

Executive Summary

Introduction

1. The Reserve Bank of India appointed this 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 this Committee are (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 licensing 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 B.R. Act and Cooperative Societies Acts of various states for strengthening the urban banking movement.

[\(Paras 1.2 & 1.3\)](#)

2. The Committee feels that there are 5 broad objectives before it. These are (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.

[\(Para 1.4\)](#)

Genesis and Architecture of UCBs:

3. 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 1 March, 1966. With this, UCBs were subjected to dual command by RBI exercising control over their banking related functions and State Governments exercising supervision over their managerial, administrative and other matters.

[\(Para 2.1 & 2.11\)](#)

4. The deposit resources of UCBs rose from a meagre sum of Rs.153 crores as at the end of

financial year 1966-67 (UCBs were brought under the purview of B.R.Act with effect from 1 March,1966) to Rs.50,544 crores as at the end of 31 March, 1999. The number of UCBs had also gone up from 1106 to 1936 during the corresponding period. Heterogeneity is a striking characteristic feature of UCB structure. Gujarat, Maharashtra, Karnataka, Tamil Nadu and Andhra Pradesh alone account for 78.9% of urban cooperative banks and over 75 per cent of their deposit resources. Notwithstanding the phenomenal progress registered by UCBs, today they, are facing five major problems (i) dual control, (ii) inadequate legal framework to regulate UCBs compared to the powers RBI has been vested with to regulate commercial banks, (iii) increasing incidence of weakness, (iv) low level of professionalism and (v) apprehensions about the credentials of promoters of some new UCBs. The Committee has attempted to address these issues in this Report.

[\(Paras 2.22, 2.23 & 2.25\)](#)

Licensing Policy of New Urban Cooperative Banks

5. This Committee has examined the feasibility of evolving certain objective criteria for determining the need for urban cooperative banks and assessing the potential of a proposed UCB. The Committee feels that in a fairly deregulated regime, neither it is feasible for the regulator to evolve certain objective criteria for assessing the need for an UCB in a given area nor does it have the wherewithal to do it. Certain conceptual tools like 'existence of credit gap' and the 'Average Population Per Bank Office (APPBO)' are not effective in determining the need for an urban bank in a given locale. Specific It, therefore, recommends that the regulator should prescribe the twin criteria i.e., a strong start-up capital and requisite norms for promoters eligibility. These two norms will suffice at the entry level for the new UCB. As regards the viability of an entity, it should be left to the judgement of the promoters. The Committee, therefore, recommends that the existing quantitative criteria for viability standards should be dispensed with and they should be replaced by qualitative norms like CRAR, tolerance limit of NPAs and operational efficiency.

[\(Paras 3.7 & 3.38\)](#)

6. The twin functions of start-up capital are (i) to meet the initial infrastructure cost and (ii) to provide a cushion against the erosion of a bank's assets. Viewed in this context, the existing Entry Point Norms (EPN) are low. The Committee also feels that EPN for UCBs should be on par with peer groups like Local Area Banks (LABs) and Regional Rural Banks (RRBs) whose clientele and area of operation are bradly similar to UCBs. The Committee also feels that the existing low EPN is one of the major causes for weakness of UCBs. The Committee, therefore, agrees with the views of Narasimham Committee Report on Banking Sector Reforms that the existing EPN are rather low. Accordingly, the Committee recommends the following 5 grades of increased EPN compared to the existing 3 grades.

[\(Para 3.18\)](#)

Table - A
(Entry Point Norms for UCBs other than unit banks)

Category of Centre	Capital (Rs. in crores)	Membership Nos.
A - population over 15 lakhs	5.00	3000
B - population over 10 lakhs but not exceeding 15 lakhs	2.50	2500
C - population over 5 lakhs but not exceeding 10 lakhs	2.00	2000
D - population over 2 lakhs but not exceeding 5 lakhs	1.00	1500
E - population not exceeding 2 lakhs	0.50	1000

7. If promoters desire to set up unit banks (1 bank-branch), the above entry point capital norms require reduction. The Committee, therefore, recommends that banks which intend to start only unit banking, should be given 50% relaxation in the entry point norms applicable to the particular centre as under.

Table - B
(Entry Point Norms for unit banks)

Category of Centre	Capital (Rs. in crores)	Membership Nos.
A	2.5	3000
B	1.25	2500
C	1.00	2000
D	0.50	1500
E	0.25	1000

However, if any UCB intends to open additional branches, it has to comply with the entry point capital prescribed for the banks as indicated in the [Table A](#).

