to certain conditions.
		Interest Subvention Scheme for short term crop loans/agriculture	Benefit not available to UCBs.	Benefit available to SCBs.	Same as SCBs	Benefit available to RRBs
4	Exposure Norms	Single and group borrower limits	Individual borrower - 15 per cent of tier-I capital Group borrowers - 25 per cent of tier-I capital	Single counterparty – Max 20 per cent of eligible capital base Connected	Individual borrower – 10 per cent of capital funds Group borrower – 15	Individual borrower - 15 per cent of owned funds Group borrowers - 25 per cent of owned funs

S. No.	Function-al area	Sub-area	Prudential Norms			
			UCBs	UNBs	SFBs	RRBs
			(For existing loans, exposures to be brought within the above limits by March 31, 2023) In addition, w.e.f. March 31, 2024, ticket size of at least 50 per cent of their loans should be up to ₹25 lakh or 0.2 per cent of tier-I capital, whichever is higher, subject to a maximum of ₹2 crore.	counterparties – Max 25 per cent of eligible capital base (Eligible capital base is effective Tier I capital)	per cent of capital funds 50 per cent of loan portfolio should constitute loans up to ₹25 lakh	
		Interbank exposure	• Interbank (single) exposure limit - 5 per cent of previous year's deposits • Inter-bank (gross) exposure limit - 20 per cent of previous year's deposits	Interbank exposure limit (except intra-day) - 25 per cent of Tier-I capital	Same as SCBs	-
		Housing, Real Estate, Commercial Real Estate	• Max sectoral exposure - 10 per cent of total assets (additional 5 per cent under certain conditions) • Max individual housing loan – ₹30 lakh (Tier-I UCBs) and ₹70 lakhs (Tier-II UCBs)	No regulatory exposure limits	Same as SCBs	No regulatory exposure limits
		Unsecured Advances	• Max total unsecured loans - 10 per cent of total	No regulatory exposure limits	Same as SCBs	-

S. No.	Function-al area	Sub-area	Prudential Norms			
			UCBs	UNBs	SFBs	RRBs
			assets (up to 35 per cent, subject to conditions) • Max individual unsecured loans – ₹0.25 lakh to ₹5 lacs, depending on CRAR level and size of UCBs			
5	Invest-ments	Non-SLR Investments	• Max non-SLR investments - 10 per cent of previous year's deposits • Can invest only in the following instruments: a. Commercial Papers, Bonds, Debentures b. Units of Debt Mutual Funds and money market mutual funds c. Shares of Market Infrastructure companies d. Security Receipts issued by ARCs	• No regulatory exposure limit on non-SLR investments • Can invest in a wide variety of instruments under non-SLR category • Can also invest in Equity Shares, Equity oriented Mutual Funds, Equity / debt / units issued by Venture Capital Funds, Asset Backed Securities (ABS) and Mortgage-Backed Securities (MBS).	Same as SCBs	• RRBs may invest in shares and debentures of corporates and units of mutual funds up to 5 per cent of the incremental deposits at the end of the preceding financial year including buying the shares/debentures from the secondary market. • No ceiling in regard to investments in bonds of (a) Public Sector Undertakings (those fully owned by Central/State Governments or in which Central / State Governments have more than 50 per cent equity holding) (b) All India Financial

S. No.	Function-al area	Sub-area	Prudential Norms			
			UCBs	UNBs	SFBs	RRBs
						Institutions • RRBs can invest their non-SLR surplus funds in risk-sharing participation certificates (PCs) issued by sponsor banks on agreed terms subject to the following: a) The Participation Certificates will be within the overall ceiling of 15 per cent of fresh lending during a year fixed for the purpose subject to Single party/group exposure norms. • Can also invest Commercial paper, Certificate of Deposits, Capital gains bonds, Bonds eligible for priority sector status, Bonds issued by Central or State public sector undertakings, with or without government guarantees; and Bonds issued by banks and financial institutions.

S. No.	Function-al area	Sub-area	Prudential Norms			
			UCBs	UNBs	SFBs	RRBs
						• Can also invest in Equity Shares, Equity oriented Mutual Funds,
		Investment in HTM category	• Max investment under HTM category - 25 per cent of total investment. But may exceed the limit if excess investment is in SLR instruments. • Max SLR investments under HTM - 25 per cent of NDTL.	• Max investment under HTM category - 25 per cent of total investment. But, may exceed the limit if excess investment is in SLR instruments. • Max SLR investments under HTM - 19.5 per cent of NDTL.	Same as SCBs	• Max investment under HTM category - 25 per cent of total investment. But may exceed the limit if excess investment is in SLR instruments • Max SLR investments under HTM - 24.5 per cent of NDTL.
		Investment in AFS category	To be marked to market at year-end or more frequent intervals	To be marked to market at quarterly or more frequent intervals	Same as SCBs	To be marked to market at quarterly or more frequent intervals
6	Liquidity Manage-ment	Liquidity Standards	LCR and NSFR not applicable	LCR and NSFR applicable	Same as SCBs	LCR and NSFR not applicable
		Access to FALLCR	Not applicable	Facility to Avail Liquidity for Liquidity Coverage Ratio applicable	Same as SCBs	Not applicable
		Access to LAF and MSF	Only CBS-enabled scheduled UCBs having minimum CRAR of 9 per cent have such access	All SCBs have access to LAF and MSF.	Only Scheduled SFBs	Only CBS-enabled scheduled RRBs having minimum CRAR of 9 per cent have access.
		Issuance of CDs	Not permitted to issue CDs	Permitted to issue CDs	Same as SCBs	-

