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POLICY REVIEW

The Reserve Bank of India appointed a High Power Committee in May 1999 under the Chairmanship of Shri K. Madhava Rao, Ex-Chief Secretary, Government of Andhra Pradesh to review the performance of Urban Cooperative Banks (UCBs) and suggest necessary measures to strengthen this sector. The terms of reference of the Committee were (i) to evolve objective criteria to determine the need and potential for organising urban cooperative banks; review the existing entry point norms and examine the relevance of special dispensation for less / least developed areas etc., (ii) to review the existing policy pertaining to branch licencing and area of operation of urban cooperative banks; (iii) to consider measures for determining the future set up of weak / unlicensed banks; (iv) to examine the feasibility of introducing capital adequacy norms for urban cooperative banks; (v) to examine the need for conversion of cooperative credit societies into primary cooperative banks and (vi) to suggest necessary legislative amendments to Banking Regulation Act and Cooperative Societies Acts of various states for strengthening the urban banking movement.

Accordingly, the Committee identified five broad objectives:

- (i) to preserve the cooperative character of UCBs
- (ii) to protect the depositors' interest
- (iii) to reduce the systemic risks to the financial system

- (iv) to put in place strong regulatory norms at the entry level so as to sustain the operational efficiency of UCBs in a competitive environment and evolve measures to strengthen the existing UCB structure particularly in the context of ever increasing number of weak banks and ;
- (v) to align urban banking sector with the other segments of banking sector in the context of application of prudential norms in toto and removing the irritants of dual control regime.

Based on the recommendations of the Committee the Reserve Bank has revised the policy applicable to UCBs. The details of policy review are summarised in this issue of the Credit Information Review.

Branch Licensing

Licensed urban co-operative banks, which are not classified as weak / sick may apply for allotment of centres under the Annual Action Plan (AAP) to the Reserve Bank of India. The Annual Action Plan should be for a period of twelve months beginning April 1 of the year and should have the approval of the board. Before applying for allotment of centres, the UCBs should ensure that they satisfy the following criteria:

- (i) Capital to Risk Assets Ratio (CRAR) of banks should not be less than that prescribed by the Reserve Bank from time to time. This condition will come into force only after application of CRAR to UCBs;
- (ii) Banks should have posted net profits during each of the preceding two years;
- (iii) Their net non-performing assets (NPAs) should be less than 10 per cent of their net loans and advances as on the last balance sheet date and they should have made requisite provisions as per the Reserve Bank guidelines;
- (iv) Banks should have achieved the target prescribed by the Reserve Bank for priority sector advances;
- (v) Banks should have demonstrated track record of compliance with provisions of the Banking Regulations Act, 1949 (As Applicable to Cooperative Societies), the Reserve Bank of India Act, 1934 and the instructions / directions issued by the Reserve Bank from time to time. They should maintain requisite level of cash reserve ratio (CRR) and statutory liquidity ratio (SLR) and also ensure timely submission of statutory and other returns.

Unit Banks

Banks which have been organised as unit banks and have been extended relaxation in the entry point capital would be eligible to open branches only after augmenting their owned funds to the level required for opening a new bank (other than a unit bank) at the place where the bank was organised or where the branch is desired to be opened, whichever is higher.

Similarly if a bank, other than a unit bank, desires to open a branch at a higher category centre than the centre at which it was established within the district of its registration, the owned funds of the bank should at least be equivalent to the entry point capital prescribed for that centre. Further, an urban co-operative bank which desires to

open a branch at a centre other than its district of registration but within the state of registration, must have owned funds not less than the entry point capital applicable for organisation of a new urban co-operative bank (other than a unit bank) at the highest category centre in that state.

As some of the existing banks may not be in a position to immediately augment their owned funds to the desired level for being eligible for branch expansion such banks will be allotted centres on restricted basis on their complying with entry point norms prescribed earlier by the Reserve Bank. However, they will have to raise their owned funds to the prescribed level by March 31, 2003, failing which they will not be eligible for further branch expansion.

