An Information Booklet on Urban Cooperative Banks, their Problems, Expectations and Remedies

The Institute of Chartered Accountants of India
(Set up by an Act of Parliament)
New Delhi

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Foreword

Banks play a vital role in economic development of a country as repositories of community's savings and as facilitator of credit. The Indian banking system has aided the economic development in an effective manner. The banking sector has shown a remarkable responsiveness to the needs of planned economy.

Co-operative banks in India are governed under many acts like Co-operative Societies Acts, Banking Regulation Act, 1949, etc. They are also regulated by the Reserve Bank of India (RBI). They are involved in financing rural sectors such as farming, poultry, and live stock and so on. They also render their services to industries, small scale units, home finance, personal finance, etc. in rural as well as urban areas.

The Institute of Chartered Accountants of India (ICAI) at its end has been extending a helping hand in the form of publications and training programmes/seminars in the relevant areas to its members to help them with evolving knowledge. This document 'An information booklet on Urban Cooperative Banks, their problems, expectations and remedies' being brought by the Committee for Cooperatives & NPO Sectors of the Institute is a landmark in this direction. It focuses on the progress and problems faced by the Urban Cooperative Banks (UCBs), expectations from the Government, RBI and ICAI for the smooth functioning of UCBs. For easy understanding and practical implementation, the document is written in a very lucid and logically flowing manner.

At this juncture, I congratulate CA. Vijay Kumar Garg, Chairman, Committee for Cooperatives & NPO Sectors, CA. V. Murali, Vice Chairman, and all other members for their efforts and contributions to bring out this publication.

I am sure this publication will be useful in developing the UCBs efficiently and effectively and solving issues relating to UCBs.

Date: Jan 18, 2013
Place: Delhi

CA. Jaydeep Narendra Shah
President, ICAI

Preface

The origin of urban cooperative banking in India can be traced to the close of nineteenth century having a history of almost 100 years. The term Urban Cooperative Banks (UCBs) till 1996 were allowed to lend money only for agricultural purposes but now their scope has widened considerably to small scale industries, housing finance, etc.

Keeping in view the widened scope of UCB and new challenges before them, Committee for Cooperatives & NPO Sectors (CCONPO) of The Institute of Chartered Accountants of India (ICAI) has brought out the document 'An information booklet on Urban cooperative Banks, their Problems, Expectations and Remedies' for the progress and development of Urban Cooperative Banks. Problems faced by the UCBs, expectations from RBI, Government & ICAI and suggested remedies are incorporated in this document.

I'd be failing in my duties if the name of CA. Jagdish R. Deshmukh is stated specifically who took the pain to pen this publication.

At this junction, I wish to express my deep gratitude to CA. Jaydeep Narendra Shah, President, CA. Subodh Kumar Agrawal, Vice-President for their continuous support and encouragement to the initiatives of the committee.

I must also thank my colleagues from the Council at the committee, Co-opted members and special invitees of the committee for their devotion in terms of time as well as views and opinions to the cause of the professional development.

I also wish to place on record the efforts put in by Dr. Amit Kumar Agrawal, Secretary, CCONPO and his team in bringing out this publication.

I firmly believe this would be one of the finest publications that will benefit the readers at large.

Date: Jan 29, 2013 CA. Vijay Kumar Garg,
Place: Delhi Chairman
Committee for Co-operatives & NPO Sectors (CCONPO)

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Chapter 1
Co-operation

1.1 Introduction

The Objective of this chapter is to learn on what principles Co-operation is founded. It tells you about how the co-operative movement has spread its message, ideas and purposes. There is a difference between activity in a co-operative spirit and in a commercial spirit.. In co-operative activity the purpose is not to earn profit but is a collective activity of the members for the benefit of the members or for some other common purpose. No one is the owner of the co-operative activity but all are members of such an activity.

1.2 Co-operation – Concept and Definition

Co-operation, meaning some sort of joint action on the part of two or more persons, began as soon as people began to associate as social beings. In the joint family system, we find an excellent example of practical cooperation. Members of such a family earn and spend jointly. They have common ties and share the same food, worship and estate. There is in such family a sort of voluntary insurance against unemployment. A member who earns comparatively less for the common pool has an equal share with others who earn much more. The association is also completely voluntary.

Definitions of Co-operation

Co-operative movement was born out of diversity. The movement, therefore, assumed diverse shapes, commensurate with the environments which gave birth to it. It is thus difficult to search out a clear cut definition of Co-operation. Some Co-operators have, however, tried to define it in the context of the circumstances in which the movement was studied by them.

Shri V.L. Mehta says that "Co-operation is only one aspect of a vast movement which promotes voluntary associations of individuals having common needs who combine towards the achievement of common economic ends".

For Sir M.L. Darling, Co-operation was a matter of faith and conviction, reaching the bounds of religion, rather than confining itself to mere economic affairs. He described Co-operation as "some thing more than a system. It is a spirit which appeals to the heart and the mind. It is a religion applied to business. It is a gospel of self-sufficiency and service."

Dr. K.N. Katju has defined it in the context of Indian conditions, "Co-operation is self-help as well as mutual help. It is a joint enterprise of those who are not financially strong and cannot stand on their own legs and therefore, come together not with a view to getting profits but to overcome disability arising out of wants of adequate financial resources and thus better their economic condition".

Mr. H. Calvert, an illustrative registrar of Co-operative Societies in the Punjab has defined Co-operation "as a form of organisation, wherein persons voluntarily associate together as human beings on a basis of equality, for the promotion of the economic interests of themselves."

The concept of co-operation, thus, envisages a democratic group of persons having one or more common needs, who voluntarily agree to do hard and honest work for one another's good if necessary, and fill the gap in their collective resources by offering their willingness and capacity to work, as security.

Co-operation is the process of working or acting together for a common purpose or benefit. The concept of co-operation is as old as mankind. Co-operation is a world- wide phenomenon. Experiments in co-operation have been carried on for over a century. In India the phenomenon came a little later.

A co-operative is a legal entity owned and controlled by its members. The members were closely associated with the enterprise as producers or consumers of products or services or as its employees. The member could get share in the earnings of the co-operative as dividend, which are divided among members according to their participation in the enterprises.

1.3 Principles of Co-operation

Co-operatives are based on the co-operative values of "self help, self responsibility, democracy and equality, equality and solidarity" and the seven co-operative principles.

(i) Voluntary and Open Membership

(ii) Democratic Member Control

(iii) Economic Participation of Members

(iv) Autonomy and Independence

(v) Education, Training and Information

(vi) Co-operation among Co-operatives

(vii) Concern for Community

The co-operative members believe in the ethical values of honesty, openness, social responsibility and caring for others.

The co-operative principles are guidelines by which co-operatives put their values into practice.

1.4 First Co-operative Movement

Robert Owen (1771-1858), is considered the father of the co-operative movement. He was involved in cotton trade. He wanted to put his workers in a good environment with education, food and shelter for themselves and their children. With this idea in mind, he opened the first co-operative store in the cotton mills of New Lenark, Scotland. Inspired by its success, he had the idea of forming "village of co-operation" where workers would come out of poverty by growing their own food, making their own clothes and ultimately becoming self-dependent. But his attempt was unsuccessful.

1.5 Co-operative Movement in India

Co-operation occupies an important place in the Indian economy. Perhaps in no other country in the world is the co-operative movement so large and diverse as it is in India. The main areas of operation of co-operatives in India are Agricultural Credit, Supplies, Marketing and Processing, Functional Co-operatives in the fields like dairy, poultry, fisheries, fruits, vegetables, Public Distribution of essential commodities, Urban credit co-operatives and Housing co-operatives.

Co-operative movement in India is the result of a deliberate policy of the state and formation of proper governing infrastructure. Co-operative movement today is committed to securing improvement in the quality of life of a vast majority of people.

1.6 Co-operative Movement in Maharashtra

Maharashtra is one of the major states of India. It is also the most urbanized and industrialized state. The Co-operative Movement has a long and golden history in Maharashtra; even today it plays an important role in the economy and social life of Maharashtra.

After the Co-operative Societies Act 1912, the movement passed through a new phase of re-organization like formation of co-operative financing agencies, formulation of co-operative educational schemes and organization of non-credit societies. There was overall progress during the period after Independence.

The movement spread out especially in the rural area where sugarcane was grown. The agriculturist pursued this concept of self-help and made the best use of the credit facilities given to him for increasing their production. Examples like Pravara Nagar Sugar Co-operative Society inspired many to organize co-operatives in the sugar sector with long term goals in mind.

The co-operatives have helped the rural and urban economy tremendously. They have been able to bring peaceful socio-economic changes and have helped institutionalize the economy to a considerable extent.

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Chapter 2
History & Progress of Urban Co-operative Banks

2.1 Origin & Development of Urban Co-operative Banks (UCBs)

The origin of the urban credit movement in India can be traced to the close of the nineteenth century. Following the success of the urban credit institutions organised by Hermann Schuktze in Germany and Luigi Luzzatti in Italy during the period 1855-1885, some middle class Maharashtrian families settled in the erstwhile Baroda state started a mutual aid society in Baroda on February 05, 1889 under the guidance of Shri Vithal Laxman Kavthekar. When the Co-operative Credit Societies Act of 1904 conferred legal status on credit societies, the first urban co-operative credit society was registered in October 1904 at Conjeevaram in Madras Province. Subsequently, the Betegiri Co-operative Credit Society in Dharwar District in the undivided Bombay Province and the Banglore City Co-operative Credit Society in the erstwhile Mysore State were registered in October 1905 and December 1905 respectively.

2.2 Historical Background

The development of urban co-operative credit societies did not receive much attention until 1915 when the Mclagan Committee referred to the potentialities for the organisation of such societies as a means of training the upper and middle urban classes in ordinary banking principles. The failure of local joint-stock banks in the country at that time gave an impetus to the growth of urban co-operative credit societies. It was then realised that urban credit societies were eminently suitable institutional agencies for collecting local savings and to provide relief to those who were in the clutches of moneylenders, by providing them with financial accommodation. Many urban co-operative credit societies came to be organised in Bombay and Madras Provinces during this period (1919-38). The urban co-operative credit societies which came into being in Bombay confined their activities mostly to the members of particular communities and their lending operations were also primarily with a view to meeting the consumption needs of their members. The great depression of the thirties did not have any visible impact on the development of urban co-operative credit movement in the country mainly because the fall in urban income was not as steep as the fall in rural income.

Later, the economic boom created by the Second World War (1939-45) provided a stimulus to the growth of urban banks in India. They grew not only in numbers but also in size, diversifying their activities considerably. Urban co-operative credit societies which had hitherto largely confined their loaning operations to the provision of the consumption credit needs of the members were called upon to take up new avenues such as financing of artisans, small businessmen and small traders for productive purposes, in the context of the hesitancy of commercial banks at that time to meet the credit needs of these classes due to the high cost of servicing of loans.

The usefulness of urban banks in financing artisans, small traders, factory workers and urban middle classes was recognised by various committees and working groups such as the Central Banking Enquiry Committee (1931), the Co-operative Planning Committee (1946), the Study Group on Credit Co-operative societies in the non – agriculture sector (1963), and the working group on industrial finance through Co-operative Banks (1968). More particularly, the Working Group on Industrial Financing through Co-operative Banks(1968) set up by the Reserve Bank of India was of the view that urban banks were eminently suitable institutional agencies in the co-operative sector to cater to the credit needs of small-scale industries run by individuals, firms and joint-stock companies.