S. No.	Function-al area	Sub-area	Prudential Norms			
			UCBs	**UNBs**	**SFBs**	**RRBs**
7	Entry Point Norm	-	Minimum net worth requirement – ₹25 lakhs to ₹4 crore, depending on category of the centre and type of the UCB. (As a matter of policy, RBI has not been issuing any UCB licenses since 2004).	Minimum equity capital of ₹500 crore for SCBs	₹200 Crore (as per 'on tap' guidelines 2019)	Minimum Authorised capital increased from ₹5 crore to ₹2000 crore *vide* The Regional Rural Banks (Amendment) Act, 2015 No. 14 of 2015 w.e.f. February 04, 2016.
8	Audit	Appointment of Statutory Auditor	Appointment of auditors in UCBs came under the purview of Registrar of Co-operative Societies. However, as per the MoUs entered into with the State Governments, a provision was made that all UCBs having deposits more than ₹25 crore are audited by Chartered Accountants. Moreover, we have also circulated LFAR to RCSs for onward circulation to statutory auditors of UCBs. Now after the recent amendments to BR Act, Section 30 of the principal Act is applicable to UCBs. DoS is working on its implementation.	Appointment of auditors is done with prior approval of RBI. (As per Section 30 of BR Act, 1949, Section 41 of SBI Act, 1955 and Section 10 of Banking Companies (Acquisition and Transfer of Undertakings Act, 1970).	Same as SCBs	A panel of auditors is prepared by NABARD and provided to the concerned RRBs, in terms of guidelines and on behalf of GoI.

S. No.	Function-al area	Sub-area	Prudential Norms			
			UCBs	UNBs	SFBs	RRBs
		Remuneration of Statutory Auditors	Remuneration of Statutory Auditors of UCBs is governed by respective Co-operative Societies Acts and comes under the purview of Registrars of Co-operative Societies.	• Remuneration of Statutory Auditors of PSBs is fixed by RBI in consultation with Central Government. (Section 41(2) of SBI Act, 1955, Section 10(2) of Banking Companies (Acquisition and Transfer of Undertakings Act, 1970) • No provision for private sector banks	Same as SCBs	Remuneration of Statutory Auditors of PSBs is fixed by DFS, GoI.
9	Manage-ment	Fit and proper criteria for Board of Directors	After the recent amendments to BR Act, RBI is now empowered to issue guidelines to UCBs on management related aspects. Work is in progress.	Section 10A of the B R Act, 1949 provides for fit and proper criteria for at least 51 per cent of the directors of a SCB.	Same as SCBs	-
		Appointment of CEO / Managing Director	After the recent amendments to BR Act, RBI is now empowered to issue guidelines to UCBs on management related aspects. Work is in progress.	• In terms of Section 35-B of the BR Act, 1949, amendment in provisions related to maximum number of directors, appointment / reappointment / termination of appointment / remuneration of	Same as SCBs	In terms of Section 11 of RRB Act 1976

S. No.	Function-al area	Sub-area	Prudential Norms			
			UCBs	UNBs	SFBs	RRBs
				director / CEO / Managing Director or Whole-time Director of SCBs requires prior approval of RBI. • Section 10 (4) of BR Act, 1949 provides for Fit and Proper criteria for chairman / Managing Director of SCBs.		
		Removal of Chairman / Managing Director / Director	• After the recent amendments to BR Act, RBI is now empowered to remove chairmen/MDs/directors	• RBI has been vested with powers under Section 36AA of the BR Act, 1949 for removal of Chairman / Managing Director / Director of Private Sector SCB. • Section 19-A(3) of SBI Act, 1955 provides for removal of shareholder director by RBI.	Same as SCBs	In terms of Section 12 and 13 of RRB Act, 1976
		Supersession of Board of Directors	After the recent amendments to the BR Act, RBI is now empowered to supersede the Board of all UCBs, albeit in consultation with the Registrar of Co-	• Section 36 ACA of the BR Act, 1949 provides for supersession of Board of Directors of Private Sector SCBs by RBI.	Same as SCBs	-