([Para 3.19](#))

8. The Committee has examined the desirability of continuance of special dispensation i.e., relaxation in entry point norms for certain categories of banks organised in less/least developed area and banks set up exclusively for women and SCs/STs. There is some merit in the argument of the critics of special dispensation that, urban banks being financial entities, any relaxation in entry point norms would lead to proliferation of weak banks. But in view of constitutional provision for reservation for SCs/STs and the state policy of empowerment of women, the Committee recommends continuation of the relaxation in EPNs to the above categories of banks for a period of 5 years and, thereafter, the RBI should review the policy.

([Para 3.32](#))

9. Good corporate governance is critical to efficient functioning of an entity and more so for a banking entity. The Committee feels that irrespective of the size of the operations, banks need to run on professional lines and UCBs are no exception to this rule. It, therefore, suggests that at least 2 directors with suitable banking experience or relevant professional

background should be present on the Boards of UCBs and the promoters should not be defaulters to any financial institution or banks and should not have any association with chitfund/NBFCs/cooperative bank or commercial bank in the capacity of Director on the Board of Directors.

[\(Para 3.25\)](#)

Branch Licensing Policy and Area of Operation

10. The Committee while broadly agreeing with the existing branch licensing policy, recommends a few changes in the policy particularly with reference to dispensing with viability standards as a prerequisite for issue of branch licences. Although UCBs are functioning in a compact area, any restriction on their expansion will hamper their growth. The Committee, recommends that RBI should extend to the UCBs the same freedom and discipline as is applicable to commercial banks in opening branches, if an UCB complies with the following broad norms: viz., (a) it should not have been in default of any of the provisions of the B.R.Act or RBI Act or Directives issued by RBI from time to time, (b) its capital adequacy is not lower than the minimum required level, (c) it must have fully complied with the provisioning norms specified by RBI, (d) its net NPAs are not more than 10%, (e) it has made profits in the last two years, and (f) its priority sector advances are not less than 60% of the total loans and advances. The Committee recommends that every UCB must submit to the RBI an Annual Action Plan (AAP). Scheduled UCBs which satisfy the eligibility criteria be given freedom to open new branches under the AAP. Non-scheduled UCBs should continue to obtain prior approval of RBI after complying the eligibility criteria. The Committee also recommends that non-scheduled UCBs should not open more than 10% of their existing branches subject to a minimum of one branch, in any given year. No UCB can open more than 2 branches on its inception or within a period of 2 years thereafter. Scheduled UCBs may be permitted to open mobile and satellite offices subject to compliance with guidelines.

[\(Para 4.15\)](#)

11. Though urban cooperative banks were initially conceived to be small entities confining their area of operation to small towns and municipal limits of cities, over a period of time some of them have started expanding to the entire state and in some cases beyond their respective states of registration. The opponents of expansion of area of operation of UCBs argue that UCBs would lose their cooperative character and structure which give them their identity viz. local feel, compact area of operation and mutual help, if they indiscriminately expand their area of operation. Proponents of expansion of area of operation, on the other hand, argue that expansion of area of operation does not necessarily dilute the cooperative character because the clientele of UCBs having common interest belonging to common ethnic group, may spread over different parts of the state or more than one state. When some Cooperative Banks of Europe have nation-wide and world-wide presence, restricting UCBs operations to districts of their registration would place artificial barriers an their growth.

[\(Para 4.22\)](#)

12. The Committee, therefore, recommends that (a) new UCBs can extend their area of operation to the entire district of their registration and adjoining districts, (b) when an UCB desires to open a branch in a district in a state other than the district in which it is registered, it must have a net worth which is not less than the entry point norms prescribed for the highest category centre in that state and (c) if an UCB desires to open a branch in a state other than the state in which it is registered, it must have a networth of not less than Rs.50 crores (which is 50% of the minimum requirement for a new private sector bank).

[\(Para 4.23\)](#)

Policy on Unlicensed and Weak Banks

13. Existence of large number of unlicensed banks has become a cause of concern for regulators. As on 30 September 1999, as many as 181 banks were still unlicensed entities. Of these, 97 banks continued to be unlicensed for over 3 decades. Existence of such large number of unlicensed banks over 3 decades, places the RBI in a state of "regulatory discomfiture".