2.3 Survey of Urban Co-operative Banks by RBI and suggestions incorporated in the Survey Report

The important development in urban co-operative banking was the survey undertaken by the Reserve Bank in 1958-59 with the object of studying the pattern of financial resources of urban banks, part played by urban banks in financing small-scale industries, the outlets for their investments and the factors underlying the success or failure in their working. The Report on the Survey of Urban Co-operative Banks published by the Reserve Bank in 1961 observed that with the growth of planning and an increase in the tempo of economic development, steps had been taken to promote the development of various types of economic activities in the sphere of co-operation. But, while much attention had been paid to the promotion of agricultural co-operatives, industrial co-operatives and various other types of co-operative societies such as those for fisheries, dairying and housing societies, similar importance had, however, not been accorded to urban banks. No special provision was made for their development in the Five Year Plans. The Report stated that the approach in this sphere seemed to be one of *laissez faire*. The Survey Report observed that this may be the result to some extent of the generally satisfactory condition and fairly good rate of progress of urban co-operative credit co-operatives. But, mainly, it would appear to be the result of the relatively less active interest taken in the problems of middle classes including the smaller traders, professional men, salaried employees etc., and the lack of attention to the potentialities of development in the institutions catering to their needs. For the promotion and development of urban banks and the full utilisation of their potentialities, the Survey Report made the following suggestions:

1. An assessment may be made of the scope of the establishment of urban banks in new centres and in different parts of existing cities and towns.
2. Active efforts should be made by the management of urban banks to expand their membership.
3. Urban banks should adopt a progressive attitude towards their functions and should try to diversify their activities and offer a wide range of facilities to their members than are now given.
4. In their loan policy, urban banks should adopt a sufficiently wide and diversified system suiting the needs of the times and of different categories of members, keeping in view loans to small industries as an important line of future development.
5. The working of urban banks should be placed on sound and efficient lines, by elimination of non-credit activities of the trading type, improvement of the accounting and operational arrangements and reduction and avoidance of overdues.
6. There should be continuous building up of member relations and publicity. (As per Report on the Survey of Urban Co-operative Banks(1961) by RBI)

2.4 Extension of the Banking Regulation Act 1949 to UCBs

The most significant development relating to Urban Co-operative Banks in recent years has been the extension to co-operative banks of certain provisions of banking Regulation Act 1949 from March 01, 1966. Earlier, the Banking Companies Act 1949 which came into force from March 16, 1949 had specifically excluded co-operative banks, including Urban Co-operative Banks, from the purview of the Act, as the Co-operative Banks were registered under Co-operative Societies Act of the respective states and as such could not be classified as 'companies'. However, with the passage of time, the operation of co-operative banks increased substantially and it was, therefore, considered anomalous to leave out co-operative banking institutions from the purview of the statutory control of the Reserve bank of India. Moreover, there was a demand from certain quarters, particularly after the introduction of the Deposit Insurance Scheme to commercial banks in 1962, that co-operative banks should also get the benefit of this scheme. This would not have been possible without Co-operative Banks being subjected to some degree of control by the Reserve bank of India.

With the extension of the Banking Regulation Act 1949 to Co-operative banks, the Reserve Bank of India acquired control over the functioning of urban co-operative banks with paid-up share capital and reserves of ₹ One lakh and were termed as 'primary co-operative banks' in matters such as maintenance of cash reserves and liquid assets, regulation of loans and advances, opening of new places of business and publication of audited balance sheet and profit and loss account. Further every Urban Co-operative Bank existing as on March01, 1966 or a new Urban Co-operative Bank organised thereafter was required to apply to the Reserve Bank of India for a licence to carry on or commence banking business. The statutory power of inspection of Urban Co-operative Banks was also vested in the Reserve bank of India which could exercise it either directly or through the concerned state co-operative bank. Powers in regard to incorporation, management and winding up continued to be governed by the State Co-operative Societies Acts concerned.

2.5 Definition of Urban Co-operative Bank

While dealing with the development of Urban Co-operative Banks, a reference may be made to the definition of these banks adopted from time to time. Initially, most of the urban banks in India were organised as credit societies and later converted into urban banks. Up to about 1939, the term 'bank' was loosely used by many societies and there was hardly any distinction between an urban co-operative bank and an urban credit society. While some urban credit societies undertook banking functions without using the word 'bank' or 'banker', there were instances where many urban credit societies not engaged in any banking functions also used the word 'bank' or 'banker'. The Mehta Bhansali Committee (1939) in Bombay made an attempt to define an Urban Co-operative Bank. According to this committee, all urban credit societies having paid up share capital of ₹ 20000/- and over and accepting deposits of money on current account or otherwise subject to withdrawal by cheque, draft or order came within the category Urban Co-operative Banks. In Madras Province, urban credit societies accepting deposits on current account and maintaining liquid resources according to the standards prescribed by the Registrar of Co-operative Societies were called urban banks. In many provinces, this term was used for credit societies working in urban areas irrespective of the size of share capital or the nature of deposits accepted by them.

According to the Co-operative Planning Committee (1946), urban banks receiving deposits on current account should have a) a paid up share capital of at least ₹20000/-; b) maintain liquid resources on the scale prescribed by the Registrar of Co-operative Societies; and c) carry to the reserve fund at least one-third of their profits till it equals the paid up share capital and thereafter at least one-fourth of the net profits. The reserve fund should be invested in gilt-edged securities or deposited in banks approved by the Registrar and should not be used for the business of the bank. (Report of the Co-operative Planning Committee (1946) Govt. of India M/o Agriculture)

Recognising the need for adoption of a uniform definition of an urban bank in the context of the ability of the institution to employ qualified, trained and experienced staff, the Study Group on Credit Co-operatives in the Non-Agriculture Sector, appointed by the Government of India under the chairmanship of Shri V.P. Varde in 1963, suggested certain norms. The Group recommended that a co-operative credit society registered under the state co-operative societies act in urban & semi-urban areas having a minimum paid –up share capital of ₹50000/- and undertaking the provision of banking facilities could be termed as an Urban Co-operative Bank.

Following the extension of certain provisions of the Reserve Bank of India Act 1934 and the Banking Regulation Act 1949 to co-operative banks from March1, 1966, an urban bank is called a primary co-operative bank and defined as a co-operative society, other than a primary agriculture credit society i) the primary object of which is the transaction of banking business; ii) the paid-up share capital and reserves of which are not less than ₹ One lakh; and iii) the by-laws of which do not permit admission of any other co-operative society as a member. The category of primary co-operative banks also includes salary earners' societies having paid-up share capital & reserves of ₹ one lakh or more and the by-laws of which provide for acceptance of deposits from non-members.

In addition to primary co-operative banks, there is a separate category of 'primary credit societies' which are allowed to call themselves as banks, but are kept outside the Reserve Bank's control until their paid-up capital and reserves come to a level of ₹ One lakh or more. The difference between a primary co-operative bank and a primary credit society is thus only in respect of their share capital and reserves, the former having paid-up share capital and reserves of ₹ One lakh and over and the latter less than ₹ one lakh.

In the light of the findings of the studies on viability of urban banks, the Committee has come to the conclusion that the definition of a primary co-operative bank as given in the Reserve Bank of India Act 1934 and the Banking Regulation Act 1949 needs amendments in so far as it relates to minimum share capital and reserves requirements.

It is interesting to note that the Banking Regulation Act does not recognise the term 'Urban Co-operative Bank' and defines it as a primary cooperative bank. The word "primary" is used to denote that the bank performs the role of a primary unit in a 3-tier cooperative credit structure.

By this definition, the Urban Cooperative Banks were made an integral part of the well developed 3-tier cooperative credit structure which was developed to cater to the needs of rural India. The Urban Cooperative Banks, by implication, have to be affiliated to District Central Cooperative Bank (DCCB) at district level and to State Cooperative Bank (SCB) at apex level and these banks, in turn, were supposed to help, nurse and guide the UCBs.

Historically, UCBs were organised in semi-urban, urban and metropolitan centres. This was the reason why they came to be popularly known as urban cooperative banks. However, the co-operators, UCBs and their federations have, strongly pleaded for deleting the word 'primary' from the statute in view of the phenomenal increase in their size and operations surpassing even District Central Cooperative Banks (DCCBs).

2.6 Evaluation of Urban Co-operative Banks

While evaluating the role of urban co-operative banks in the banking system, it is relevant to quote the views expressed by some of the all India Committees as well as a few state committees which have had occasion to review their working.

1. The banking Commission appointed by the Government of India in February 1969 under the chairmanship of Shri R G Saraiya has observed as follows:

> Urban co-operative banks do useful work in mobilising deposits and financing the sector of small borrowers such as small-scale industries, professionals, retailers and so on. Another useful activity is financing of house construction and repairs for members of the banks. Also, this

type of banking provides a useful avenue for those who have the necessary ability to set up a bank.

2. The Committee on Problems of Urban Co-operative Banks in Maharashtra appointed by the Govt. of Maharashtra in December 1974 under the chairmanship of Shri V M Joglekar has commented on the performance of the Urban Co-operative Banks in Maharashtra in the following words:

> "The performance of the urban bank in Maharashtra, taken as a whole, is fairly satisfactory. The sustained growth over the years may be traced to the devoted and selfless management by non-officials. Not only the number of urban banks has increased, but membership which is a measure of people's involvement, has also increased. Deposits have gone up considerably. The deposits from non-members are more than those of the members, which is a positive proof of the fact that the urban banks have secured the confidence of the depositing public of urban and semi-urban areas."

It is observed that urban banks have grown not only in number but also in size. However, in numerical terms, the growth has not been even, but has rather been marked by glaring regional imbalances. The banks in general have increased their membership, although in some cases they have confined their membership to small groups of people. Operationally, they have endeavoured to function keeping in view their major objectives, viz., i) promotion of thrift and mobilization of resources from the community they serve; ii) provision of credit at reasonable rates to small borrowers; iii) provision of banking and other subsidiary services.

A class of urban cooperative banks, which are popularly called, Salary Earners' Banks also emerged as a matter of course and have had their own place in the urban cooperative banking system over the years. These banks are essentially thrift societies set up by employees of governmental departments/ PSUs/large establishments for mutual help on the principles of cooperation. These societies also started using the word 'bank' and were accepting deposits from members of public.

Since Reserve Bank of India did not find any rationale for their continuing as banking entities, as they were essentially thrift societies, they were advised to go out of the purview of the B.R. Act, after returning the deposits to non-members. As a result, 599 salary earners' banks went outside the purview of the B.R. Act, during the period 1 March, 1966 to 30 June, 1977 by converting themselves into cooperative credit societies. Marathe Committee had also endorsed this view.

2.7 Vision Document

The Vision Document for UCBs highlighted the problems of the sector and outlined the broad measures to be adopted to enable the UCBs emerge as a sound and the healthy network of banking institutions providing need-based quality banking services, essentially to the middle & lower middle classes and marginalised sections of the society. In line with the proposals of the Vision Document, the Reserve Bank continued to take several initiatives.

In June 2004, it was decided not to issue fresh licences for setting up new banks or for opening new branches, until a suitable framework for regulation and supervision was put in place for the existing UCBs. In March 2005, the Reserve bank prepared a draft Vision Document for UCBs which, *inter alia*, discussed the problems of the sector and highlighted the issue of dual regularity mechanism which restricted the ability of the Reserve bank in handling the weaknesses of entities in the sector. In order to address the problem of dual control, Vision Document proposed the adoption of a consultative approach for deciding the future set up of weak and sick banks in each state. In terms of the Vision Document, the Reserve Bank approached the State Governments for signing MOU to ensure greater convergence of approach of the two agencies entrusted with the regulation and supervision of UCBs.