S. No.	Function-al area	Sub-area	Prudential Norms			
			UCBs	UNBs	SFBs	RRBs
			operative Societies in case of single-state UCBs.	• Section 24A of SBI Act, 1955 provides for supersession of entire Central Board of SBI by RBI.		
10	Other activities	Agency Banks	UCBs are not appointed as agency banks.	SCBs can be appointed as agency banks for conducting Government Business.	Not permitted	RRBs can act as sub agents for handling pension and other government business of the concerned banks
		Credit Guarantee Fund Trust for Micro and Small Enterprises (CGTMSE) coverage	UCBs are now eligible MLIs under CGTMSE (w.e.f. March 3, 2020).	SCBs are member lending institutions (MLI) under CGTMSE, through which credit guarantee is provided for credit extended to MSEs (for credit up to ₹200 lakh)	Same as SCBs	Selected RRBs fulfilling the prescribed criteria. The Trust shall cover credit facilities (Fund based and/or Non fund based) extended by select RRB(s) to a single eligible borrower in the Micro and Small Enterprises sector for credit facility not exceeding ₹50 lakh by way of term loan and/or working capital facilities on or after entering into an agreement with the Trust, without any collateral security and/or third-party guarantees.
		Small Savings Schemes	UCBs are not permitted to operate Small Savings Scheme.	SCBs are permitted to operate Small Savings Scheme (SSS).	Not permitted	Not permitted

S. No.	Function-al area	Sub-area	Prudential Norms			
			UCBs	UNBs	SFBs	RRBs
11	Powers for reconsti-tution and amalga-mation of banks	Powers available to RBI	After the recent amendments to the BR Act, powers under Section 45 of the BR Act are now available to RBI in respect of UCBs.	Under Section 45 of the BR Act, after imposition of moratorium on SCBs, RBI has been vested with powers to prepare scheme for reconstruction or amalgamation of such banks which comes in effect after the approval of Central Government.	Same as SCBs	Amalgamation is conducted by GoI in consultation with NABARD in terms of 23 A, B, C and D of RRB Act, 1976.
12	Bench-mark Rate for lending	Guidelines on use of a Benchmark Rate	UCBs are permitted to determine their lending rates taking into account their cost of funds, transaction costs etc with the approval of their Board. They have not been issued any instructions for linking the lending rates with any internal or external benchmark.	Lending rates for all new floating rate personal or retail loans, or loans to Micro and Small Enterprises is required to be benchmarked to external benchmark w.e.f. from October 01, 2019.	Same as SCBs	RRBs are permitted to determine their lending rates taking into account their cost of funds, transaction costs etc with the approval of their Board. They have not been issued any instructions for linking the lending rates with any internal or external benchmark.

B. Regulatory Approvals

Sr. No.	Function al area	Activity	Approval conditions			
			UCBs	UNBs	SFBs	RRBs
1	Licensing	Annual Business Plan (Opening of Branches,	**(Prior approval route)** Only UCBs satisfying	Domestic scheduled commercial banks (other than RRBs) are permitted to open,	In terms of Circular DOR.NBD.No.44/16.13.218/2019-20 dated March 28, 2020,	**(Automatic Route)** Regional Rural Banks are required to submit their Annual Banking Outlet

Sr. No.	Functional area	Activity	Approval conditions			
			UCBs	UNBs	SFBs	RRBs
		Extension Counter)	FSWM criteria are eligible to apply.	unless otherwise specifically restricted, Banking Outlets in Tier 1 to Tier 6 centres without having the need to take permission from RBI in each case.	existing SFBs have been granted general permission to open banking outlets subject to adherence to Unbanked Rural Centre norms as per RBI circular on 'Rationalisation of Branch Authorisation Policy - Revision of Guidelines' dated May 18, 2017. Further, as per Guidelines for 'on tap' Licensing of SFBs in the Private Sector dated December 05, 2019, (new) Small finance banks will have general permission to open banking outlets from the date of commencement of business as per Circular dated May 18, 2017.	Expansion Plan (ABOEP), with the approval of Board of Directors, together with the consolidated details of proposals for opening, closing, shifting, merger and conversion of the banking outlets to Regional Office concerned of RBI, and to NABARD for monitoring.

Sr. No.	Functional area	Activity	Approval conditions			
			UCBs	UNBs	SFBs	RRBs
		Opening of On-site ATMs	**(Automatic Route)** FSWM UCBs are permitted, without prior approval from RBI. **(Prior approval route)** Non - FSWM UCBs can open with prior approval of RBI.	In terms of para 8 of Circular dated May 18, 2017, SCBs are allowed to set up onsite/offsite Automated Teller Machines (ATMs) at centres / places identified by them, including SEZs.	In terms of para 8 of Circular dated May 18, 2017, SFBs are allowed to set up onsite/offsite Automated Teller Machines (ATMs) at centres / places identified by them, including SEZs.	**(Automatic Route)** All RRBs are permitted to open to install on-site ATMs without prior approval from RBI.
		Opening of Off-site/mobile ATMs	**Only FSWM UCBs can open Off-site/mobile ATMs.** **(Automatic Route)** FSWM UCBs having net worth of at least ₹50 crore are permitted, without prior approval from RBI. **(Prior approval route)** FSWM UCBs having net worth less than ₹50 crore are required to obtain prior approval from RBI.	In terms of para 8 of Circular dated May 18, 2017, SCBs are allowed to set up onsite/offsite Automated Teller Machines (ATMs) at centres / places identified by them, including SEZs.	In terms of para 8 of Circular dated May 18, 2017, SFBs are allowed to set up onsite/offsite Automated Teller Machines (ATMs) at centres / places identified by them, including SEZs.	(Automatic Route) All RRBs are permitted to open to install off-site ATMs without prior approval from RBI.
		Specialized branches - Central Processing Centres (CPCs)	**(Prior approval route)**	In terms of para 10 of circular dated May 18, 2017, SCBs having general permission can set up Administrative	In terms of Circular DOR.NBD.No.44/16.13.218/2019-20 dated March 28, 2020, existing SFBs have	**(Prior approval route)** Prior permission of concerned RO is required by RRBs.