[\(Para 5.1\)](#)

14. The main reason for proliferation of unlicensed banks is on account of statute induced expansion. Under the provisions of Section 5(ccv), a primary credit society whose paid up capital and reserves attain the level of Rs. 1 lakh and whose main objective is to carry on banking business, automatically secures urban banking status. The Committee, therefore, recommends that in order to choke this automatic route of transformation into UCBs, this Section of B.R.Act, needs to be amended. Many of the unlicensed banks were not given licences due to non-compliance with entry point capital norms, non compliance with the provisions of B.R.Act, 1949 (AACS) and RBI Act, high level of NPAs and unsatisfactory operating results etc. The Committee, expresses its concern about RBI allowing so many unlicensed banks to continue to operate for so long a period. It, therefore, recommends that UCBs: (a) which are brought under the purview of B.R.Act, 1949 (AACS) in 1966, should be either given licence by RBI if they comply with the norms prescribed by it by 31 March 2002, or their applications for licences be rejected. (b) Primary cooperative societies which were converted into UCBs after 1 March 1966, and remained unlicensed should be given licences or their applications for licences rejected by 31 March, 2002 or within 5 years from the date of commencement of banking business whichever is later and (c) for all primary credit societies which apply for licence in future, the licence should be granted or rejected within a period of 6 months from the date of application and pending grant of licence, such societies must not be permitted to carry on banking business.

[\(Paras 5.2, 5.3 & 5.6\)](#)

15. RBI should also make its policy of licensing of unlicensed banks more transparent and precise. The Committee, therefore, recommends that if an unlicensed bank (a) attains minimum level of CRAR prescribed by the regulator, (b) its net NPAs are not in excess of 10% , (c) it has made profits during each of the last 3 years and (d) it has complied with the statutory framework of BR.Act/Directive issued by RBI, should be licensed.

[\(Para 5.6\)](#)

16. Increasing incidence of sickness in UCBs has become a constant cause of concern for RBI. As at the end of 31 March 1999, as many as 293 banks have been classified as weak. Of these, 112 do not comply with even the minimum capital requirement of Rs.1 lakh prescribed under Section 11 of B.R.Act, 1949 (AACS). The Committee feels that (a) inadequate entry point capital, (b) lack of professionalism and politicisation of management, (c) absence of compliance of prudential norms (d) absence of system for timely identification of weakness and (e) dual control over UCBs are some of the major contributory factors for sickness in UCBs.

[\(Paras 5.7 & 5.10\)](#)

17. Though there are institutional mechanisms like State Level Rehabilitation Review Committee (SLRRC) and Bank Level Rehabilitation Review Committee (BLRRC) to review the performance of weak banks, the progress has not been quite satisfactory. Besides, the existing parameters for classifying weak banks, in the opinion of the Committee, suffer from several defects. There should be a system to flash early warning signals to detect the incipient sickness so that financial position of a bank may not further deteriorate. The Committee, therefore, believes there should be separate criteria for identification of weak and sick banks and recommends the following objective criteria.

[\(Para 5.28\)](#)

Parameter	Weak bank	Sick bank
CRAR	Less than 75% of minimum prescription or	Less than 50% of minimum prescription and
Net NPA	10% or more but less than 15% of loans and advances outstanding as on 31 March or	15% or more of loans and advances outstanding as on 31 March or
History of Losses	Showing net losses in operation for two years out of the last three consecutive financial years	Showing net losses in operation for the last three consecutive financial years

18. The Committee also feels that BLRCCs have not achieved much and it recommends dismantling the same. It, however, recommends that SLRCs should continue.

[\(Para 5.28\)](#)

19. The Committee also recommends that once an UCB is classified as a sick bank, action may be taken under the provisions of Section 45 of the B.R.Act, 1949 to place it under moratorium. During the period under moratorium, it must, however, reconstruct or amalgamate with another UCB and if this is not possible, the bank's licence to carry on banking business must be withdrawn.

[\(Para 5.28\)](#)

20. If, however, RBI feels that even without reconstruction or amalgamation a sick UCB can be rehabilitated and it should be allowed to continue to operate, then it would be necessary for RBI to ensure that bank's CRAR is not allowed to deteriorate below the ratio which exists when it is identified as a sick UCB. The Committee, therefore recommends that RBI/GOI create a Rehabilitation Fund which would be used as subordinated debt for the purpose of maintaining the CRAR of sick UCBs at the level which existed when it is declared sick. If the rehabilitation scheme succeeds the loan amount would be returned to the Rehabilitation Fund. Since, CRAR is not applicable to UCBs, it is not feasible to compute exact quantum of the Fund. Assuming the minimum networth needed to be maintained for the sick UCBs would be equivalent to 4% of its loans and advances portfolio, and considering that only some of the sick UCBs with positive networth would be considered as capable of rehabilitation, the size of the Fund is estimated at around Rs.40 crores.