As a part of the MOU, it was decided to set up State Level Task Force for Co-operative Urban Banks (TAFCUBs) comprising representatives of the Reserve Bank, State Government and Federation/Association of UCBs. TAFCUBs identify the potentially viable and non-viable UCBs in the State and provide a revival path for the former and a non-disruptive exit route for the latter set of banks. The exit route could include merger/amalgamation with stronger banks, conversion into societies or ultimately as a last resort, through liquidation. Till the end of March 2007, MOUs (Appendix I) have been signed with 19 State Governments and Central Government (in respect of multi-state UCBs), which encompass 1597 UCBs, i.e.90% of the bank representing 95% of deposits of the sector. The increased public confidence in the UCBs sector is reflected in the growth in the deposits by 6.1 per cent during 2006-07 over and above the increase of 8.6 per cent during 2005-06, thereby reversing the declining trend of 2004-05. (RBI Annual Report 2007-08 – Impact of Vision Document on Urban Co-operative Banks – page 233). As on March 2010, MoUs have been entered into with Central Government and all 28 States having presence of UCBs, thus covering the entire UCB sector.

2.8 Two-tier Regulatory Structure

The Vision Document sets out the objective of rationalising the regulatory and supervisory framework for UCBs to enable the smaller UCBs gain in strength. In order to achieve this objective, banks were classified as Tier I banks and Tier II banks. (Appendix II)

According to Vision Document prepared by RBI, Tier I Banks are Unit Banks with deposits less than ₹50 crore.

The definition for Tier Banks has since been amended vide circular dated March 07, 2008 as under:

Tier I Primary Urban Co-operative Banks Means:

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 per cent 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 reorganisation of the district.

and Tier II banks, i.e. all other UCBs.

Prudential norms for Tier I and Tier II banks were also revised. While Tier II banks are under the 90-days NPA norm as applicable to commercial banks, the 180-days NPA norms for Tier I banks (Non Performing Assets) has been extended to March31, 2008 and further extended to March31, 2010. This is intended to provide a measure of relief to the small UCBs as lower provisioning is required, which, in turn, would translate into higher profits that could be used to shore up the capital base of these banks. These banks are, however, required to build up adequate provisions in the intervening period to enable them to migrate to 90-days norms in future.

Another relaxation extended to Tier I banks pertains to investments made in Government Securities. In view of the market risks associated with such investments, Tier I UCBs have been given exemption for maintaining SLR in Government Securities (up to 15% of NDTL) to the extent of funds placed in interest- bearing deposits with State Bank of India & its subsidiaries and the public sector banks including IDBI Ltd. Tier II banks have also been subjected to the stricter provisioning norms on 'standard advances' which can be 2% for certain type of exposures.

The proportion of SLR holdings in the form of Government and other approved securities as percentage of NDTL was revised and non-scheduled UCBs were asked to maintain SLR of 7.5% by September30, 2009, 15% by March31, 2010 and 25% by March31, 2011. Non-SLR investments of UCBs continue to be limited to 10% of a bank's total deposits as on March 31 of the previous year.

2.9 Liberalisation of Branch Licensing Policy for UCBs

Further, arising out of the comfort of coordinated supervision/regulation in States that have signed MOU with the Reserve Bank, certain additional business opportunities have been extended to the eligible banks in such States as also to the Multi-State UCBs. These facilities include permission to set up currency chest, sell mutual fund products, grant of authorised Dealer category I and II licenses, permission to open new ATMs, relaxed norms for conducting insurance business on non-risk participation basis and conversion of extension counters into branches. It was also announced in the Annual Policy 2006-07 that financially sound banks in such States would also be considered for being given licenses to open branches, a facility which was not available to the UCBs since 2004. The Reserve Bank decided to grant approvals for branch expansion including off-site ATMs in respect of such UCBs on the basis of their Annual Business Plans subject to certain conditions, which included the maintenance of a minimum CRAR of 10% on a continuous basis and other regulatory comfort.

Based on the Annual Business Plans submitted by UCBs for 2008-09 and 2009-10, 275 banks were allotted centres to open 402 branches, 23 extension counters, 21 off-site ATMs and conversion of 16 extension counters into full-fledged branches as on March31, 2009. (Report on Trend and Progress of Banking in India 2008-09 – RBI - page 86)

2.10 Rating Model for UCBs

In order to bring about supervisory convergence between UCBs and commercial banks, the rating models were revised from the inspection cycle beginning March31, 2009. With the introduction of revised rating model, the gradation system of UCBs was dispensed with. The revised CAMELS rating model was made applicable to UCBs with deposits of ₹100 crore and above, and a revised simplified version of the same was made applicable to UCBs with deposits of less than ₹100 crore. The UCBs had to be rated on the basis of the CAMELS components, *viz,* Capital, Assets Quality, Management, Earnings, Liquidity and Systems and Control on a scale of 1 to 100, and based on the weighted average of the ratings of the components. UCBs had to be assigned rating of A+ to D.

2.11 Role of Urban Banks Department (UBD)

The regularity and supervisory functions over primary co-operative banks were being attended to by the Urban Banks Division of the Agricultural Credit Department. In July 1982, consequent to the establishment of the National Bank for Agriculture and Rural Development (NABARD), the Urban Banks Department was formed as a division of the Department of Banking Operations and Development and continued to attend to all functions concerning primary co-operative banks. Subsequently, with effect from February1, 1984, the Urban Banks Division of the Department of banking Operations and Development was constituted as a full-fledged department and renamed as Urban Banks Department.

The Urban Banks Department of Reserve Bank of India has been broadly assigned three functions in overseeing the activities of primary (urban) co-operative banks. These are

- Regulatory
- Supervisory and
- Developmental

The Urban Banks Department performs these functions through its 17 Regional Offices.

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Chapter 3
Research Methodology

3.1 Methodology

This research study is based on Primary as well as Secondary data. The primary data is sourced in the form of questionnaires, interviews with the Chairman, some members of the Board of Directors, Chief Executive Officer and Sr. Officers of the selected UCBs. As regards the secondary source, the relevant data have been collected from both published and unpublished record of selected UCBs in Maharashtra State, Annual Reports as well as half yearly reports of Reserve Bank of India; also, relevant books, journals, souvenirs and the data available on web sites were used for this research work.

More weightage is allocated to the concept and implementation of the subject of Unban Co-operative Banks, their problems, expectations and remedies available. For this purpose, publications and press notes were collected from the web sites of The Reserve Bank of India and others.

3.2 Objectives of the Study

For the last 29 years, this researcher has been working with the banking sector and has discovered that the Urban Co-operative Banks are, indeed, giving banking facilities to grass root persons. As on 31st March, 2011 there were 1645 UCBs all over India and their total deposits were ₹209949 crore, indicating faith the of the common man in the UCBs (As per Report of the Expert Committee on Licensing of New Urban Co-operative Banks – 2011). At the same time, however, during the last five years several banks closed down and depositors lost their hard-earned money. To save this people's movement, it is very essential to understand their problems, their expectations from Government and Apex Bank and their limitations. It is also necessary to find out some remedies that will help the UCBs to survive in the present world of competition.

3.3 Scope of Study

The study is limited to twenty five Urban Cooperative Banks in Maharashtra State, Scheduled & Non–Scheduled both. It is restricted to their problems, and their expectations from State and Central Government and Reserve Bank of India. Remedies will be identified for solving the problems of UCBs that will encourage them to prosper further and contribute to the banking and financial sector of the country. This should also help the UCBs to survive in the present world of competition.

3.4 Selection of Sample Banks

The study is based on a sample survey of 25 banks in the state of Maharashtra. All the UCBs are selected from the state of Maharashtra because it alone accounted for 64.7 per cent of deposits and 66.2 per cent of total advances. Out of the 53 scheduled urban co-operative banks, 38 are located in the state of Maharashtra. (www.cab.org.in)

As on March 31, 2011, there were 539 UCBs in Maharashtra; the number has come down from 630 banks as on March31, 2006. This reduction was due to closer of some weak banks and also merger of a few weak banks with the stronger ones. While selecting the banks, every care is taken to select banks in every category - Tier I, Tier II, Mahila Banks, Unit Banks , Multistate Banks and Scheduled Banks.

Sr. No.	Name of the Selected Bank	Category of the Bank
1	The Akola Janata Commercial Bank Ltd., Akola	Multi State Scheduled Bank
2	The Akola Urban Co-operative Bank Ltd., Akola	Multi State Scheduled Bank
3	The Khamgaon Urban Co-operative Bank Ltd. , Khamgaon	Multi State Scheduled Bank
4	Nagpur Nagrik Sahakari Bank Ltd., Nagpur	Multi State Scheduled Bank
5	Shikshak Sahakari Bank Ltd., Nagpur	Uni- State Scheduled Bank
6	Peoples Co-operative bank Ltd., Hingoli	Tier II Multi State Bank
7	Jijamata Mahila Sahakari Bank Ltd., Satara	Tier II Mahila Bank
8	Jijamata Mahila Nagri Sahakari Bank Ltd., Buldhana	Tier I Mahila Bank
9	The Yavatmal Mahila Sahakari Bank Ltd., Yavatmal	Tier I Mahila Bank
10	Dr. Panjabrao Deshmukh Urban Co-operative Bank Ltd., Amravati	Tier II Bank

11	The Yavatmal Urban Co-operative Bank Ltd., Yavatmal	Tier II Bank
12	The Vaidyanath Urban Co-operative Bank Ltd., Parli- Vaijnath	Tier II Bank
13	Nanded Merchants Co-operative Bank Ltd., Nanded	Tier II Bank
14	Tirupati Urban Co-operative Bank Ltd., Nagpur	Tier II Bank
15	Parshwnath Co-operative Bank Ltd., Kolhapur	Tier II Bank
16	Shree Mahavir Sahakari Bank Ltd., Jalgaon	Tier I Bank Unit Bank
17	Akola Merchant Co-operative Bank Ltd., Akola	Tier I Bank Unit Bank
18	Valmiki Urban Co-operative Bank Ltd., Pathari, Dist.: Parbhani	Tier I Bank Unit Bank
19	Shri Anand Nagari Sahakari Bank Ltd., Chandrapur	Tier I Bank
20	Vidarbha Merchant's Urban Cooperative Bank Ltd., Hinganghat, Dist.: Wardha	Tier I Bank
21	Shriram Urban Co-operative Bank Ltd., Nagpur	Tier I Bank
22	Umiya Urban Co-operative Bank Mydt., Nagpur	Tier I Bank
23	Janata Sahakari Bank Ltd., Amravati	Tier I Bank
24	Arvind Sahakari Bank Ltd., Katol, Dist.: Nagpur	Tier I Bank
25	Samruddhi Co-operative Bank Ltd., Nagpur	Tier I Bank

Chapter 4
Problems faced by Urban Co-operative Banks

As regards UCBs, the issues of governance come under the purview of the respective State Governments and the Reserve Bank of India takes care of the prudential aspects of these banks. However, in practice, because of various reasons such as personal vested interests, political interference, financial irregularities and dual control, many UCBs have become breeding grounds for financial indiscipline and mismanagement resulting in huge losses and failure of banks.