Sr. No.	Functional area	Activity	Approval conditions			
			UCBs	UNBs	SFBs	RRBs
		/ Retail Asset Processing Centres	UCBs satisfying FSWM criteria are eligible to apply through the ABP route.	Offices (Head / Regional / Zonal Offices etc.), Training Centres, Back Offices (Central Processing Centres (CPCs) / Service Branches), Treasury Branches and Call Centres, etc. without prior permission from RBI.	been granted general permission to open banking outlets including specialised branches. Further, as per Guidelines for 'on tap' Licensing of SFBs in the Private Sector dated December 05, 2019, (new) Small finance banks will have general permission to open banking outlets including specialised branches , from the date of commencement of business, as per Circular dated May 18, 2017.	
		Shifting of Branches	**(Prior approval route)** Shifting of branch from one city to another requires prior approval from RBI.	In terms of Para 5 of circular dated May 18, 2017 (to be read with para 3 of our circular dated August 06, 2015), domestic scheduled commercial banks (other than Regional Rural Banks) may shift, merge or close all 'Banking Outlets' (except rural outlets and sole semi-	In terms of Para 5 of circular dated May 18, 2017 (to be read with para 3 of our circular dated August 06, 2015), SFBs may shift, merge or close all 'Banking Outlets' (except rural outlets and sole semi-urban outlets) at their discretion subject to compliance with the	RRBs may shift, merge or close all banking outlets (except rural outlets and sole semi-urban outlets) at their discretion. Merger, closure and shifting of any rural banking outlet as well as a sole semi urban banking outlet would require approval of the DCC/DLRC and Regional Office concerned of RBI.

Sr. No.	Functional area	Activity	Approval conditions			
			UCBs	UNBs	SFBs	RRBs
				urban outlets) at their discretion subject to compliance with the guidelines issued in this regard.	guidelines issued in this regard.	
		Closure of Branches and Extension Counters	**(Automatic Route)** UCBs can close un-remunerative branches / extension counters without prior permission of RBI subject to certain conditions.	same as above	same as above	
		Extension of Area of Operation beyond the state of registration	**(Prior approval route)** FSWM UCBs having a net worth of at least ₹50 crore are eligible to apply.	Not applicable	Not applicable	Not permitted. Area of operation of RRBs is fixed by GoI.
2	Schedul-ing	Scheduling of UCBs (prior Approval)	**(Prior approval route)** UCBs satisfying certain criteria are eligible to apply.	**(Prior approval route)** New SCBs after commencement of operations are eligible to apply.	**(Prior approval route)** New SFBs after commencement of operations are eligible to apply.	RRBs are Scheduled Commercial Banks. Newly amalgamated RRBs are Scheduled by RBI on the basis of certificate issued by NABARD.
3	Market related Approvals	Secondary Market Transactions in Government Securities – Intra-day short selling	**(Automatic Route)** UCBs having NDS-OM membership and satisfying certain criteria are permitted without prior approval from RBI.	Allowed	Same as SCBs	**(Automatic Route)** RRBs having NDS-OM membership and satisfying certain criteria are permitted without prior approval from RBI.

Sr. No.	Functional area	Activity	Approval conditions			
			UCBs	UNBs	SFBs	RRBs
		Ready Forward Contracts in Corporate Debt Securities (Automatic Route)	**(Automatic Route)** Scheduled UCBs satisfying certain criteria are permitted without prior approval from RBI.	Allowed	Same as SCBs	-
		AD Category I	**(Prior approval route)** Scheduled UCBs satisfying certain criteria are eligible to apply.	Allowed subject to prior approval	SFBs are not eligible	Not applicable
		AD Category II	**(Prior approval route)** Scheduled UCBs satisfying certain criteria are eligible to apply.	Allowed subject to prior approval	Same as SCBs	Not applicable
		Maintaining NRE / NRO Accounts	**(Prior approval route)** 'A' rated UCBs satisfying certain criteria are eligible to apply.	Allowed subject to approval	Same as SCBs	**(Prior approval route)** RRBs may open and maintain NRE/NRO account subject to certain conditions prescribed by RBI.
		Currency Chest	**(Prior approval route)** 'A' rated Scheduled UCBs satisfying certain criteria are eligible to apply.		Same as SCBs	
		Liquidity Adjustment Facility	**(Prior approval route)**		Scheduled SFBs only with process same as SCBs	**(Prior approval route)**