[\(Para 5.28\)](#)

Application of CRAR to UCBs

21. In the opinion of the Committee, the continued financial stability of UCBs cannot be ensured unless they are subjected to the discipline of maintenance of prescribed minimum capital to risk assets ratio (CRAR). While a quick review of 50 (other than weak banks) UCBs showed that 76% of them had reached the minimum CRAR prescribed for commercial banks, the Committee realises that it may be difficult for all UCBs to immediately comply if a minimum norm is made applicable to the whole UCB sector.

[\(Paras 6.4 & 6.5\)](#)

22. It has been represented to the Committee that the ability of UCBs to raise additional capital to meet CRAR norms is limited (a) by their inability to make public issue of capital, (b) the fact that members can reduce their capital and (c) particularly by the quantitative ceiling imposed by the State Cooperative Societies Acts, and Multi-State Cooperative Societies Act,1984, on the number of shares an individual can hold. The Committee is in favour of removing these quantitative restrictions but is in favour of imposing a percentage ceiling whereby no single individual can hold more than 5% of the share capital of an UCB.

[\(Para 6.8\)](#)

23. The Committee is also in favour of UCBs being subjected to CRAR discipline in a phased manner with initially a lower CRAR norms being prescribed for non-scheduled UCBs as compared to scheduled UCB. The following norms are, therefore, recommended.

Date	Scheduled UCB	Non-Scheduled UCB
31st March 2001	8%	6%
31st March 2002	9%	7%
31st March 2003	As applicable to commercial banks	9%

[\(Para 6.14\)](#)

24. Until an UCB attains the specified CRAR norms, the Committee recommends that it should be required to transfer not less than 50% of its net profits to the Reserve Fund and there should be a ceiling of 20% on the percentage of dividend it can distribute to its members.

[\(Para 6.14\)](#)

Conversion of Cooperative Credit Societies into UCBs:

25. RBI had been pursuing the policy of allowing cooperative credit societies as defined in Sec. 5 (ccii) of B.R. Act, (AACS) to convert themselves into urban cooperative banks, provided they attain entry point norms prescribed by RBI. But it has been suggested that allowing conversion of credit societies into UCBs in over banked areas might tantamount to back door entry into the Urban Banking fold.

[\(Para 7.6\)](#)

26. The Committee, however, believes that denying the benefit of conversion of cooperative credit societies which have a good track record of profits, which comply with entry point norms prescribed by RBI and have already been serving certain sections of a given area, while allowing new urban cooperative banks whose promoters' antecedents are untested, would be an unfair policy stance. It, therefore, recommends that such of the credit societies whose networth is not less than the entry point capital prescribed for new banks in that given centre, which have been posting profits during each of the last 3 years, which have earned "A" audit rating and whose methods of operation are not detrimental to the interests of the depositors, may be allowed to convert themselves into UCBs.

[\(Para 7.11\)](#)

Legislative reforms in central and states statutes

27. Application of certain provisions of B.R. Act, 1949 to urban cooperative banks in 1966, inaugurated regime of dual control. The dual control has become a very serious problem affecting the functioning of the urban cooperative banking sector. After interaction with urban cooperative banks and their Federations, independent observers of cooperative movement and banking sector and after perusal of certain provisions of some State Cooperative Societies Acts, the Committee is convinced that dual control regime is perhaps one of the most vexatious problems of urban cooperative banking movement. The Committee is of the view that duality in command, per se, is not the issue but it is the absence of clear cut demarcation between the functions of the State Governments and the

Reserve Bank of India that has been responsible for the irritants thrown up by the dual control regime.

[\(Paras 8.1, 8.2, 8.3\)](#)

28. Branch licensing, expansion of area of operation, fixing interest rates on deposits and advances, audit, and investments are essentially banking related functions. The Registrars of Cooperative Societies of many States continue to exercise their powers over these areas under the mistaken impression that they can do so under the general provision of Cooperative Societies Act which empowers them to exercise general supervision and control. The Committee, therefore, strongly feels that the State Acts should be amended so as to categorise the banking related functions and the functions of the State Governments separately. The Committee feels that areas relating to investments, prudential norms, branch licensing, remission of debt, change of management should exclusively come under the realm of banking related functions and RBI should be the sole regulatory authority. Registrar of Cooperative Societies of the State concerned should confine his activities to registration, approval and amendments to bye-laws, election to Management Committees, protection of members' rights, and supersession of Management Committees for violation of the aforesaid activities. The Committee recommends that Multi-State Cooperative Societies Act, 1984, State Cooperative Societies Acts and B.R. Act be amended accordingly.