Extension of Area of operation

The policy regarding area of operation of UCBs has also been revised.

To the adjoining districts

With a view to giving more operational freedom to UCBs in regard to area of operation, it has been decided to allow new as well as existing urban co-operative banks to extend their area of operation to the whole district of registration and to its adjoining districts within their state of registration without prior permission of the Reserve Bank of India. UCBs now need not approach the Reserve Bank for seeking “no objection” in this regard and they may directly approach Registrar of Co-operative Societies of the concerned state for extension of area of operation to the entire district of registration and its adjoining districts within the state of registration. Only licensed urban co-operative banks, which are not classified as weak / sick, will be eligible for extension of area of operation beyond their present limits.

Beyond the adjoining districts

An urban co-operative bank desirous of extending its area of operation beyond adjoining districts to its district of registration but within the state may do so with prior permission of the Reserve Bank subject to:

Beyond the state of registration

An urban cooperative bank with the prior approval of the Reserve Bank may extend its area of operation beyond its state of registration provided its owned funds are not less than Rs.50 crore and it complies with all the prescribed norms.

Requests regarding extension of area of operation may be made to the concerned regional office of the Reserve Bank under whose jurisdiction the UCB is functioning.

Genesis and Architecture of UCBs

The urban cooperative banks have contributed significantly to the well being of lower income groups of the urban and semi urban populace. Perhaps, the urban cooperative credit movement in India, was the first ever attempt at micro credit dispensation in semi urban and urban areas. The UCBs and other cooperative banks were essentially governed by the state governments under the provisions of their respective State Cooperative Societies Acts. But with the increasing demand for introduction of deposit insurance to cooperative banks, it was felt necessary to bring them under the purview of the Banking Regulation Act, 1949 (B.R.Act). The urban cooperative banks were, therefore, brought under the purview of B.R. Act, effective from March 1, 1966. With this, UCBs were subjected to dual command by the Reserve Bank of India exercising control over their

banking related functions and state governments exercising supervision over their managerial, administrative and other matters.

Its owned funds (share capital + free reserves) should not be less than the entry point capital prescribed for the highest category centre in that district/s for organising a new multi-branch bank. As the existing banks may take sometime to achieve the revised entry point norms (EPNs) their requests for extension of area of operation would be considered based on EPNs prescribed earlier till March 31, 2003. Thereafter, only such banks' requests would be considered which have achieved the EPNs prescribed by the Reserve Bank in August 2000. Apart from this the UCB should have also complied with other norm relating to priority sector lending, non-performing assets, cash reserve ratio, statutory liquidity ratio and profits.

Extension Counters

The existing policy for opening of extension counters by UCBs has also been revised.

Eligibility norms

An UCB, which desires to open extension counters, should comply with the following norms;

Licensed urban co-operative banks which are not classified as weak / sick, are eligible to open extension counters. Only scheduled urban co-operative banks, which fulfil the norms prescribed by the Reserve Bank of India can open extension counters, without prior permission. However, such banks should approach the concerned regional office of the Reserve Bank for post facto approval, within one month from the date of opening of extension counters. Non-scheduled UCBs have to obtain prior approval of the Reserve Bank for opening extension counters within the premises of educational institutions, big offices, factories and hospitals of which the concerned UCB is the principal banker. Request from other banks to the institution may be considered, only if opening of an extension counter is not considered feasible by the principal banker and / or its base branch is beyond 10 kilometers from the extension counter. No extension counter should be opened in market place, residential colony, shopping centre, etc. The number of direct beneficiaries / accounts attached to the institution should be at least 500. Extension counters should not be opened merely for collection of fees, payment of bills for electricity, water, telephones, etc. These are primarily the responsibilities of the concerned institution.

Facilities

The facilities at an extension counter should be restricted to acceptance of deposits; issue and encashment of drafts and mail transfers; encashment of travellers' cheques and collection of bills.

