

# **Branch Licensing Policy and Area of Operation of Urban Cooperative Banks**

## **Legal Framework**

4.1 Provisions of section 23 of the B. R. Act, 1949 (As Applicable to Cooperative Societies) enjoin upon urban cooperative banks to obtain specific licence from Reserve Bank of India for opening a new place of business (branch) or changing, otherwise than within the same city, town or village, the location of an existing place of business. Before granting licence, the Reserve Bank may require to be satisfied by an inspection or otherwise as to the financial condition and history of functioning of the cooperative bank, the general character of its management, adequacy of its capital structure and earning prospects and that public interest will be served by the opening or change of location of the place of business, as the case may be. For the purpose of this section, 'place of business' includes any sub-office, pay office, sub-pay office or any place of business by whatever name called at which deposits are accepted, cheques cashed or monies lent. Thus, opening of branch or extension counter or collection centre or any other place of business, by whatever name called, at which any of the above activities is carried out, would require specific prior permission of the RBI.

## **Evolution of Branch Licensing Policy**

4.2 With a view to promoting orderly and balanced growth of the urban cooperative banking in the country and to avoid unhealthy competition amongst UCBs, RBI did not favour UCBs operating outside the district in which they were registered except in rare circumstances such as in areas which were found to be most backward and where there were no prospects for organisation of new UCBs for serving the needs of small and middle class people, cottage industries, artisans, etc. In such cases, preference was always given to the existing UCBs functioning in the adjoining district and in case no such bank from such district was interested in opening of its branch at the required place/s, then only banks from other districts within the State were considered for the purpose.

4.3 In order to coordinate the programme of opening of branches by the commercial banks and urban cooperative banks in a consolidated manner based on the aforesaid criterion, small Working Groups comprising representatives of commercial banks, UCBs and officers of RBI, were formed to chalk out banking plans for identifying the unbanked/underbanked pockets in these centres. This practice was in vogue till the RBI put in place liberalised branch licensing policy in 1993 for UCBs.

4.4 The Marathe Committee, appointed by RBI in the year 1991, had also addressed the issue of branch licensing of urban banks. The Committee had suggested that branch expansion of UCBs may be permitted for sustaining growth of existing banks and it felt "unless there are overwhelming reasons to the contrary, an application for issue of a branch licence need not be rejected, of course subject to the compliance with the relative eligibility criteria/statutory requirements". Based on the recommendations of the Committee, a mid-term review was made in June 1993 and branch expansion programme was liberalised and banks were allotted centres for branch expansion without many restrictions. As per the observations made in the review, allotment of centres for branches for some time up to 1995 was allowed on tap basis till the concept of Annual Action Plan (AAP) was introduced in January 1996.

### **Present Branch Licensing Policy**

4.5 Under the present policy, urban cooperative banks, satisfying the following norms, can prepare an Annual Action Plan (AAP) for opening branches during the next year and send the same to the RBI for its approval:

- i) The bank should be licensed under Section 22 of the B.R.Act, 1949(AACS) and not classified as weak.
- ii) It should have posted net profits during the preceding three consecutive years.
- iii) It should have achieved the prescribed targets for lending to priority sector.
- iv) Its non-performing assets (gross) should be within the permissible level of 15% of total loans and advances outstanding and it should have made full provision therefor.
- v) It should have complied with the statutory framework of the B.R. Act/ R.B.I Act/directives of RBI.

4.6. Centres for opening branches are presently allotted taking into account status of bank's compliance with statutory framework; maintenance of CRR/SLR as envisaged under the Act; timely submission of statutory returns; adoption of prudential accounting standards regarding income recognition, asset classification, provisioning and rectification of defects pointed out in the statutory inspections, etc. Thereafter, UCBs are required to make applications to the concerned RBI office after making arrangements for premises, etc. for obtaining specific licence for opening branches at the allotted centres. The new system of AAP gave a fillip to opening of new branches as a large number of UCBs came forward with requests for opening branches. However taking advantage of this liberalised scenario, many smaller UCBs approached RBI with unrealistic AAPs for opening new offices. This has, perhaps, been one of the important reasons why some UCBs which have been allotted centres did not open branches at the allotted centres necessitating cancellation of some of the allotted centres. It is also reported that some UCBs which have been issued licences to open branches have not opened them even after two to three years of the grant of the licences.