Sr. No.	Functional area	Activity	Approval conditions			
			UCBs	UNBs	SFBs	RRBs
			Scheduled UCBs are only eligible.			Scheduled RRBs are only eligible
		Membership to NDS-OM	**(Prior Approval route)**	**(Prior Approval route)**	Same as SCBs	**(Prior Approval route)**
4	Customer Services	Trading Facility to De-mat Account Holders	**(Prior approval route)** FSWM UCBs, registered as depository participant with SEBI and satisfying certain criteria are eligible to apply.	Allowed	Require prior approval	-
		Engaging the services of Business Correspondents (BC) / Business Facilitators (BF)	**(Prior approval route)** UCBs satisfying FSWM criteria are eligible to apply.	In terms of Para 8 of circular dated July 01, 2014, scheduled commercial banks including Regional Rural Banks (RRBs), Local Area Banks (LABs) may formulate a policy for engaging Business Correspondents (BCs) with the approval of their Board of Directors subject to compliance with the guidelines issued in this regard.	In terms of para P of circular dated July 01, 2014, scheduled commercial banks including SFBs may formulate a policy for engaging Business Correspondents (BCs) with the approval of their Board of Directors subject to compliance with the guidelines issued in this regard.	**(Automatic Route)**
		Internet Banking	**(Prior approval Route)** UCBs which have implemented Core Banking Solution (CBS) and migrated to Internet	Allowed subject to approval	Same as SCBs	**(Prior approval Route)** RRBs which have implemented Core Banking Solution (CBS) and migrated to Internet Protocol Version 6 (IPv6)

Sr. No.	Functional area	Activity	Approval conditions			
			UCBs	**UNBs**	**SFBs**	**RRBs**
			Protocol Version 6 (IPv6) and complying with certain criteria are eligible to apply.			and complying with certain criteria are eligible to apply.
		Mobile Banking	**(Prior approval Route)** UCBs satisfying certain criteria are permitted	Allowed subject to approval	Same as SCBs	**(Prior approval Route)** RRBs satisfying certain criteria are permitted
		Centralised / Decentralised Payment System (RTGS / NEFT)	**(Prior approval Route)** UCBs satisfying certain criteria are permitted	**(Prior approval Route)** SCBs satisfying certain criteria are permitted	Same as SCBs	**(Prior approval Route)** RRBs satisfying certain criteria are permitted
		Internet Banking (View Only)	**(Automatic Route)** UCBs which have implemented Core Banking Solution (CBS) and migrated to Internet Protocol Version 6 (IPv6) and complying with certain criteria are permitted without prior approval from RBI.	-	Same as SCBs	**(Automatic Route)** RRBs which have implemented Core Banking Solution (CBS) and migrated to Internet Protocol Version 6 (IPv6) and complying with certain criteria are permitted without prior approval from RBI.
5	Fee based income services	PAN service Agents	**(Prior approval route)** All UCBs are eligible to apply.	Do not require prior approval	Undertake non-risk sharing simple financial services activities, not requiring any commitment of own fund, such as distribution of mutual fund units, insurance products, pension	-

Sr. No.	Functional area	Activity	Approval conditions			
			UCBs	**UNBs**	**SFBs**	**RRBs**
					products etc with the prior approval of RBI for first three years from the date of commencement of operations	
		Issue of Pre-paid payment instruments	**(Prior approval route)**	**(Prior approval route)**	Same as SCBs	**(Automatic Route)** RRBs complying with the instructions issued by DPSS are eligible to operate. Mobile Banking permission is also required to launch mobile based pre-paid payment instruments (mobile wallets & mobile accounts).
		Point of Presence (PoP) services under PFRDA's National Pension System by UCBs	**(Automatic Route)** FSWM UCBs having a net worth of at least ₹100 crore and are satisfying certain other criteria are permitted without prior approval from RBI.	Permitted	Undertake non-risk sharing simple financial services activities, not requiring any commitment of own fund, such as distribution of mutual fund units, insurance products, pension products etc. with the prior approval of RBI for first three years from the date of commencement of operations	-

Sr. No.	Functional area	Activity	Approval conditions			
			UCBs	**UNBs**	**SFBs**	**RRBs**
		Insurance agency business as corporate agents without risk participation	**(Automatic Route)** UCBs having a net worth of at least ₹10 crore and are not classified as Grade III or IV bank are permitted without prior approval from RBI.	Permitted	Undertake non-risk sharing simple financial services activities, not requiring any commitment of own fund, such as distribution of mutual fund units, insurance products, pension products etc. with the prior approval of RBI for first three years from the date of commencement of operations	**(Automatic Route)** RRBs may take up corporate agency business, without risk participation, for distribution of all types of insurance products, including health and animal insurance, without prior approval of RBI
		Marketing of units of Mutual Funds as agents	**(Automatic Route)** All UCBs are permitted without prior approval from RBI, subject to certain riders.	Permitted	Undertake non-risk sharing simple financial services activities, not requiring any commitment of own fund, such as distribution of mutual fund units, insurance products, pension products etc. with the prior approval of RBI for first three years from the date of commencement of operations	**(Automatic Route)** All RRBs are permitted without prior approval from RBI, subject to certain conditions.
6	Capital augmentation	Issuance of preference share	**(Prior approval route)**	Permitted	Same as SCBs	-

Sr. No.	Functional area	Activity	Approval conditions			
			UCBs	**UNBs**	**SFBs**	**RRBs**
			All UCBs are eligible to apply.			
		Issuance of LTD	**(Prior approval route)** All UCBs are eligible to apply.	Not applicable	Not applicable	Not applicable