UCBs in general were suffering from issues like, sharp increase in number of banks and branches, large number of financially unsound banks, steep increase in interest expenses on deposits consequent to deregulation, high rate of interest on deposits and advances, adverse selection of borrowers, low capital base, dual/triple control, high exposure to real estate and other sensitive sectors, lack of professionalism, political interference, unlicensed UCBs, low level of computerization, faulty recruitment system / excess staff / poor skill, low level of operational efficiency, high operating costs etc.

4.1 Problems due to Market Competition

As the co-operative sector has made a rather late entry in the banking sector, these banks have come up against a lot of problems in the face of stiff market competition. In most of the areas where commercial banks have opened the branches, thanks to Government patronage, they are always considered safer by most of the investors, clients. Further, commercial and private banks have huge branch networks, technological setup and other infrastructural advantages, which normally co-operative bank won’t be able to provide. The advantage co-operative banks enjoy is the local patronage of local directors and shareholders, comparatively higher rate of interest offered to depositors and better services to their client. But many a times these factors will not be of any use, because normally investors tend to think of safety of their funds, rather than a slightly a better return. Further, high cost of funds naturally leads to higher interest on loans, which naturally results in decline in the quality of assets of the bank. Over a period of time, poor quality of assets will naturally lead to fall in credibility and rating of the bank, which unless rigorously checked, may lead to collapse of the bank itself.

The huge resource base, better quality of assets, lower cost of lending, more organized/scientific housekeeping etc. of commercial banks, always gives them an edge over co-operative banks in getting the lion's share of market business. Most of the quality business of the market goes to nationalised banks due to the above cost factor, and co-operative banks are left with other risky business and so are invariably associated with higher cost of operation. Various restrictions on Government offices, schools, colleges, Nagar Parishad, Municipalities, Village Organisations etc., not to deal with co-operative banks, further add to the problem. All the low cost deposits of these government departments go straight to nationalised banks, which already are well-placed. Schools, colleges and other charitable institutions are prohibited by State Government directives, not to open accounts with co-operative banks. Many times, this apartheid treatment goes to such a level that, even demand drafts issued by co-operative banks are not accepted by Government Departments, Local Bodies and schools & colleges. If this sort of treatment is given to co-operative banks, how can the co-operative banks get low cost deposits like commercial bank, how can they improve their bottom line, and generate good profit? When urban co-operative banks work in such an environment, it is time drastic reforms were introduced to remove the above anomalies of market competition.

Some of the major problems due to market competition are listed below:

(i) Poor Working Capital Base:

The urban Banks do not have a large Working capital base as compared with commercial Banks in the financial Market. Thus with limited funds at their disposal, the UCBs have to face tough market competition. Generation of profit is directly linked with the volume of capital funds. Larger the Working Capital, higher is the profit. Further, the UCBs have to pay higher cost for purchase of funds in order to survive in the financial market. The cost of funds also reflects on their business. The UCBs have to struggle hard to maintain Net Interest Margin (NIM) due to high cost of funds. Further, there is also a limit up to which UCBs can deploy the working funds in Interest Bearing Assets (IBA), whereas the commercial banks have many channels for deploying their funds. To conclude, in the financial market, Nationalized Banks, PSBs, Private Banks, Foreign banks exist as strong financial contenders against the small financial UCB organization. On comparison it appears that there is a sky-high gap between UCBs and commercial Banks.

(ii) Interest Rates on Deposits:

The interest rates floated by commercial banks/PCBs are matching their desired NIM (Net Interest Margin) which is also based on “Interest Rates Sensitivity Structure & Inflow and outflow of Cash as per Liquidity Structure” of concerned banks ALM. Although the Interest Rates offered by Commercial Banks are less than the rates offered by the UCBs, the customers feel safer depositing money with them, though lucrative interest rates are simultaneously offered by UCBs. During the last few years many UCBs were liquidated, some merged with other stronger banks, and a few are in poor financial condition (Weak/Sick). Hence the customers hesitate to make deposits with UCBs, as they know that if they conduct business with them, they run the risk of seeing their deposits wiped out one fine morning.’

High Interest rate on Loans & Advances: As UCBs are accepting deposits on high rates of interest, they are also charging higher rates of interest on loans and advances, as compared to those by commercial banks. Charging high interest rate is the only option for them to maintain the required NIM (Net Interest Margin). Also, as the rate of interest on loans and advances is more in UCBs as compared with that of commercial banks, quality business of the market goes to commercial banks, and co-operative banks are left with other risky business.

(iii) Adverse Selection of Borrowers:

As stated above,, the cream or prime customers are opting for nationalized or private banks and there is no other option for the UCBs but to accommodate remaining borrowers. The bank has to compromise on many issues while sanctioning loan to such borrowers. This ultimately affects their recovery position and increases NPA

(iv) Non - availability of Multi-faceted product services offered by Commercial Bank:

Non-Scheduled & other UCBs falling in lower grades are deprived of entering into many services such as Debit Cards, Credit Cards, RTGS, NEFT, Forex Business etc, at par with commercial / Private / Foreign Banks. This reduces their Non-Banking business income, besides diverting their esteemed customers to Scheduled or Commercial Banks for these transactions.

(v) Poor Technological Support:

Limited resources at the disposal of the UCBs limit their purchasing power to go in for high technological support for their banking business. Very few

UCBs can avail of Internet banking, Mobile Banking, SMS Banking, Core Banking Systems etc. This has put a break to their development.

(vi) Untrained and Low Qualified Staff:

In commercial and private banks, qualified and experienced staff is recruited because these banks are giving attractive salaries and facilities to their staff. But in UCBs things are quite different. Due to poor salaries, highly qualified and trained banking personnel are not prepared to work in UCBs. Those who are working in UCBs are untrained and poorly qualified staff. This tells upon their capacity to attract more business, afford qualitative services, and the result is low output. Due to poor banking knowledge of staff working in UCBs, the customers do not get quick and desired service.

(vii) Micro - Branch Net Work:

Due to low Net worth position, many UCBs are unable to expand their Branch network in the same or adjacent districts or entire state or more than one state. This limits their business sphere. Most of the UCBs are conducting banking business within one town/city or a few adjacent districts only. For transfer of funds to other areas, the UCBs do not have proper branch Network. Hence the UCBs are dependent on other commercial banks for effecting transfer of funds to other parts of districts/state/Nation. This hampers their progress.

(viii) Financial & Marketing Techniques:

With the introduction of new age commercial banking, existing nationalized banks and other non-banking financial companies are shrinking the market share of UCBs, especially in housing & auto finance sector. UCBs are also finding it difficult to penetrate as the annual budget for business promotional expenses of each of these market competitors is much more than the actual revenue income of some of the UCBs. This adversely affects the business share for UCBs as they are far behind on financial & marketing technique aspects in the current scenario.

(ix) Borrower-wise Interest Rates:

UCBs do not have liberty to consider borrower-wise interest rate. They have to follow their loan policy strictly. But this is not the case in other banks. In many cases concessional or reduced rates are applied on loans and advances given to premium or good borrowers by the commercial and private banks.

(x) Restriction on accepting Govt. Deposits:

There are restrictions on Central, State Govt. Departments, Local Authorities and even Charitable Trusts etc., on having deposit accounts with urban co-operative banks. All low-cost deposits or no interest deposits of these offices go straight to nationalized banks. Even Demand Drafts and Bank Guarantees given by co-operative banks are not accepted by Govt. Departments, Local bodies & even schools & collages. UCBs are deprived of such low-cost deposits and have to take deposits on higher rate of interest, which ultimately reduces their Net Interest Margin.

(xi) Competition from Co-operative Credit Societies:

In the area of operation of all the UCBs, there are many co-operative societies, which are directly competing with the UCBs. As these societies are not under the control of Reserve Bank of India, they are not following NPA and other norms so strictly. These co-operatives are conducting banking business without any stringent norms and regulations. They are also using unethical ways to attract customers. They are giving loans to their customers, even without taking collateral securities. As these societies are giving-hassle free services to their customers, more and more, people are attracted to them, which in turn directly affects the business of the UCBs, which are following all the norms and guidelines of Reserve Bank of India and the Government.

(xii) Low level of computerization:

Even today some urban co-operative banks are maintaining their accounts manually. Their working, therefore, is very slow-paced. The level of operational efficiency in such banks is very low. They cannot compete with their counterparts in the market. As most of manpower is involved in manual working of the bank, they cannot give good services to their customers.

(xiii) High Operating Cost:

Management of the commercial and private banks is vested in the hands of professional and expert persons and hence every precaution is taken to control operating cost. Since most of the UCBs are not run by professionals, they are unable to keep operating costs in check. Among the many reasons for high operating costs in UCBs are faulty recruitment system, excess staff, unwanted expenses made by the bank, high interest paid, heavy legal charges paid due to large quantum of litigation etc., This ultimately reduces the profit of the bank.

4.2 Problems due to dual control

Another major hurdle faced by co-operative banks is the dual control by two authorities viz., Reserve Bank of India and State Co-operative Department. Due to this, the banks often face uncomfortable situations. The multicity of command centres and absence of clear-cut demarcation between the two authorities have been the most complicated problem of urban co-operative banking movement.

There are separate sets of audits, enquiries conducted by State Government bodies. There are statutory audits, various MIS, long drawn system of board election schedules, permission for area of operation, staff recruitment etc. State Government bodies are not that much professional in nature to control the present vast system of co-operative banks, and because of this many a time, lot of delay takes place in taking major decisions. This automatically results in reduced efficiency of banks. If commercial banks are totally governed by RBI, a more professional body, why does this type of dual system of control operate for co-operative banks? Needless to say, due to this, lot of precious time of CEOs/ Managers is being wasted on these matters, which otherwise would have been productively used. With internal/concurrent audit system already in place, this dual control system should be abolished/reduced, so that, these banks can be better controlled by a single professional body like Reserve Bank of India.

It is high time that corrective action is taken in this regard, so that co-operative banks also become more vibrant units like commercial banks. Co-operative banks contribute a lot in developing banking habits in villages and semi-urban areas, so they should be allowed to function more systematically with fewer hurdles.

Problems due to Dual Control are as given below:

i. Duality of Control:

The urban co-operative banks are regulated and supervised by State Registrar of Co-operative Societies, Central Registrar of Co-operative Societies in case of Multi State Cop-operative banks, and by RBI. The RCS and CRCS exercise the powers in regard to incorporation, registration, management, amalgamation, & reconstruction and liquidation. The banking related functions, such as issue of license to start new bank/branch, matters relating to interest rate, loan policies, investments, prudential exposure norms etc. are regulated and supervised by the Reserve Bank of India. The multicity of command centres and absence of clear-cut demarcation between the two authorities have been the most complicated problems of urban co-operative banking system. As a consequence, RBI is not empowered to take the needed unilateral action against the management of an earring UCB and it requires the assistance of the concerned Registrar of Co-operative Societies to take necessary action. This system of dual control is often claimed to have been one of the important factors responsible for the less-than-satisfactory performance of several UCBs.