Capital Adequacy Norms

It has been decided to implement capital to risk assets ratio (CRAR) norms to urban co-operative banks in a phased manner with effect from March 31, 2002 as indicated below:

Scheduled Urban	Non-Scheduled Urban Co-	To be achieved by
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Co-operative Banks	operative Banks	
8 per cent	6 per cent	March 31, 2002
9 per cent	7 per cent	March 31, 2003
As applicable to commercial banks	9 per cent	March 31, 2004
As applicable to commercial banks	As applicable to commercial banks	March 31, 2005

Classification of UCBs

From March 31, 2002, an UCB (including non-scheduled, scheduled, salary earners' and newly licensed banks) will be classified as "weak" or "sick" as per the norms given below:

Norm	Weak banks	Sick banks
CRAR	CRAR falls below the level of 75 per cent of the minimum prescription; OR	If CRAR falls below the level of 50 per cent of the minimum prescription; AND
Level of NPAs	Net NPAs 10per cent or more but less than 15 per cent of loans and advances outstanding as on March 31. OR	Net NPAs 15 per cent or more of loans and advances outstanding as on March 31. (However, if an urban bank is having Net NPAs more than 15 per cent of its loans and advances outstanding as on March 31, but not meeting other norms for its classification as a "sick", such a bank will be classified as a "weak" bank) OR
Profitability	Showing net losses in operation for two years out of the last three years consecutive financial years.	Showing net losses in operation for the last three consecutive financial years.

The system of constituting bank level rehabilitation review committees is discontinued with immediate effect. Urban Co-operative Banks classified as "weak" should formulate an action plan for revival on their own or with the help of experts in banking/management. The system of monitoring the progress achieved in their revival will, however, continue to be done by the Reserve Bank and by the State Level Review Committee.

Investment of Funds

It has been decided to prohibit parking of urban co-operative banks (UCBs) deposits with other UCBs, except for maintaining balances in current accounts for meeting their clearing and remittance requirements. UCBs should, therefore, not place any fresh deposits with other UCBs. Parking of funds / keeping deposits by urban co-operative banks with other UCBs may pose a systemic risk and can affect depositing banks' financials in the event of any financial problem afflicting the deposit accepting bank.

The UCBs, which are maintaining funds in the form of fixed deposits or term deposits with other UCBs are required to unwind the outstanding deposits with other UCBs before the end of June 2002. The banks should report on a quarterly basis their position of fixed deposits with other UCBs / institutions to respective regional offices of the Reserve Bank, under whose jurisdiction they are functioning. The first of such statement should report the position as on March 31, 2001.

Operations in Call / Notice Money Market

To reduce excessive reliance by urban co-operative banks on call / notice money market, it has been decided that on a daily basis, the UCB's borrowings in call / notice money market should not exceed 2 per cent of their aggregate deposits as at the end of March of the previous financial year. UCBs will, however, be free to lend in the call / notice money market without any limit. UCBs will have to report their borrowings and lending in the call / notice money market to the respective regional offices of the Reserve Bank on a fortnightly basis (as per reporting fortnight) within ten days after the end of the fortnight to which they relate).

Limits on discounting of UCBs Pay Orders

UCBs should note that commercial banks may establish appropriate inter-bank monetary limits for discounting of pay orders issued by UCBs, taking into account the size of their deposits / net-worth etc.

Equity Finance

It has been decided to bring in the following changes in urban co-operative banks' finance against shares/debentures:

- (i) UCBs should not entertain any fresh proposals for lending directly or indirectly against security of shares either to individuals / stockbrokers or to any other entity. They should not grant advances for financing Initial Public Offerings (IPOs).
- (ii) If UCBs have lent to stock brokers or have made direct investment in shares which were not permissible activities, they should take immediate steps to recall such advances / dispose off such investments.
- (iii) Where the UCBs have granted and disbursed advances to individuals against security of stocks / debentures up to the permissible limit (i.e., Rs.10 lakh against physical scrips and Rs.20 lakh against physical demat shares), such advances should be repaid by the borrowers by the contracted date. Such facilities should, under no circumstances, be renewed.