[\(Para 8.13\)](#)

29. The Committee is conscious that in a competitive federal polity, the State Governments may be reluctant to carry out these amendments to the Acts. It, therefore, recommends that unless necessary amendments are made to the respective State Act and Multi State Cooperative Societies Act as suggested above, RBI may not licence any new bank, nor allow the branch expansion of the existing banks in a State which does not carry out these amendments. Pending amendments to State Cooperative Societies Acts, UCBs will have the freedom to register under the amended Multi-State Cooperative Societies Act.

[\(Para 8.14\)](#)

30. With a view to contain the growth of weak banks, the Committee suggests amendments under Section 5(ccv) of B.R. Act (AACS) so as to arrest automatic transformation of primary cooperative credit societies into urban cooperative banks. Similarly Section 5(ccvi) also needs to be amended to delete the word "primary" and Primary Cooperative Banks should be known as Urban Cooperative Banks. UCBs must also to be allowed to admit any cooperative society, other than a cooperative credit society or a cooperative bank, as their members. It also recommends amending Section 7 from stopping primary credit societies using the words "bank", "banker" etc. Besides, Section 30 of B.R. Act with regard to appointment of auditors should also be made applicable to UCBs. The Committee feels that RBI should be vested with powers to remove Directors, CEO of a bank and recommends that Section 36AA of B.R. Act, 1949 [As Applicable to Banking Companies (AABC)] may be extended to UCBs. RBI should also be vested with powers in regard to moratorium of UCBs on the lines of Section 45(4) to 45(15) of B.R. Act (AABC). The Committee also

suggests amendments to B.R.Act (AACS) so as to make the format of Balance Sheet be in consonance with Schedule III of B.R.Act (AABC).

[\(Para 8.21,8.22,8.23,8.24,8.25,8.26,8.27,8.28,8.29,8.30,8.31,8.32,8.33, 8.34\)](#)

Other Related Issues

31. During its interaction with the State Government officials, bankers and federations certain related issues which are outside the scope of the Terms of Reference but have an important bearing on the functioning of UCBs were brought before the Committee. One of them relates to reduction in the target set for priority sector advances. The Committee feels that urban cooperative banks are essentially required to cater to the needs of low/middle income groups. Bringing down the targets of priority sector advances will go against the stated objective. Besides, of over 1400 reporting urban cooperative banks as on 31 March 1998, 84.1% have attained the target in deploying 60% of their advances to priority sector. The Committee is, therefore, not inclined to agree for reduction in the existing priority sector target for UCBs

[\(Paras 9.20 and 9.21\)](#)

32. The Committee, during its visits to various centres, was told by UCBs that there is need for larger currency chest facility as many a time, RBI offices and scheduled commercial banks, who are maintaining currency chests, either do not entertain them nor the surplus cash is accepted for deposits. The Committee feels that this is a genuine grievance and requests RBI to increase the Currency chests facilities by allowing other scheduled commercial banks as well as scheduled urban cooperative banks to open currency chests by giving incentives to meet the initial and the recurring expenditure.

[\(Para 9.11\)](#)

33. Under provisions of section 24 of the B.R. Act, urban cooperative banks are required to invest their SLR funds either in approved securities or with DCCBs/SCBs. Many representatives of urban cooperative banks have expressed their concern over the financial health of DCCBs and felt that they should be given an opportunity to invest their funds with scheduled urban cooperative banks and scheduled commercial banks. While there is some merit in this representation, the Committee is also aware of the impact of adoption of such a policy on the viability of DCCBs/SCBs in the event of flight of deposits from DCCBs/SCBs to other banks. It, therefore, suggests that RBI may examine this request in the light of recommendations to be submitted by Task Force under the Chairmanship of Shri Jagdish Capoor, Deputy Governor, Reserve Bank of India, to suggest suitable package for cooperative banks.

[\(Paras 9.14, 9.15 & 9.16\)](#)

34. One member (Dr. Sawai Singh Sisodia) suggested a different Entry Point prescription for new UCBs. Another member, (Dr. Mukund L.Abhyankar) is unable to agree with our recommendation on non-voting shares and prescribing a ceiling on individual share holding

in UCBs. Another member, (Shri Subhash S.Lalla) is also unable to agree with our recommendations on (1) the area of operation being taken out of the purview of RCS, (2) allowing UCBs to park SLR funds in commercial banks, (3) deleting the word "primary" from the B.R. Act and (4) on dual control.

[\(Paras 3.21 & 9.22\)](#)