UCBs are treated as co-operative societies when it comes to Government aid, whereas for implementation of prudential norms and other matters Sec 5(c) of Banking Regulation Act is made applicable. Thus only disadvantageous provisions of these dual acts are made applicable.

ii. Two Inspections/Audits:

The Bank has to face two inspections one from RBI & another from DDR. The Bank has to spare more time for these inspections/Audits. The Bank has also to report compliance to both the authorities. This hampers their developmental programs since much time is spent by them during audit and inspection of the bank.

iii. Submission to Two Authorities:

The Bank has to submit various forms of financial information to both the authorities. This eats away their precious time, that could otherwise be utilized for other developmental work.

iv. Delay in obtaining Approval:

The Management part is controlled by RCS, whereas Banking part is under the jurisdiction of RBI. The Bank has to obtain approval from both the authorities on many important decisions. This involves more time and additional staff has to be deputed by the Bank for the purpose.

v. Different Approach :

Many ratios e.g. CD ratio, CAMELS ratings etc are being calculated by two authorities on different bases. The Bank has to follow both sets of instructions. Many banks are confused over different items of control and in dilemma whether to seek approval from RCS or RBI. NPA/CRAR/NDTL/CRR/SLR/NET WORTH/ALM calculations are not being separately computed by RCS and in many audits by RCS; it is observed that the tables worked out by bank are taken as correct, without verifying its accuracy. On many occasions, the computation on NPA duly audited by the Statutory Auditors, undergo changes at the level of RBI. When two separate opinions are expressed on the same issue, the Banks do not understand how to react in such situation. The parameters applied by RCS and RBI for recruitment of staff are also different. In this cofusing scenario, the staff accept both the authorities. However the problem remains unresolved.

vi. Non-professional Approach of Govt. Department:

State Govt. bodies are not that so professional in nature as to be able to control the present vast system of co-operative banks, and because of this, very often a lot of delay takes place in taking major decisions. This automatically results in reduced efficiency of the banks. When commercial banks are totally governed by RBI, a more professional body, why does this type of dual system of control operate for cooperative banks? Because of this, a lot of precious time of CEOs / Managers is being wasted on these matters, which otherwise would have been productively used.

vii. Audit Fees :

The Bank has to pay heavy Audit fee for Statutory Audit whereas the RBI is not charging anything on their Inspection.

viii. Different Gradation:

The Audit Grade given by RCS is mostly different from the gradation given to Bank by RBI. Not only this, many ratios calculated by both the authorities are different.

ix. Issue of Circulars:

RBI is regularly issuing circulars to Banks whenever there are changes in the current policies/instructions/guidelines. These circulars are available, immediately, on the web site of the RBI. But this is not so in the case of circulars issued by the RCS.

x. Way of Disposal:

The disposal on various issues at RBI level is faster than at RCS level. Due to slow disposal of urgent matters at the level of RCS, the Bank has to face many problems.

xi. Training Programs:

RBI is organizing training programs for Staff & management of Co-operative banks, to strengthen their banking and Co-operative principles knowledge, throughout the year and that too free of cost or at a nominal cost. This does not happen in the case of RCS.

xii. Recovery of NPA:

There is continuous follow-up and pressure for recovery of NPA loans by RBI but pendency of recovery suits under Section 101 of the Maharashtra State Co-operative Societies Act, 1960, awards, due to reluctance and apathy of cooperative department ruins the efforts put in by UCBs for recovery of NPA. While executing Section 101 Award for recovery, wilfull defaulters create litigation problems by exploiting loopholes in legal procedures.

4.3 Other problems

Now a days, there is hardly any difference in the business transacted by Commercial Banks, Private Banks and Co-operative Banks. But co-operative banks are still far less equipped to face the present day requirements of customers from banking sector. Other than the above two major problems faced by co-operative banks, there are some other problems and hurdles faced by this sector, as compared to commercial and private banks.

These problems are as below:

i. Lacking in Professional attitude:

The UCB framework is lacking in professionalized attitude and approach, not only at Management Level but also at operational level. This is one of the single most important problems plaguing co-operative banks. Though as per RBI norms, it is mandatory to have two professional directors on the Board, the professional directors do not take active part in the working/development of the bank. Excepting these two directors, the other directors on the Board generally do not have adequate Banking knowledge. Hence latest developments in the Banking world do not catch their attention. RBI has taken several measures to infuse professionalism in these banks but they are not effective enough in spirit or in implementation. This is more so in the area of disbursement of loans and advances, which is more or less the prerogative of Directors. Security orientation is more visible than purpose or repayment capacity orientation. This is the major reason for drastic fall in assets' quality. Improvement in the functioning of UCBs can only be achieved if the persons who manage the affairs of the UCBs are professionally competent, devoid of vested interests and subject to supervision and control.

ii. Poor Salary & Wage Structure:

Highly professional staff is not eager to work in the UCBs due to their poor Wage Structure. This blocks the development of professional attitude and approach among them. A lot of staff does not care about maintaining proper office records of various transactions being conducted by them in their day-to-day banking business.

iii. Deregulated Working Hours:

Working hours in UCBs are not fixed. The Staff knows the time of reporting to Bank but is not certain when they shall be relieved from duty in the Bank in the evening. Thus the staff is heavily burdened with work. This is continued throughout the year. The staff does not get leave at the time when they need it badly.

iv. Poor amenities/facilities provided by management:

UCB staff is deprived of general amenities and facilities like those provided by commercial and other banks to their staff. This breeds frustration in the UCB staff and kills their initiative to work hard.

v. No scope for self-development:

Since many UCBs happen to be small in size, there is no scope for the staff for further promotion to higher positions. Many employees retire in the same grade as they were appointed in. This becomes monotonous and kills their aspirations to make progress in the banking field. Further they have to carry on the same type of work throughout their service, hence they become lethargic and avoid work.

vi. Faulty Recruitment System:

In most of the UCBs, appointment of staff is not done on merits but on other factors, like relationship with the director, workers of the political parties, money power etc. Every powerful director tries to appoint their men in the bank, which ultimately results in excess staff in the bank. This excess staff increases the operating cost of the bank, affecting its profit.

These employees are very poor in understanding the requirements of clients and have hardly any freedom to take important business decisions. Both management and operational staff do not have the natural ability to adapt themselves to the rapid changes that are taking place in Banking Industry. So naturally, both quality of service and quantity of business are affected.

vii. Concentration of Powers:

In some UCBs the powers are centralized in the hands of a few Directors, which neutralizes the basic concept of democracy; the decisions are taken as per the will and whims of these powerful directors, mostly, in their personal interest, and not in the interest of the bank.

It is true that elections are held at intervals but very often the same members continue to be in office for years together and sometimes officebearers' post passes from father to son or to members of the same family.

viii. Interference of Board Members in the working of the Bank:

Though RBI has issued guidelines to Board not to interfere in the day-to-day working of the Bank, many directors are not inspired by these guidelines and think that it is their right to get the work from the staff as they desire. This obstructs personality development of the staff. The staff has to work as per the instructions of the masters who many times are unaware of office procedures, norms, rules, regulations etc. and far removed from the banking environment. Many UCBs suffer on account of this approach and cannot achieve desired progress.

ix. Rift in Board members:

Rift in the Board members automatically affects the progress of the UCB. This is a very common problem in many banks. Most of the energy of directors is wasted in keeping the rival group down and holding on to power. Hence little attention is given to the development of the bank.

x. Political control on Bank:

Many UCBs are under the control of political leaders. UCBs which are politically dominated due to influence of these leaders, suffer due to inadequate banking knowledge of the personnel running the Bank. The decisions taken by such persons are not in the interests of the bank but always guided by some political motives or goals.

xi. No liberty to invest in High Return Investments:

UCBs do not have the liberty to invest the surplus profit in high return giving investments as the Reserve Fund, Building Fund etc. are mandatory to be invested in District or State Co-op. Banks which often give them comparatively smaller interest. Even this investment becomes non-performing investment (NPI), as the financial condition of some of the District Central Banks is very poor, and consequently the UCBs have to make huge provision on this NPI. This further worsens the financial condition of the banks. So UCBs should be allowed to invest Statutory Reserve & Other Funds in nationalised banks. It will be quite safe and profitable.

xii. Stringent regulatory controls:

Many co-operative banks are not in a position to bear the impact of regulatory controls being imposed by various regulatory authorities like RBI, DDR, Income Tax Dept., Service Tax Dept, RCS and RBI .etc., as effectively as commercial banks. Profit level of cooperative banks is far less comfortable to meet the NPA requirements, tax requirements and other provisions. Although the co-operative banks are financially not so strong as compared to big commercial banks, they are subject to all the regulatory and tax controls and obligations as equally applicable to commercial banks. Bottom line of cooperative banks is so thin that, obligations like 33% income tax, 12% service tax etc. is very difficult to bear.

xiii. Govt. Debt Waiver Schemes:

Because of the various Debt Waiver & Relief Schemes by Central & State Governments, UCBs continue to face recovery problems with their good customers also, in the belief that fresh package/incentive would be provided to them, which ultimately increases its NPA.

xiv. Closure of Bank in the area:

This is one of the most sensitive problems before the banks. If any bank in the area is closed or liquidated by RBI due to its financial bankruptcy, it has a serious impact on the business of other UCBs in the area. Confidence of customers will shaken and they will look for the other better options. This has tremendously affected many banks in the past.

xv. Language Problem:

In most of the UCBs in Maharashtra, official language is Marathi. All policies, proceeding of all meetings are written in Marathi. In rural banks even the officers cannot speak and understand English language. On the other hand, most of the RBI officers are from out of the state and cannot understand the local language. This creates a communication gap between the bank staff and the inspecting officer. This, sometimes result in unnecessary observations by the inspecting officer, though all the requirements were fulfilled by the bank.

xvi. Notional loss on Investments:

All UCBs have to invest 25% of NDTL in Government Securities (SLR Investment). Market value of the Government Securities fluctuates due to movement in interest rates and other factors also. When market rate of securities which are marked to market, moves downwards at the end of the year, the bank has to make provision for loss on notional basis. Small urban co-operative banks, especially, have to face its impact on profitability. So RBI should increase the limit for holding “Held to Maturity” category investment.

xvii. Third Party Collection Facility:

Nationalized banks are providing third party collection facility to their regular customers as per RBI's norms. But as per the RBI's norms, third party collection is not allowed by the UCBs.

xviii. Multiple Loan:

Due to lack of centralized data of borrowers there is double or multiple loan to single borrower.

xix. Exposure Norms:

When the UCBs are downgraded, their exposure limits are promptly reduced. It has cascading effect on the income and flight of capital. The interest income comes down immediately as the accounts above exposure limits are asked to bring down balances. These time-tested standard accounts normally shift to other banks where as NPA accounts continue with these banks. While leaving the bank, these standard accounts demand for refund of capital which compounds the problem of UCBs.

xx. No special provision in Co-operative Act:

There has been a demand for many years from the co-operatives that a separate chapter be included for UCBs in Co-operative Societies Act, but it has not yet been considered by any state government. And hence, all common provisions applicable to co-operative societies are also applicable to UCBs, even though these are banking institutions holding crores in deposits of the public.

Reference

1. Data collected with the help of questionnaire from 25 selected UCBs in the Maharashtra State.
2. On the basis of information received from interviews with Directors, CEOs and senior officers of the 25 selected banks.

Chapter 5
Expectations & Remedies

5.1 Expectations from Government

(a) **Rehabilitation of sick UCBs:** Government should take up rehabilitation of weak and sick UCBs. It should provide them Loans & Advances to be repaid on long term basis or compensate their Asset-erosion caused without mollified intentions. In the past, only the West Bengal Government appointed expert committee who dealt with various problems faced by Co-operative banks and which came out with the suggestion that financial assistance by Government is the solution. The Govt. has accepted the report and finalized the package to be given. But, shockingly, no other Government has helped the UCBs.

Whenever a nationalized bank is in trouble, Government provides funds to improve its capital adequacy. Similar assistance may be made available for co-operative banks also.