The management of the UCBs should immediately communicate these instructions as also the steps being taken by them to implement the new guidelines to the concerned borrowers.

The UCBs should report, to the respective regional offices of the Reserve Bank, their existing out-standings to individual borrowers and other entities against shares on a quarterly basis in the prescribed format. Any violation of these instructions will attract penalties.

Other Investments

It has been decided to increase the proportion of SLR holdings in the form of government and other approved securities as percentage of net demand and time liabilities (NDTL) of the scheduled urban co-operative banks as follows:

Category of UCBs	Investment in government and other approved securities as percentage of NDTL	
Scheduled UCBs	15	20
Non-Scheduled UCBs		
UCBs with NDTL of Rs.25 crore & above	10	15
UCBs with NDTL of less than Rs.25 crore	Nil	10

UCBs will have to achieve the revised norms by end-March 2002.

Further, with effect from April 01, 2003, all scheduled UCBs will have to maintain their entire SLR assets of 25.0 per cent of NDTL only in government and other approved securities.

All the scheduled UCBs and non-scheduled UCBs with NDTL of Rs.25 crore and above would now be required to maintain investments in government securities only in SGL accounts with the Reserve Bank or in constituent SGL accounts of public sector banks or Primary Dealers (PDs). Non-scheduled UCBs with NDTL of less than Rs.25 crore may maintain government securities in physical or scrip form.

Classification and Valuation of Investments

From the year ending March 31, 2002 UCBs are required to classify their entire investment portfolio as on March 31, 2002 under three categories viz. 'Held to Maturity', 'Available for Sale' and 'Held for Trading'. In the balance sheet, however, the investments will continue to be disclosed as per the existing classification.

The investments under the 'Available for Sale' and 'Held for Trading' categories should be periodically marked to market or at more frequent intervals.

The investments under the 'Held to Maturity' category need not be marked to market as in the case of 'Permanent' securities at present.

Classification of investments, shifting of investments among the three categories, valuation of the investments, methodology for booking profit / loss on sale of investments and providing for depreciation should be in accordance with the prescribed guidelines.

UCBs should formulate an investment policy with the approval of their board of directors to take care of the requirements on classification, shifting and valuation of investments under the revised guidelines. Besides, the policy should adequately address risk-management aspects, ensure that the procedures to be adopted by UCBs under the

revised guidelines are consistent, transparent and well documented to facilitate easy verification by inspectors and statutory auditors.

No Abridged Names

UCBs should meticulously follow the Reserve Bank's instructions while using abridged names on advertisements, stationery items, etc. It was observed that many primary (urban) co-operative banks still do not use the word "co-operative" in their names as appearing in the certificate of registration issued by the Registrar of Co-operative Societies as well as in the licence issued by the Reserve Bank and continue to use their names in abridged (short) form on various stationery items, advertisement, hoarding, name boards, etc. This not only caused confusion in the minds of general public but also did not show the correct status of the co-operative bank.

Urban Banks : A Profile

The number of primary cooperative banks has gone up from 1106 in 1966-67 to 2050 as at the end of March 2000, inclusive of 90 salary earners' banks, of which 51 PCBs were scheduled. Gujarat, Maharashtra, Karnataka, Tamil Nadu and Andhra Pradesh accounted for 78.9 per cent of these and 75 per cent of their deposit resources. The aggregate deposits of PCBs stood at Rs. 28,544.61 crore as at the end of March 2000 and outstanding advances at Rs. 17,285.51 crore during the same period. The credit deposit ratio of PCBs was 63.3 per cent as at end June 1999. Gross non-performing assets of 1748 PCBs aggregated Rs. 4534.60 crore or 12.2 per cent of their total advances as at the end of March 1999.