4.7 In 1996, the RBI reviewed its policy to curb this practice, and a ceiling of 5 branches per bank in an AAP was introduced. While this did not affect smaller banks, larger banks, particularly scheduled urban cooperative banks felt aggrieved at this ceiling and they desire that discretion should be given to them to open branches, if they comply with the prescribed standards set by the RBI as in the case of commercial banks.

4.8 Under Annual Action Plan, no fixed time frame is prescribed for UCBs. They are required to prepare tentative annual plans for branch expansion without any reference to a particular year viz., calendar year, financial year or a cooperative year. Responding to the questionnaire circulated by the Committee whether AAP period should be a calendar year or financial year, majority of the UCBs opined that the AAP should be coterminous with the financial year. The

Committee considered all these views and felt that the existing concept of AAP may be allowed to continue. The UCBs may also prepare AAP for a period of twelve months as is being done now. However, it is desirable to apply some time frame for opening branches at allotted centres. A branch should normally be opened at the allotted centre within a period of two years from the date of allotment of centre or within a period of one year from the date of issue of licence, whichever is earlier. This time frame needs to be strictly adhered to and if the branch is not opened within this period, the allotment or licence should be deemed to lapse.

## **APPROACH OF THE COMMITTEE**

### ***A. Extension Counters:***

4.9 The Scheme of extension counters (ECs) was introduced in commercial and urban cooperative banks with a view to mobilising deposits and inculcating saving habit among workers/staff/students of big industrial units, hospitals, educational units, etc. who, because of their common working hours and non-availability of banking facilities within a reasonable distance, find it difficult to carry out their banking transactions. Extension counters are intended to provide banking facilities to above categories of people at their work place itself. Therefore, only limited deposit related transactions are permitted at these extension counters. Since the above facilities are not intended for general public, extension counters are not allowed in residential colonies, shopping complexes, market places, etc. Opening of extension counters is governed by the same legal framework i.e, section 23 of the B.R. Act. Prior permission of RBI was necessary to open extension counters. Legally an extension counter does not have the status of an independent branch. With a view to simplify the procedure, RBI had allowed (in June 1993) opening of extension counters without its prior permission subject to compliance with certain eligibility criteria. The RBI, is, however, reported to have learnt that some UCBs tend to circumvent these guidelines and open extension counters at ineligible places and operate them almost like regular branches without even obtaining prior permission of RBI. Normally, this route is opted by those UCBs which are otherwise ineligible for branch licensing under the existing policy of the RBI. Having heard the views of bankers/ federations on this issue in the interface sessions and as per the responses to questionnaire, the Committee is convinced that liberal licensing dispensation should not be used as an instrument to circumvent the regulatory procedure. The Committee, therefore, strongly feels that only scheduled urban cooperative banks, which comply with RBI' norms, may be allowed to open extension counters without prior permission of RBI. Non-scheduled urban cooperative banks should however, obtain prior permission of RBI for opening of extension counters. RBI may also consider decentralising the decision making in this regard, to its Regional Offices.

### ***B. Mobile and Satellite Offices***

4.10 Commercial banks have been allowed to open mobile and satellite offices subject to compliance with certain guidelines regarding security and internal controls. However, UCBs have not been allowed this facility since this venture requires special skill and better internal control mechanism. The Committee feels that the branches of scheduled urban cooperative banks may extend banking facilities through well protected mobile vans with regular account books, a small safe containing cash, etc., to specified places on specified days in a week at specified hours. If a scheduled UCB is convinced of the need, the satellite offices may also be established at fixed premises in the surrounding / neighbouring places to be controlled and operated from a

base branch only after informing the concerned Regional Office of RBI.

### ***C. Branch Licensing***

4.11 Though urban cooperative banks were conceived as entities of persons primarily belonging to lower and middle income groups at the time of their inception, no entity can always remain stagnant and lateral expansion is inevitable. Growth of UCBs is an offshoot of their expansion. The Committee endorses the view expressed by Marathe Committee that "unless there are overwhelming reasons to the contrary, an application for branch licensing should not be rejected". In the responses received from some banks and federations, a view was expressed that if UCBs comply with the regulatory guidelines, they should be allowed to open branches within their area of operation without specific permission from the RBI. This view has been advanced because District Central Cooperative Banks (DCCBs) are enjoying such a freedom. The DCCBs are specifically given this facility under Section 23 of the B.R.Act, 1949, keeping in view the responsibility devolving on them for the disbursement of agricultural loans and their obligation for serving the affiliated primary cooperative societies. If urban cooperative banks are allowed to open branches without restraint there is every possibility that it will result in multiplication of branches competing with each other in a particular centre in over banked areas, wasteful duplication ultimately leading to weakness. For an orderly expansion of branches, it is necessary that there should be some regulation on branch expansion of UCBs. In effect, the above demand for freedom questions the very relevance of section 23 of the B.R.Act, 1949 and makes a case for repealing the same. This issue was also addressed by the Marathe Committee and it expressed its disinclination to agree with the above view. Even in case of commercial banks, requirement regarding branch licensing has not been dispensed with, to ensure orderly growth of the banking system in the country. Interestingly, majority of UCBs and federations in their response to questionnaire have emphatically endorsed the need for some sort of RBI regulation on branch expansion.