(b) **Budgetary Support:** The Government should consider the urban co-operative bank as an essential factor in the overall banking and credit environment of the society. This sector is totally overlooked or not given its required weightage while designing and implementing various financial policies both at Central and State level. No budgetary support is extended for the improvement, uplift and expansion of urban credit through urban banks by the Government and other designated institutions. No Finance Minister ever finds it necessary prior to designing his budget or even ongoing analysis and overviewing implementation of the budgetary allocation. Though these banks are the most competent for financial inclusion and over time have proved their ability to provide credit at grassroot level effectively they are not the part of any of the Government Schemes designed for urban uplift and financial inclusion of the urban poor.

(c) **Relaxation from Income Tax:** It should exempt UCBs from paying Income Tax. If this is not feasible, then they should be given at least a few more years' tax holiday. Even if tax is to be imposed, it should be at a far lesser rate than that for other banks. The Government should make a proper provision in the new Direct Tax Code Bill for UCBs. .

A strong reason given by the World Council of Credit Union, for exemption of retained earnings of cooperative banks from tax is that these amounts increase the lendable resources of the cooperative banks that extend credit to the needy sections of society, providing value addition to the economy.

(d) **Deputation of Government officers on Board:** It should depute Government Officers with good knowledge and experience of co-operative banking, on Boards where Government has helped these Banks. These officers will keep watch on the working of the bank and will definitely help in improving the overall health of the bank.

(e) **Separate Laws for UCBs:** The Government should frame separate laws for UCBs which will help them to recover loans and advances from the borrowers without any scope for wilful defaulters.

(f) **Public Issue of Share Capital:** Government should allow the UCBs to raise capital from Capital Market (Public Issue) on the lines of Private Banks. This will solve the problem of capital inadequacy.

(g) **Government Business:** Government should assign business of revenue receipts and payments to UCBs as well. Today most of the schemes offered and sponsored by the Govt. to the citizens are routed through SBI, Commercial Banks and State sponsored banks, thus keeping out the cooperative banks from the main stream. This should be minimized and better role should be assigned to them.

Payment of Salary and wages is now made through Commercial banks. Government should also allow UCBs to perform this function.

(h) **Salary of Staff:** The Government should fix Salary & Wages of Urban Banks staff at par with State Government salaries. This will definitely boost the morale and efficiency of the working staff and they will give better service to the banks' customers. Also, the Government should recruit the Bank Staff on merit and transfer them from one bank to another irrespective of the category of the Bank.

(i) **Eligibility of Directors:** The Government should specify the eligibility criteria laying down the minimum qualifications and experience for appointment as directors of UCBs. At least 50% of the total Directors should have banking experience. Then only can they understand the latest trends in the banking system and work towards fast-tracking the growth of the bank.

(j) **Superseding of Board of Directors:** If the Board of Directors is superseded by the Co-operative department for any reason, it should not be kept superseded for more than six months.

5.2 Expectations from RBI

(a) **Lesser Regulatory Control:** RBI being the regulator has changed its earlier policies in the recent past, but the sector is expecting further more sensitisation of the regulator while equating various strata of urban banking with other major players in the banking system. Prudential norms which regulate small urban banks, which are operating mostly in a single district and that to the limitation of urban and semi urban centres, only may be designed appropriately considering the client exposure available to them and the resources explorable by these banks.

Even though RBI has imposed regulatory requirements in a phased manner, its impact is still on a higher side. In no way are co-operative banks in a position today to be at par with gigantic commercial, private banks. How can it be reasonable when the same level of NPA, CRAR are imposed on a big bank like SBI and small Tier I co-operative bank? Even today, quality of assets of a co-operative bank is not at all comfortable, because of high cost factor and low level of professional approach. Profit levels of co-operative banks are so low that, they are not in a position to absorb the present strict levels of provisioning. It may take years to attain that level of high proficiency. Till then it is highly advisable to provide more regulatory cushions to at least unscheduled co-operative banks, as otherwise slowly and surely they will crumble under their own weight.

(b) **Abolition of Cash Reserve Ratio (CRR):** Earlier, the RBI was paying interest on the amount of CRR maintained by the bank with RBI at the rate ranging from 1% to 3.5%. However, since March31, 2007 the RBI has stopped paying interest on CRR. RBI should either do away with CRR or compensate the banks for the losses incurred as the banking system was not earning any interest on it. Phasing out of CRR would release scarce capital resources which will help the banks in reducing rates for the industry. Instead, RBI should increase the SLR on the lines of CRR percentage.

(c) **Frequency of RBI Inspection:** RBI should conduct Inspection of all Urban Banks every year. This will improve overall health of all Banks. The duration of RBI inspection is very short. Due to this limited period, the RBI inspectors cannot conduct detailed scrutiny. Because of this, sometimes major defects in the banking operations remain unrectified and proper action is not taken in time.

(d) **Qualification & Experience of Directors and Staff:** Even though RBI has made two professional directors mandatory in the board of directors of all urban co-operative banks, the provision is far from satisfactory. The ambit of qualifications for the professional director is so vast that, even a lawyer can be included. Chairman and Vice-Chairman, who normally take all major policy decisions, should compulsorily be banking professionals with some banking experience. Likewise, some regulatory framework, as regards educational qualifications and experience should be fixed for appointment of clerical staff and officers. Unless RBI takes some drastic decisions in this regard, things will remain the same.

(e) Periodical Meetings: Regional offices of the RBI should arrange periodical meetings of all Urban Banks' executives to solve their problems and discuss various issues like Scope, Development and adopting changes in RBI policies.

(f) Training Centers at RBI Regional Offices: RBI may set up training centres at their regional offices also for the employees of the UCBs at affordable fees, so that these employees will be better equipped to cope with the changing trends in banking. RBI should arrange these training programs round the year, for the staff of Urban Banks.

(g) Uniform Format & Special Law: RBI should spell out specific credit appraisal procedure for all types of advances with details of formats for such Scrutiny Note including documentation on the lines of KYC Policy. RBI should introduce common formats for account opening, Loans and advances, purchase of drafts, Bank Guarantees, Pass-Books, Account statements, KYC documents, Loan documents, etc; this will make the financial transactions more transparent and uniform. It should also co-ordinate with the Government for enacting a special Law for Bank loans and their recoveries.

(h) Member of Clearing House: All UCBs should be allowed to open a current A/c with RBI. They should be made direct members of the Clearing House.

(i) No limit on Housing Loans: Overall ceiling on Housing Loans should be deregulated because it is safe and fully secured type of finance for UCBs. Also, it is very essential to remove the maximum limit on the amount of housing loan as due to inflation, the prices of houses in urban areas have increased tremendously and the borrower are going to other commercial banks as there is no maximum limit for housing loan there.

(j) I.T. Support by RBI: There is very little computerisation in small UCBs and inadequate awareness about the importance of computerisation in increasing competiveness. The RBI should make available, quality I.T.

software and other infrastructure to all UCBs, irrespective of their size, category or profitability. This will maintain uniformity, in all UCBs, in respect of computerisation and will increase the overall efficiency of the banks.

(k) **Inform Working Result:** The RBI is getting all information in the prescribed format on monthly/ quarterly/ half yearly/ yearly basis and analyzing it regularly. On the basis of this data, RBI should inform the concerned bank about its working results along with its observations on it. This will definitely help banks to further strengthen their financial position and advance their business.

(l) **Restriction on purchase of non-banking assets:** There is restriction on purchasing of non-banking assets by the UCBs. But it has been observed by most of the bankers that they are compelled to take possession of the mortgaged properties of big defaulters for recovery of the overdues. But when these properties are put up for auction, they do not fetch reasonable value, since the prospective buyers apprehend high risk and trouble in purchasing these properties owned by influential persons, having nexus with politicians , criminals etc.

Under such circumstances, the banks have no option but to purchase such a property, which is not meant for their justifiable use, to prevent its sale at throwaway price. Once the property is purchased by the bank and mutated in the bank's name then it fetches lucrative offers from prospective buyers.

In view of this, restraining the UCBs from acquiring such assets/properties will put them to hardship in recovery of mounting overdues from big, influential defaulters.

(m) **Single Regulator:** All the matters relating to administration of the UCBs are entrusted to the co-operative department where the banks have to face many problems due to red tape. So, it will be preferable to place them under the single control of RBI which will bring qualitative improvement in the working of UCBs.

(n) **Public Honouring of Good Work:** RBI should encourage better management in co-operative banks by publicly honouring the UCBs which have excelled on all parameters set by the RBI; this will recognize good work and encourage other UCBs to emulate them..

(o) **Currency Chest to UCB:** UCBs should be given Currency Chests and the norms should be relaxed, as SBI and other banks are not giving proper cooperation in the matter of catering to the seasonal needs of the UCBs. On many occasions, cash is not made available to the extent requested when it is badly needed. More effective control is expected on currency chests or services rendered by currency chests to UCBs. Under Clean Notes Policy, RBI should allow the Banks to exchange soiled Notes directly from the counters of RBI.

(p) Knowledge Support to UCBs: RBI should appoint a full time officer at every regional office, possessing good knowledge of all rules and regulations applicable to UCBs and at the same time possessing good knowledge of local language, to solve the problems of UCBs, as the CEO/Managers of these small banks are not capable of interpreting the circulars properly, issued by the RBI and other authorities.

(q) Increase Deposit Insurance: At present DICGC coverage is available on deposits up to ₹ One lakh, This discourages depositors from depositing more than the sum insured. The limit should be increased up to deposits of ₹ Five lakh by moderate increase in premium.

(r) Separate NPA Norms for UCBs: NPA norms for UCBs should not be at par with those for nationalised banks. The borrowers of the urban banks are mostly based in rural areas where the income generation is entirely linked with the yield from agriculture. So, ninety days' NPA norms are very stringent and hence relaxation should be given.

(s) Free access to all activities: In the present environment of liberalisation, RBI should allow UCBs to have free access to all activities, which are allowed to commercial banking sector, without any restrictions. This will only activate the true spirit of competition and UCBs will be benefited by it.

(t) UCBs should be nominated as notified Bankers for raising Public Debts.

(u) RBI should impose a ban on such Boards as are running the Urban Banks on political initiatives/support/influence.

(v) UCBs should be permitted to select an auditor from the list of auditors maintained by the Reserve Bank.

5.3 Remedies available

(a) Board to follow Banking Principles strictly: The Boards of UCBs should avoid running the Bank with political support and interference. The Boards of the Banks should give more thrust on the performance of the bank staff as per RBI guidelines rather than moulding them as per their perceptions and ideologies which may not be consonant with banking principles.

(b) Forum of Urban Banks: There should be a forum of Urban Banks working in one jurisdiction and the forum should meet regularly to interact with each other and resolve their issues. The Bankers should identify wilful defaulters and exchange this information with the members of the forum and ban them from getting any advance from any bank.

(c) Professional Approach: In adopting full and comprehensive professionalism, the Urban Bank should follow strict time schedule for opening, closing of their business house. The Banks should give weightages to quality of customer rather than their personal relationship with the customers.

In the present Risk-environment, Bankers should go by rules while discharging their duties. The Staff should seek orders in writing for executing any type of banking transaction and should not carry out oral orders. The Board and the staff should adhere to Banking principles while attending to customers.

(d) Diversify Activities: UCBs can diversify their activities in non-interest income sectors like insurance, mutual funds and other related businesses to increase their profitability and expand their customer base.