Annex 8

BOARD OF MANAGEMENT

The Urban Co-operative Banks (UCBs) are registered as co-operative societies under the state co-operative law / Multi-state co-operative societies Act and have been granted banking licence by the RBI under the provisions of BR Act, 1949. Thus, UCBs have been under the purview of two regulators viz. RCS/CRCS and RBI, giving rise to the issue of dual regulation. Further, prior to the enactment of the Banking Regulation (Amendment) Act, 2020, the RBI had limited powers relating to management of UCBs. Taking cognizance of this issue, the Expert Committee on Licensing of new UCBs (2011) headed by Shri Y.H. Malegam suggested segregation of the ownership of the UCB as a co-operative society from its functioning as a bank and proposed a new organisational structure consisting of Board of Management (BoM) in addition to Board of Directors (BoD). Under this structure, it was envisaged to infuse the desired professionalism at the policy making and decision-making levels in a UCB through BoM. It was further envisaged that RBI would exercise regulatory powers over BoM in a manner similar to BoD of a banking company. The High-Powered Committee (HPC) headed by Shri R. Gandhi also reiterated the need of BoM in UCBs. It, *inter alia*, recommended that constitution of the BoM should be a precondition for branch expansion and extending the area of operations of the UCBs.

2. Based on the recommendations of the HPC and with due consultations with the stakeholders, the RBI issued guidelines on BoM in UCBs on December 31, 2019. The guidelines require UCBs (except all Salary Earners' Banks) with deposit size of ₹100 Crore and above to constitute BoM by making suitable amendments in their bye-laws, within one year of issuance of these guidelines. The BoM shall comprise of persons with special knowledge and practical experience in banking to facilitate professional management and focused attention to the banking related activities of the UCBs. Further, based on HPC's recommendation, constitution of BoM was made a mandatory requirement for allowing UCBs (except Salary Earners' Banks) with deposit size of ₹100 Crore and above, to expand their area of operation and open new branches. The members of BoM are required to have special knowledge or practical experience in respect of one or more of the matters *viz.* Accountancy, Agriculture and Rural Economy, Banking, Co-operation, Economics, Finance, Law, Small scale industry, Information Technology, any other subject, which would, in opinion of the RBI, be useful to the UCB. The RBI shall have powers to remove any member of BoM if the person is found to be not meeting the criteria prescribed by RBI or acting in a manner detrimental to the interests of the bank or its depositors or both. Further, the BoD shall seek concurrence from RBI before removing any member of the BoM / accepting the resignation tendered by any member of the BoM. The RBI shall also have powers to supersede the BoM if the functioning of BoM is found unsatisfactory.

3. While the UCBs were in the process of implementing the guidelines of BoM, the BR Act was amended by the enactment of the Banking Regulation (Amendment) Act, 2020. The amendment Act has, *inter alia,* made the management related provisions of the Act applicable to UCBs. These provisions lay down the requirement of the Board of UCBs to have not less than 51 per cent members having special knowledge/experience in specified areas (Section 10A), restricting the tenure of a Director up to 8 years (Section 10B), prior permission of the RBI for appointment of Chairman (Section 35B). The amended Act also empowers the RBI to supersede the BoD of UCBs (Section 36AAA) and to remove Directors of a UCB (Section 36AA).

4. As far as applicability of provisions of the Act related to management are concerned, the amendment Act has brought UCBs nearly on par with the banking companies. During the interactions of the Committee with the stakeholders, UCBs and their federations brought to the notice of the Committee the difficulty of getting professionals to join the BoM. It was also argued that the BoM would create an additional tier of governance and power centre with attendant lack of clarity on roles and responsibilities. The Committee deliberated on the issue at length and concluded that the concerns raised are not new and that the BoM was a reasonable alternative despite these difficulties and shortcomings in the absence of adequate power for the RBI in matters relating to governance of UCBs. The Committee considers that going by the logic of the Malegam Committee or HPC in recommending the BoM, it was more a second-best solution in the absence of statutory provisions of the kind now brought in the BR Act. Now that the RBI's powers over matters relating to Governance are on par with those of commercial banks, the solution to the problem which the Malegam Committee and HPC tried to address through the BoM is available in the legislative framework. In the circumstances, the Committee felt that the BoM will bring to fore its disadvantages for solving a problem which is now addressed under the statute within the framework of the law.

5. In view of the aforesaid, **the Committee is of the view that with the recent amendments in the Act, BoM may not be required and recommends that the regulatory prescription to UCBs to constitute BoM may be withdrawn. However, while doing so, it may be ensured that the UCBs are complying with the provisions of the amended Act in letter and spirit.**

JYOTINDRA MEHTA
PRESIDENT

NAFCUB

Date 30th JUly 2021

To,

The Chairman
Expert Committee on Primary (Urban) Cooperative Banks

Dear Sir,

Sub: Final Recommendations of the Expert Committee on Urban Cooperative Banks

It has been a privilege for me to be a member o the Committee and discuss issues related to the terms of reference with very learned Chairman and fellow members in the Committee.

