N S Vishwanathan Committee on Urban Cooperative Banks

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Recently, an RBI expert panel suggested a four-tiered structure for urban cooperative banks and said that large UCBS which conform to the parameters should be allowed to function as SFBs and universal banks. The panel has also advocated for mergers of weak UCBs. Let us know about UCBs and their function in detail.

In news: RBI panel bats for treating large co-op banks as SFBs
Placing it in syllabus: Economy
Dimensions:

- Brief History of UCB’s
- Difference between UCB’s and Commercial Banks
- Supervisory Action Framework (SAF) for Urban Co-operative Banks (UCBs)
- Recommendations of the committee on UCB’s

Content:

Brief History of UCB’s:

- The term Urban Co-operative Banks (UCBs), though not formally defined, refers to primary cooperative banks located in urban and semi-urban areas.
- These banks, till 1996, were allowed to lend money only for non-agricultural purposes. This distinction does not hold today.
- These banks were traditionally centred around communities, localities and workplace groups. They essentially lent to small borrowers and businesses.
- Today, their scope of operations has widened considerably.

- **Anyonya Sahakari Mandali**, established in **1889** in the province of **Baroda**, is the **earliest known cooperative credit union in India**
- Urban co-operative credit societies, in their formative phase, came to be organised on a community basis to meet the consumption oriented credit needs of their members.
- The enactment of **Cooperative Credit Societies Act, 1904**, however, gave the real impetus to the movement.
- The Cooperative Credit Societies Act, 1904 was amended in 1912, with a view to broad basing it to enable organisation of non-credit societies.
- The Maclagan Committee of 1915 was appointed to review their performance and suggest measures for strengthening them. The committee observed that such institutions were eminently suited to cater to the needs of the lower and middle income strata of society and would inculcate the principles of banking amongst the middle classes.
- it is of interest to recall that during the banking crisis of 1913-14, when no fewer than 57 joint stock banks collapsed, there was a there was a flight of deposits from joint stock banks to cooperative urban banks.
- The constitutional reforms which led to the passing of the **Government of India Act in 1919 transferred the subject of "Cooperation"** from Government of India **to the Provincial Governments.**
- Concerns regarding the professionalism of urban cooperative banks gave rise to the view that they should be better regulated.
- Large cooperative banks with paid-up share capital and reserves of Rs.1 lakh were brought under the purview of the **Banking Regulation Act 1949** with effect from 1st March, **1966 and within the ambit of the Reserve Bank's supervision.**
- This marked the beginning of an era of duality of control over these banks. Banking related functions (viz. licensing, area of operations, interest rates

etc.) were to be governed by RBI and registration, management, audit and liquidation, etc. governed by State Governments as per the provisions of respective State Acts.

- In 1968, UCBs were given the benefits of the Deposit Insurance facility.
- A feature of the urban banking movement has been its heterogeneous character and its uneven geographical spread with most banks concentrated in the states of Gujarat, Karnataka, Maharashtra, and Tamil Nadu.
- While most banks are unit banks without any branch network, some of the large banks have established their presence in many states when at their behest multi-state banking was allowed in 1985.
- Recently the problems faced by a few large UCBs have highlighted some of the difficulties these banks face and policy endeavours are geared to consolidating and strengthening this sector and improving governance.
- They are registered under the Cooperative Societies Act, 1912. They are regulated by the Reserve Bank of India under the Banking Regulation Act, 1949 and Banking Laws (Application to Cooperative Societies) Act, 1965.
- Primary Cooperative Banks which are otherwise known as Urban Cooperative Banks are registered as Cooperative Societies under the Cooperative Societies Acts of the concerned States or the Multi-State Cooperative Societies Act function in urban areas and their business is similar to that of Commercial Banks.
- They are licensed by RBI to do banking business. Reserve Bank of India is both the controlling and inspecting authority for the Primary Cooperative Banks.

Difference between UCB’s and Commercial Banks:

The major differences between commercial and

cooperative banks are indicated below:

- A bank which is established to provide banking services to individuals and businesses is called a **Commercial Bank**. Whereas, **cooperative bank** is a bank that provides financing to agro and rural industries/bodies and to trade and industry in urban areas (but up to a certain limit).
- A commercial bank is **incorporated under Banking Regulation Act, 1949.** On the contrary, a cooperative bank is **registered under the Cooperative Societies Act, 1965.**
- The **area of operation of a commercial bank is comparatively larger than a cooperative bank**, as opposed to the cooperative banks which are confined to a limited area.
- **Commercial banks** can be **considered as joint stock companies**, incorporated as a banking company that **operates for a bottomline (profit) motive.** As opposed to **Cooperative banks**, which are **cooperative organisations**, that **work for service (Financial Inclusion, Community Service) motive.**
- The **borrowers in a commercial bank are account holders**; they **do not have any voting power**. Unlike **Cooperative banks, wherein, the borrowers are members** that influence the credit policy **through their voting power**.
- **Commercial bank's primary function is to accept deposits** from the public and p**rovision loans to individuals or businesses**. In contrast to this, a **cooperative bank's primary business is to accept deposits from members and the public**, and grant loans to farmers and small businessmen.
- Commercial banks generally offer an array of products to its customers, whereas there are **limited products provided by the cooperative banks** to its members and the public.
- The commercial bank's interest rate on deposits is

relatively lower than a cooperative bank.