(e) Issue of Shares at a Premium: UCBs should be allowed to issue their shares at a premium. Over a period of time, UCBs build up sizeable reserves and therefore have a Net worth which is significantly higher than the nominal value of the share capital. It is, therefore, suggested that if fresh capital is to be issued by existing UCBs, it would be more appropriate if all fresh capital is issued at a premium, based on the Net worth at the end of the preceding year as certified by the UCB's auditors; all redemption of capital is also to be made on that basis.

(f) New Blood in the Management: In the wider interests and healthy growth of the movement there is need for a transfusion of new blood in the management. Of course, this calls for an awakening in the general body of members who are at present generally indifferent towards the working of the banks. This apathy on the part of members is, in fact, responsible for concentration of power in a few hands and is a big hindrance to the democratic functioning of the UCBs.

(g) Exchange of Information & Experience: There is need for an exchange of information and experience between the various UCBs working in the area, and the promotion and creation of co-operative and banking related projects in a co-ordinated manner. Also, all Urban Banks should have common and identical fees for giving out advances and for other services.

(h) Decentralization of Training : The co-operative training college at Pune gives training to senior personnel of the urban cooperative banks in the country. There are several other training centres at a number of other places also. No doubt, these centres are rendering yeoman's service to the urban co-operative banks, but they are still not sufficient considering the number of UCBs and their staff. The programme of education and training should be decentralised to ensure that all the local UCBs are involved in training programmes which can enhance their effectiveness.

(i) Quality Instructor: The success of the UCBs training and education programmes is mainly dependent upon the quality of the educational instructor. Hence, every care should be taken to select the right type of persons with suitable academic qualification, requisite practical experience and last but not the least, with a good knowledge of local language, to interact with the participants in a meaningful way.

(j) Education Committee: Each UCB must form an Education Committee, in addition to other committees, which will keep up with literature on co-operative banking and educate the staff of the UCB and members also. The Education Committee will look after training programme, facility for education of staff, directors and members. It should also arrange various programmes on financial literacy, for non-members also in its area of operation.

(k) Loans to Directors & their Relatives: At present, there is a ban on loans to directors and their relatives. Actually, members join urban co-operative banks to avail the facilities offered by them and this is permissible under co-operative principles and philosophy. Though the UCBs are functioning on commercial lines, profit maximization is not the sole objective of UCBs. Rather, their primary objective is the provision of affordable banking facilities to their members and catering to their credit needs. Hence, RBI should evolve a mechanism for putting a check on the misuse of this facility rather than imposing a total ban on it.

(l) Minimizing of Restriction on loans: There are lots of restrictions on types of loan UCBs can give. Such restrictions are not there in case of commercial and private banks. This differential treatment should go.

(m) **Parent Organization for UCBs:** With the growing networking of UCBs and their utility in financial uplift and financial inclusion, which is need of the hour, it is necessary that a separate apex organization exclusively for urban co-operative banks be set up on the lines of NABARD. The parent Organization should provide a wide range of services to UCBs such as providing loans and advances, refinance, payment and settlement services, IT services, ATM network services, investment banking, fund management, management consultancy, capacity building services and even capital support.

(n) **Follow Rules & Guidelines:** Every bank should strictly follow the circulars and guidelines issued by the RBI, from time to time, in connection with regular banking business as well as housekeeping and internal control. Further, the Banking Law & Practice, State Co-operative Act and all other relevant acts should be strictly followed.

(o) **Points to be reviewed at a Board Meeting** : In every Board Meeting it is very important that the board discuss or review position of NPA, percentage of CRAR, profitability of the bank, maintenance of CRR and SLR, follow-up of RBI directives etc. This will help in bringing about overall improvement services of the bank.

(p) **Social Obligations:** This is a very important matter, even though it is not a financial one. Every bank has to meet its social obligations being a part of society. Bank can use their surplus funds for the welfare of their staff as well as people in the surrounding areas. This will help maintain good relations with the people in the area and ultimately benefit the bank.

Reference:

1. Data collected with the help of questionnaire from 25 selected UCBs in the Maharashtra State.
2. On the basis of information received from interviews with Directors, CEOs and senior officers of the 25 selected banks.

Chapter 6
Conclusion and Suggestions

6.1 Conclusion

Co-operation is the backbone of rural and semi-urban economy. It should not be allowed to collapse only because of weak links in the system. RBI and State Government should put in place a system which will ensure success in the co-operative movement.

The Govt. and RBI should consider the Co-operative banks as essential factor in the overall banking and credit environment of the society. These banks are the most competent tool for financial inclusion and over time have proved their ability to provide credit at the grassroot level effectively. The only thing is that they need proper cushioning, guidance, advice and support.

With the growing networking of UCBs and their utility in financial uplift and financial inclusion, which is need of the hour, it is felt necessary that a separate umbrella organization exclusively for urban co-op. banks may be designed on the lines of NABARD. UCBs with their unique and exclusive organizational set up will be the most effective tool for the financial inclusion of urban poor and hence this sector needs special attention in the years to come.

Co-operation if run on trust, honesty, and confidence is the best alternative to Corporate Sector; we feel that it should not be allowed to collapse. The Government and the Reserve Bank should nourish this sector.

Suggestions

On the basis of views and opinions taken from 25 selected Urban Co-operative Banks in Maharashtra State, certain suggestions can be given for both regulators and Board of Directors of the Banks, which if accepted, will definitely improve the overall financial health of UCBs and the functioning of the banking sector, and ensure better service to lakhs of depositors and customers of the Urban Co-operative Banks.

6.2 Suggestion to Board of Directors:

1. The experienced and qualified Board of Directors will make the management efficient. The Board of Directors should be well qualified and

must have a good knowledge of the co-operative banking along with the ability to take correct decisions. At least 50% of the total Directors should have banking experience. Then only can they understand the latest trends in the banking system and try to fast-track the growth of the bank. Likewise, some regulatory framework, relating to educational qualifications and experience should be fixed for appointment of clerical staff and officers.

2. Salary structure of the staff should be revised after, say, every five years. This will reduce staff turnover in the bank. The staff will be assured that they will get higher salary after a certain period. Bank should give all benefits to the staff like PF, Gratuity, and Group Insurance etc. to safeguard their future.

3. The bank management should pay more attention to training of the employees. Each UCB must form an Education Committee, in addition to other committees, which will look after the training facility of staff as well as members. The Education Committee will look after training programme, facility for education of staff, directors and members. It should also arrange various programmes on financial literacy, for non-members also, in its area of operation.

4. Computerisation is the need of the present day which enables the UCBs to provide efficient and better services to customers, enables them to compete with nationalised banks, and to reduce the cost of operation. The UCBs should also provide technology-driven banking services to its customers, like ATM, Mobile banking, Debit/Credit Card, Electronic Fund Transfer, Internet Banking etc.

5. The UCBs should arrange welfare programmes for the members, staff and their children. These welfare activities may be in the form of computer training, personality development programmes, award and prizes for bright students etc. As part of their social responsibility, they should also make donations from their surplus profit to educational institutions, libraries, charitable institutions, hospitals, cultural organisations etc.,.

6.3 Suggestions to Regulators

1. The State and Central Governments should keep in mind that the UCBs are not just co-operative societies but they are banking entities. If co-operative banks are inefficient then it will have an impact on the whole banking sector. So, the Government should enact legislation that will help the co-operative banks perform in a manner that is in the overall interests of the depositors and the society.

2. The State Governments should help revival of UCBs by giving adequate financial package. It will help to increase employment, production, and per capita income of the state which will ultimately help government to fill its kitty through increased direct and indirect tax collections. The restoration of confidence of depositors and investors in the banking system will be an additional benefit.

The banks are always termed as the nerve centre of the economy. Any adverse impact on the banking system has exponential impact on the economy. When one co-operative bank fails, the whole co-operative banking system bears the stigma and takes a hit. The so called strong banks suddenly look fragile. It is said that a stitch in time saves nine. Hence, if the illness in the presently sick UCBs is cured, the other healthy UCBs will not be infected.

3. The system of dual control is often claimed to have been one of the important factors responsible for the less than-satisfactory performance of several UCBs. The effective regulation and supervisory control of UCBs would warrant that there should be clearly defined control system.

The RBI has appointed a committee on licensing of new UCBs under the chairmanship of Shri Y. H. Malegam which recommended that:

- UCBs play a useful role and there is need for a greater presence of UCBs in unbanked districts and in centers having population less than 5 lakh.
- The existing well managed co-operative credit societies meeting certain financial criteria like profits, capital adequacy, NPAs' proportion etc. should be given priority for granting licenses as urban co-operative banks particularly in unbanked or inadequately banked centers.
- The committee also recommended an umbrella organisation that will provide temporary liquidity to the member UCBs. All the non-scheduled urban co-operative banks in India shall be the compulsory members of this Umbrella Organisation.

If these recommendations are accepted by RBI, it will definitely strengthen the urban cooperative banks, and new UCBs with sound financial position & qualified, professional staff will come into existence. This will also be beneficial to existing UCBs as their umbrella organisation will solve their temporary liquidity problem.

Co-operation is a better choice as compared to the Corporate Sector if run on trust, honesty and confidence. The Government and Reserve Bank should sponsor this field in the interests of the common man.

The UCBs should keep in mind that they have to first survive in the present world of competition and then grow. They should accept the challenge and succeed by giving better customer service at a competitive cost. UCBs should diversify their activities in non-interest income sectors also to increase their profitability and expand their customer base. There is need for exchange of information and experience between the various UCBs working in the area.

No doubt, the future of UCBs is bright but at the same time it is challenging. For every UCB, coordination between management, customers and regulators is an important requirement. The experienced and enlightened Board of Directors will make the management efficient. The future of UCBs lies in capacity building exercise, characterized by conservation, consolidation, competition, cost-consciousness and customer orientation.

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Chapter 7
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Chapter 8
Annexures

8.1 Annexure-I

Vision Document a Draft MOU

This Memorandum of Understanding dated ………. between the Government of the State of ………represented by ……..having office at ………. (hereinafter referred to as 'the State') and the Reserve Bank of India having its Central Office at Shahid Bhagat Singh Marg, Post Box No. 406, Mumbai – 400 001 (hereinafter referred to as 'Reserve Bank').

Whereas the State administers the ……….Co-operative Societies Act, and the Reserve Bank is the regulator of co-operative banks under the Banking Regulation Act,1949(as applicable to cooperative banks), the State and the Reserve bank exercise regulatory powers over co-operative banks concurrently; And whereas it is considered essential to have coordination between the State and the Reserve Bank for ensuring proper regulation of co-operative banks; It has, therefore, been decided to enter into a Memorandum of Understanding between the State and the Reserve Bank as under:

1. On requisition of the Reserve Bank under Section …………. of the ……..Co-operative Societies Act, for supersession of the Board of a co-operative bank and appointment of Administrator therefor, the State shall comply with the requisition forthwith.
2. On requisition of the Reserve Bank for winding up of a co-operative bank and appointment of a Liquidator therefor under Section ………. of the ………Co-operative Societies Act, the State shall comply with the requisition forthwith.
3. The Board of the a Co-operative bank shall not be superseded by the Registrar without the prior approval of the Reserve Bank
4. The election to the Board of a co-operative bank shall not be postponed nor the tenure of the Board extended without concurrence of the Reserve Bank.
5. The State shall introduce long form audit report for conducting statutory audit of all urban cooperative banks. For banks with a

deposit base of over ₹ 25 crore the State shall provide for the statutory audit to be mandatorily conducted by qualified Chartered Accountants to be appointed in consultation with the Reserve Bank of India.