I am thankful to the Chairman and the members for accepting some of my suggestions and those of federations and banks. More particularly, I would like to list out the following where our points of view have been incorporated:

1. Recommendation to drop the requirement of constituting BOM in all tier II banks and making it a condition for branch expansion.

2. Making scheduling of eligible banks automatic.

3. Inclusion of Revaluation Reserve in computation of Tier I capital.

4. Inclusion of UCBs as eligible banks in all the government schemes such as MUDRA, CGTMSE, Interest Subvention/Subsidy Scheme, etc.

5. Approval b Govt. for UCBs to undertake Government Business, with prescribed criteria.

6. Empowering TAFCUBs to play important role in rehabilitation of weak banks.

7. Recommending resumption of Licensing of new UCBs, though conditional to UO becoming operational, revising earlier proposed recommendation of continuing to keep the issue on hold.

NATIONAL FEDERATION OF URBAN COOPERATIVE BANKS AND CREDIT SOCIETIES LTD.
B-14, 3rd Floor, A-Block Shopping Complex, Naraina Vihar, Ring Road, New Delhi-110028, India
Telephone : 25771170, 25770108 Fax : 25779710, Mob. : +91 9427613701 E-mail : nafcub.jyotindramehta@gmail.com, coop@nafcub.org

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8. Grouping the banks into 4 groups according deposits for differential regulation.

9. Allowing very large banks all the freedom available to commercial banks by prescribing Basel III norms.

10. Donations to be considered as contribution to capital without accompanying voting rights.

11. Recommending relaxations/enhancement in housing loans and gold loans

However, the Report includes many recommendations that I had opposed and even the sector is also not in favour. As a representative of the sector, I would regretfully have to voice my dissent, with a request to take note of it and include the same in the body of the report.

My dissent on various recommendations is as detailed below

1. Problems arising in implementing B R Act after amendment

I do not agree with the recommendation that by RBI just considering clarifying the position appropriately to RCS/CRCS on jurisdictional issues arising out of Banking Regulation (Amendment) Act 2020 will solve the problems of UCBs in this regard. It will require a committee to examine the issues and both sides agreeing to a road map of implementation. In absence of such a clear understanding the UCBs could be put to unending regulatory problems and delays.

2. Voluntary conversion of UCBs to Joint stock companies

I strongly disagree with the endorsement of the idea of voluntary conversion of UCBs to joint stock companies. It militates against the purpose and concept of cooperation. It is not simple issue of all the shareholders opting for changing the structure of the organization. As cooperatives are based on principles of taking limited returns and creating collective reserves which are passed on to next generation of members / shareholders to be held on trust. It is not ethical for a particular generation of shareholders to encash this surplus by converting the cooperative into a joint stock company and making windfall gains.

NATIONAL FEDERATION OF URBAN COOPERATIVE BANKS AND CREDIT SOCIETIES LTD.
B-14, 3rd Floor, A-Block Shopping Complex, Naraina Vihar, Ring Road, New Delhi-110028, India
Telephone : 25771170, 25770108 Fax : 25779710, Mob. : +91 9427613701 E-mail : nafcub.jyotindramehta@gmail.com, coop@nafcub.org

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It is definitely not moral for the regulator to encourage this unethical practice by according permission to and legitimizing the route by providing guidelines for such conversion. If the members are so interested, the bank may be wound up by liquidation of assets and satisfaction of all liabilities, and the shareholders may form a joint stock company and approach the RBI with a proposal for granting a banking license.

3. Regulatory Prescriptions

A. Tier I banks

i. I do not agree with the recommendation that we should put a figure of minimum capital of ₹ 2 crore and ₹ 5 crore at this juncture for banks that have been licensed on the basis of entry point norms and are meeting the regulatory requirement of CRAR. The idea of banks being well capitalized at all times can be achieved, instead of recommending arbitrary figures to be met in a given time frame, by prescription of steady growth of 10 per cent in net worth every year as suggested by me in discussions and connecting it to the eligibility for opening branches. This would have been a more constructive way of achieving the same goal for the Tier I banks, notwithstanding the reasoning that without minimum prescribed net worth the banks these days will not be able to meet the expenses needed for technology. Tier I banks do not do big capital expenditure on technology as they are all on use and pay system.

ii. While the prescription of 9 per cent CRAR is alright, I do not agree with the loading of 2.5 per cent, both, for not meeting with the minimum capital norm and for not being member of UO. This should be 1 per cent so that the maximum requirement of CRAR is not more than 11 per cent for Tier I banks.

iii. I do not agree with the prescription of annual increase of 10 per cent in branch expansion of The Tier I banks and of their opening branch in unbanked areas. They should allowed to open branches based on availability of the head room capital, as most of them have very few branches and there is no point in prescribing the 10 per cent norm. It was repeatedly mentioned that UCBs generally open branches in urban clusters and they are not unbanked.