Supervisory Action Framework (SAF) for Urban Co-operative Banks (UCBs)

- Under the provisions of the **Banking Regulation Act, 1949**, **RBI is entitled to assess the financial position of a bank and issue directions**/instructions thereunder.
- The **supervisory action framework seeks an expeditious resolution of UCBs experiencing financial stres**s.
- The supervisory action framework was first **introduced in 2014.**
- The Reserve Bank of India had introduced the supervisory action framework **to better manage stressed urban cooperative banks.**
- The guidelines of SAF **include threshold limits for asset quality, profitability, and capital adequacy.**
- In the **initial stage of deterioration** in the financial position, **self-corrective action by the management of the UCBs themselves**
- In case the financial position of the bank does not improve then SAF is initiated by the Reserve Bank.
- It is **similar to the Prompt corrective active framework, imposed on scheduled commercial banks.**
- In early 2020, the Reserve Bank of India (RBI) revised supervisory action framework (SAF) for urban co-operative banks (UCBs) in a bid to keep a check on them.
- A UCB may be placed under **supervisory action framework when its net non-performing assets (NPAs) exceed 6%** of its net advances.
- As soon as this threshold is breached, the regulator may initiate multiple actions, depending on severity of stress.
- In December 2019, RBI also proposed reduction in loan amount an urban co-operative bank can lend to a single entity and a group of borrowers to 10% and 25%,

respectively, with an aim to prevent Punjab and Maharashtra Co-operative (PMC) Bank-like scams, caused by large exposure to one group.

Recommendations of the committee on UCB's

In February, the RBI had the constitution of the Expert Committee on Primary (Urban) Co-operative Banks under the **chairmanship of N S Vishwanathan,** former RBI Deputy Governor. It recommended to:

Allow UCBs to Function as SFBs

- Well governed large urban cooperative banks (UCBs) which meet parameters should be allowed to function along the lines of small finance banks (SFBs) and universal banks

Four Tiered Regulatory Structure:

- It suggested a **four-tier structure for UCBs depending upon the deposits** and prescribed **different capital adequacy and regulatory norms** for them based on their sizes.
- UCBs can be split into four categories –
  - Tier-1 with deposits up to Rs 100 crore;
  - Tier-2 with deposits between Rs 100-Rs 1,000 crore,
  - Tier-3 with deposits between Rs 1,000 crore to Rs 10,000 and
  - Tier-4 with deposits of over Rs 10,000 crore.

Norms for Each Tier of UCB:

- The minimum **Capital to Risk-Weighted Assets Ratio (CRAR)** for them could vary from 9 per cent to 15 percent and for Tier-4 UCBs the Basel III prescribed norms.
- Tier-3 urban cooperative banks with deposits of Rs 1,000 crore to Rs 10,000 crore must function like SFBs if they meet a capital adequacy ratio of 15%. The loan portfolio of tier-3 urban cooperative banks shall conform to the

stipulations made for SFBs

- Tier-4 UCBs with deposits of over Rs 10,000 crore should be allowed to function like universal banks if they meet the 9% capital adequacy ratio requirement, leverage ratio and have a fit and proper board and chief executive. Such UCBs can be given operational freedom for branch expansion and authorized dealer licence on a par with universal banks.
- The panel has also prescribed separate ceilings for home loans, loan against gold ornaments and unsecured loans for different categories of UCBs.

Recommendations on all-inclusive directions (AID)

- committee emphasised that **all-inclusive directions (AID)** should be treated on a par with moratorium under Section 45 of the Banking Regulation Act.
- If AID is imposed, a bank should not continue thereunder beyond the time permitted to keep a bank under moratorium – three months extendable by a maximum of another three months.
- Currently about 50 UCBs are under AID, causing a lot of hardship to depositors as deposit withdrawals are capped.

Merger and Consolidation of UCBs

- On consolidation of UCBs, the panel said that RBI should be largely neutral to voluntary consolidation except where it is suggested as a supervisory action.
- The committee said that under the Banking Regulation (BR) Act, the RBI can prepare a scheme of compulsory amalgamation or reconstruction of UCBs, like banking companies.
- 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

Changes to SAF

- The panel further said Supervisory Action Framework (SAF) **should follow a twin-indicator approach** – it should **consider only asset quality and capital measured through NNPA and CRAR** – instead of triple indicators at present.
- The **objective of the SAF should be to find a time-bound remedy to the financial stress** of a bank.
- 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, it said.

Reasons for Underperformance of UCBs

- The report said 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.
- 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.

Mould your thought: Differentiate between UCBs and Commercial Banks? Discuss the major recommendations of Vishwanathan Committee to improve working of UCBs in India.

Approach to the answer:

- Introduction
- Give major differences between UCBs and Commercial Banks
- Discuss the need for Committee (i.e. recent problems in UCBs with example)
- Write the suggestions of the committee in this regard

- Conclusion