6. The State shall modify the audit rating models such that the same is brought in alignment with the gradation system adopted by the Reserve Bank of India.

7. The State shall work to raise the standards of corporate Governance by putting in place certain minimum fit and proper criteria for members to be eligible for seeking election for the post of director or for being appointed as CEO, based on guidelines provided by Reserve Bank.

8. The State shall provide for upgradation of HR and IT in co-operative banks in consultation with the Reserve Bank.

9. The State shall provide for conduct of special audit of a co-operative bank if requested by the Reserve Bank and for submitting of report to the Reserve Bank within the time stipulated by it.

The State government hereby notes that the Reserve Bank would be constituting a State level Task Force on Urban co-operative banks (TAFCUB) for identification of potentially viable UCBs and that in the event of any of the above terms being not observed, the Reserve Bank, at its discretion, would wind up the TAFCUB and it would be at liberty to initiate such corrective action in terms of the provisions of the B.R. Act, 1949 (AACS) as it considers appropriate with respect to the urban cooperative banks in the state, notwithstanding any recommendations that might have been made by the TAFCUB.

In witness whereof the parties hereto have signed this Memorandum of Understanding at …….on this ………..day of ……2005.

…………………………………..

For the State

……………………………….

For the Reserve Bank of India.

Witnesses

1. ……………………

2. ……………………

8.2 Annexure-II

Proposed 2-Tiered Regulatory Regime

UCBs may be classified into the following two tiers of regulatory regime:

a) **Tier I:** Unit Banks with deposits up to ₹ 50 crore

b) **Tier II:** All other Banks

To determine the deposit base, the fortnightly average of the NDTL reported in the statutory returns in the preceding accounting year may be reckoned so that a stable and reliable basis is adopted.

The prudential norms recommended for banks falling under different Tiers are as under:

(I) Tier I Banks i.e. Unit Banks with deposits less than ₹50 crore

(i) Asset classification norms:

To identify NPAs on the basis of 180 day delinquency norm for three more years commencing March 31 2005 but build up adequate provisions in the BDDR over the next three years such that they would be able to transit to 90 day NPA norm by March 31 2008. Since the 90 day norm for asset classification came into force effective March 31 2004, revised asset classification norm should not result in any write back of provisions and the new norm would be applicable for identification of NPAs in 2005 and onwards.

Note: Extant instructions would apply for agricultural loans.

(ii) Provisioning norms:

The provisioning norms will be as under for another three years:

Sub-standard : 10%

Doubtful (up to one year) : 100% of unsecured portion plus 20% of secured portion

Doubtful (one to three years) : 100% of unsecured portion plus 30% of secured portion

Doubtful for more than 3 years: 100% of unsecured portion plus 50% of secured portion

Loss : 100%.

Note: (i) A Sub standard account will be classified as doubtful after 18 months.

(ii) All the above provisioning norms will apply for another 3 years. Consequently implementation of the instructions requiring classification of substandard account into doubtful category after 12 months instead of 18 months and 100 % provisioning for doubtful assets of over 3 years would be deferred by another three years. As such the banks should build up adequate provisions over this period to facilitate smooth transition.

(iii) Norms for Investment:

(iii.i) SLR: The minimum SLR holding in Government and other approved securities as a percentage of NDTL for non scheduled UCBs is presently 15 % for banks with NDTL of over ₹ 25 crores and 10% for the remaining non scheduled UCBs. It is observed that the smaller banks, particularly those operating in rural, semi-urban centers, find it difficult to make investments in G-Sec due to lack of access to the markets. In order to meet SLR requirements, these banks often have to purchase G-Sec at a price that is higher than prevailing market rates, as they do not have the wherewithal to obtain information on current market price of these securities, like access to PDO-NDS platform etc. While efforts will be made to enable access to securities' market through Primary Dealers, in the interregnum, these banks could be exempted from compulsory investment in G-Sec to the extent of the deposits kept by them in SBI, Associates and Nationalised banks.

(iii.ii) Non-SLR: Present limit of 10% of total investments would continue.

(iv) Borrowings: Not to exceed 2% of deposits

(v) Capital Adequacy:

At present all UCBs are required to comply with 9% CRAR akin to commercial banks. For easier understanding and simplification, it is suggested that CRAR in respect of Tier I banks may be replaced with a Net Owned funds to NDTL ratio. It is proposed that a NDTL to NOF ratio of 15 could be prescribed.

(vi) Exposure Norms:

10% of capital funds or ₹40 lakhs, whichever is lower for individual borrower and 20% or ₹80 lakhs, whichever is lower, for group, would be applicable in order to contain concentration risk for the Tier I banks. Off-Balance sheet exposure not to exceed 2 percent of NDTL.

(vii) Sensitive Sector Exposure:

Tier I banks should not be allowed to take any direct exposure to real estate, builders or to the capital market. However, loan for individual housing may still be extended by these banks up to the present limit of ₹15 lakh per individual borrower.

(viii) Audit:

Concurrent audit should be compulsory for all banks. Statutory audit should be done using Long Form Audit Report. Statutory audit of banks with deposit base of over Rs 25 crore should be entrusted to chartered accountants.

TIER - II (All other banks) :

For all banks, other than unit banks with deposits upto ₹50 crore, all regulations as applicable to commercial banks should be applied, However, for these banks the extant relaxations for UCBs could remain in force for the period already prescribed. Further, facilities and opportunities available to commercial banks should, as far as possible, be also made available to such banks to enable them to grow and compete with commercial banks. Banks that do not comply with the regulations should either reduce their operations to qualify for the relaxed regulations applicable for unit banks with deposits less than ₹50 crore or may be required to convert into cooperative societies.

8.3 Annexure-III

Questionnaire

"Urban Cooperative Banks, their Problems, Expectations and Remedies"

General Information:

Name and address of the bank	
R O Jurisdiction	

Date of registration	
Date of license	
Date of commencement	
If from mahila / salary earners / SC / ST	
Whether uni-State or multi-State	
Tier I (unit / single district) / Tier II bank	
Number of branches	
Location of branches	
Management – Board of Directors or Administrators	

Problems faced by the UCBs:

1. Problems due to Market competition:-

S.No.	Question	Answer
1	Whether there are so many branches of other banks in your area of operation?	Yes / No
2	Whether the network of your bank is proper to give competitive service to your customers?	Yes / No
3	Whether the technological setup and other infrastructure of your bank are proper in comparison with that of other commercial banks?	Yes / No
4	Whether the rate of interest on loans and advances is at par with that of the nationalized banks?	Yes / No
5	Whether your bank is getting Government business?	Yes / No
6	Whether demand drafts issued by bank are accepted	Yes / No

	by the government departments?	
7	Whether the capital base of the bank is sufficient to stand in the financial market?	Yes / No
8	Whether the staff in your bank is well qualified and trained to give desired services to the customers?	Yes / No
9	Whether co-operative societies and non-banking financial companies are giving steep competition to your bank?	Yes / No
10	Whether your bank is able to attract prime customers?	Yes / No

2. Problems due to dual control:-

S.No.	Question	Answer
1	Whether the bank is facing any problem due to dual control of RBI and Co-operative Department?	Yes / No
2	Is there clear cut demarcation of control between the two authorities?	Yes / No
3	Whether the guidelines issued by these two authorities are properly understood by you?	Yes / No
4	Whether the State Government Authority is professionally competent to control the present vast system of co-operative banks?	Yes / No
5	Whether the decisions are taken by the regulators in time?	Yes / No
6	Whether this type of dual control for co-operative banks is proper?	Yes / No
7	Whether UCBs should be under the control of RBI only, on the lines of commercial banks?	Yes / No
8	Whether the parameters used by both the authorities for evaluating the financial position of banks are the same?	Yes / No
9	Whether the gradation given by these two authorities is the same?	Yes / No
10	Whether the disposal on various issues of bank at State Government level is proper?	Yes / No

3. Other problems:

S.No.	Question	Answer
1	Whether the management of the bank is professionally competent?	Yes / No
2	Whether the bank is professionally equipped at operational level?	Yes / No
3	Whether the salary structure of the staff of the bank is similar to that of nationalized banks?	Yes / No
4	Whether the working hours in the bank are proper and the staff is not heavily burdened?	Yes / No
5	Whether the staff is provided with general amenities and facilities?	Yes / No
6	Whether there is any scope for self-development of staff in the bank?	Yes / No
7	Whether the appointment of staff in the bank is done on merit?	Yes / No
8	Whether the staff is competent enough to adapt to changes taking place in the banking industry?	Yes / No
9	Whether major decisions are taken by the management in a democratic way?	Yes / No
10	Whether the Board members are interfering in the day-to-day working of the bank?	Yes / No
11	Whether the Board members are dominated by any political party?	Yes / No
12	Whether due to Government Debt Waiver Scheme, the bank is facing any recovery problem?	Yes / No
13	Whether any urban co-operative bank was closed in the area of operation of the bank?	Yes / No
14	Do you expect favourable changes in the Co-operative Act for Urban Co-operative Banks?	Yes / No
15	Whether the staff is facing any language problem at the time of inspection by RBI?	Yes / No

Expectations & Remedies:

1. Expectations from Government:-

S.No.	Question	Answer
1	Whether the government should take up rehabilitation work of weak and sick UCBs?	Yes / No
2	Whether the government should give budgetary support for the improvement and expansion of urban credit through UCBs?	Yes / No
3	Whether the urban banks should be exempted from paying Income Tax?	Yes / No
4	Whether the government should frame separate laws for UCBs?	Yes / No
5	Whether the UCBs should be allowed to raise capital from capital market?	Yes / No
6	Whether the government should give business of revenue receipts and payments to UCBs?	Yes / No
7	Whether the government should prescribe minimum qualification & experience for the eligibility of directors of UCBs?	Yes / No
8	Whether the government should fix the salary of urban banks' staff at par with State Government staffs' salary?	Yes / No
9	Whether the government should depute officers having good knowledge and experience on the board of the bank?	Yes / No
10	Whether in case of superseding of Board the period should be restricted to six months?	Yes / No

2. Expectations from RBI:-

S.No.	Question	Answer
1	Whether the policies of RBI are very strict in nature while regulating UCBs?	Yes / No
2	Whether the RBI should compensate the banks for CRR balances which are not earning any interest?	Yes / No
3	Whether the frequency and duration of RBI inspection is adequate?	Yes / No

4	Whether the training facility provided by the RBI for the directors and staff of the bank is sufficient and proper?	Yes / No
5	Whether RBI should introduce common formats for all types of transactions in the UCBs?	Yes / No
6	Whether all UCBs should be allowed to open current account with the RBI?	Yes / No
7	Whether the ceiling on housing loan should be de-regulated?	Yes / No
8	Whether the RBI should make available uniform I.T. software and infrastructure to all UCBs?	Yes / No
9	Whether the restrictions on purchase of non-banking assets should be relaxed?	Yes / No
10	Do you prefer single regulator for UCBs?	Yes / No
11	Whether the UCBs should be given Currency Chests?	Yes / No
12	Whether the problems and queries of the UCBs are addressed at RBI level immediately?	Yes / No
13	Whether the DICGC coverage should be increased?	Yes / No
14	Whether the NPA norms for the UCBs should be relaxed in vis-a-vis those of nationalized banks?	Yes / No
15	Do you expect public honouring of good work in urban co-operative banks by the RBI?	Yes / No

3. Remedies available:-

4. Any other remark:-

Chief Executive Officer

Name:

Mobile No.

Date:

Note: Information may be given on additional sheet, if necessary.