NATIONAL FEDERATION OF URBAN COOPERATIVE BANKS AND CREDIT SOCIETIES LTD.
B-14, 3rd Floor, A-Block Shopping Complex, Naraina Vihar, Ring Road, New Delhi-110028, India
Telephone : 25771170, 25770108 Fax : 25779710, Mob. : +91 9427613701 E-mail : nafcub.jyotindramehta@gmail.com, coop@nafcub.org

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B. Tier II banks

i. It has been argued by us that in the absence of credible avenues of raising capital for all small and mid-sized banks of tier I and tier II there is no logic in prescribing a steep increase of 6 per cent, from present 9 per cent to 15 per cent, in CRAR with 1 per cent reduction, if they are the members of the UO. I do not subscribe to the recommendation. It should not have been more than 12 per cent at the most, with 1 per cent more for not being the member of the UO.

ii. I do not agree on ceiling of 10 per cent on number of branches that can be opened annually and, on the compulsion, to open branches in unbanked areas. As in tier I, banks in tier II also should have been allowed to open branches up to the head room capital permits without the ceiling of 10 per cent and prescription of compulsory opening of branches in unbanked areas

iii. The recommendation that Tier II banks may continued to be under RBI prescription of loan limit (50 per cent of loan accounts to be under ₹ 25 lakhs or 0.2 per cent of capital subject maximum of ₹ 1 crore) and PSL (75 per cent of advances) is not agreeable. The reduction of PSL to 50 per cent and removal of ceiling of ₹ 1 crore was proposed by sector and it should have been recommended. The recommendation of 95 per cent of incremental loans be subject to the norms till the bank becomes compliant would not really serve the purpose. It would have been meaning full if the percentage was close to 50 per cent so that the growth requirements of existing good borrowers are met and they remain with the banks.

C. Tier III banks

I do not agree with the recommendations for following reasons:

i. While the recommendation that banks having deposits of over ₹ 1000 crore meeting with the net worth criteria of ₹ 200 crore and CRAR of 15 per cent will be entitled for all the operational freedom of an SFB that include entire country as area of operation, freedom to open branches, automatic scheduling, AD licensing etc. is good, 1% reduction I CRAR if bank is member of UO should have been included instead of making it optional for Tier III banks.

NATIONAL FEDERATION OF URBAN COOPERATIVE BANKS AND CREDIT SOCIETIES LTD.
B-14, 3rd Floor, A-Block Shopping Complex, Naraina Vihar, Ring Road, New Delhi-110028, India
Telephone : 25771170, 25770108 Fax : 25779710, Mob. : +91 9427613701 E-mail : nafcub.jyotindramehta@gmail.com, coop@nafcub.org

(5)

ii. Tier III banks will be hardest hit if the loan limit and PSL norms as existing are either not made inapplicable to them or diluted as suggested for tier II banks.

D. Tier IV banks

i. The recommendation of all Tier IV banks having deposits of over ₹ 10,000 crore and net worth of over ₹ 500 crore will governed by Basel III and commercial banks CRAR prescription and will be eligible for all the regulatory freedom of a universal commercial bank also implies that the existing loan limit and PSL norms of UCBs will not be applicable to them.

The recommendation that banks in tier IV b virtue of deposit size but ineligible to be authorised to function as universal bank should conform to regulations applicable to tier IV banks but will be given operational freedom of tier II banks is not acceptable and I dissent on this recommendation which also prescribes the loan limit / PSL norms of SFBs for them.

Ii. I oppose the recommendation of not providing any regulatory incentive / nudge for Tier IV banks to become members of UO.

4. SAF and TAFCUB

i. My dissent is on the fact that there is no clarity in recommendation as to how the present problem of TACFUB having become ineffective with the introduction of SAF is to be solved. TAFCUB is still an important forum to bring all the stakeholders together, notwithstanding the primacy that the Banking Regulation Act amendment confers upon RBI. All the stakeholders, big and small come together with TAFCUB.I also have to dissent on the emphasis that SAF should be such that resolution time is minimized and stating that the all-inclusive direction should be treated on par with moratorium under Sec45 and if imposed should not continue to there under beyond the time permitted to keep a bank under moratorium. Recommendations for action under Stage III SAF will help in neither rehabilitation nor merger of existing number of weak banks thereby not helping the depositors' interest. Stage III is being recommended when the net worth is very much positive. If all inclusive directions are imposed at this stage, (there are over 50 banks under this category), the banks will have to close down.

NATIONAL FEDERATION OF URBAN COOPERATIVE BANKS AND CREDIT SOCIETIES LTD.
B-14, 3rd Floor, A-Block Shopping Complex, Naraina Vihar, Ring Road, New Delhi-110028, India
Telephone : 25771170, 25770108 Fax : 25779710, Mob. : +91 9427613701 E-mail : nafcub.jyotindramehta@gmail.com, coop@nafcub.org

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5.Umbrella Organisation

I do not agree with recommendation on UO that for Tier III and Tier IV banks there should be no nudge to become UO members and that for them it should be completely voluntary. If 1451 UCBs (Tier I and Tier II) are benefitted from UO, definitely remaining 88 Tier III and IV banks will also stand to gain. As the banks with sizeable resources, they should be nudged to become members of UO by imposing 1% extra CRAR for not becoming members.

The above are my dissenting observations which may kindly be included in the report.

Thanking You,

I remain,

Yours Faithfully,

Jyotindra

(Jyotindra Mehta)
Member,
Expert Committee