4.12 Though the Committee is largely in agreement with the existing branch licensing policy, it is, however, of the view that the viability standards in their present form have lost regulatory relevance. Hence, attainment of viability norms should not be a pre-requisite for granting branch licence. However, unlike commercial banks, small UCBs often do not undertake adequate viability studies of an area before approaching RBI for branch expansion. Besides, market reports also point to the fact that the managements of UCBs sometime find branch expansion as a way of extending largesse to their supporters. The Committee, therefore, feels it appropriate to have a cap on the number of branches the non-scheduled UCBs can open in an year.

4.13 The Committee feels that while generally greater freedom should be given to UCBs to open new branches, this dispensation should be conditional on the UCBs having previously complied with all regulatory requirements and having demonstrated financial strength and efficient working. Evidence of satisfactory performance can be available only after an UCB functions for some time after its inception. Under the existing policy of the RBI, no UCB is allowed to open a branch for a period of two years from the date of commencement of its banking operations. In the Committee's view, this provision may be too restrictive and needs to be relaxed to permit an UCB to open not more than two branches at its inception or within a period of two years thereafter, provided its functioning is otherwise satisfactory.

4.14 Since entry point capital norms are different for different categories of centres, there is a possibility of banks trying to circumvent these norms by registering a bank in a lower category centre and extending its operation to a higher category centre through the medium of a branch. It is, therefore, necessary to provide that before a bank registered in a centre opens a branch in a higher category centre, its networth must at least be equal to the entry point capital norm applicable for the higher category.

### **Recommendations**

4.15 The Committee's recommendations with regard to branch licensing policy are as under:

(i) The opening of new branches by the banks should continue to require licences from RBI. Before a licence is granted, RBI should satisfy itself that the bank has complied with regulatory requirements and has demonstrated financial strength and efficient working. In particular :

(a) It should have not been in serious default of any of the provisions of the Banking Regulations Act 1949 (AACS) or the Reserve Bank of India Act, 1934 or the directives issued by RBI from time to time.

(b) Its capital adequacy ratio should not be lower than the minimum ratio prescribed by RBI for the time being.

(c) It must have fully complied with the provisioning norms specified by RBI.

(d) Its net NPAs must not exceed 10% of its total loans and advances.

(e) It must have earned profits in each of the two preceding accounting years.

(f) Not less than 60% of its total loans and advances, as shown in its latest Balance Sheet, should be to the priority sector.

(ii) Every UCB must submit to RBI an Annual Action Plan (AAP) which would be for a period of twelve months. Scheduled UCBs which satisfy the conditions specified in this para may be given freedom to open new branches within the AAP without prior permission of RBI. Other UCBs would be required to obtain prior permission from RBI before opening a branch.

(iii) No UCB should be permitted to open more than two branches (other than its office of registration) on its inception or within a period of two years thereafter.

(iv) While there may be no restriction on the number of branches a scheduled UCB can open in a twelve month period, other UCBs should not normally be permitted to open more than 10% of their existing branches (subject to a minimum of one branch) within a twelve month period.

(v) No UCB should be allowed to open a branch in a centre which falls in a category which is higher than the centre in which the UCB is registered unless it has networth atleast equal to the entry point capital applicable to that higher category.

(vi) Scheduled UCBs may be permitted to open extension counters, mobile and satellite offices subject to compliance with such guidelines as RBI may prescribe.

### **Area of operation**

4.16 The issue of area of operation of UCBs had engaged the attention of various committees in the past. Unlike commercial banks, the area of operation of UCBs has an important bearing on their functioning because a compact area of operation would ensure mutual knowledge and cohesion among their members, which is the quintessential character of cooperation. The study team appointed by RBI in 1973 had observed that the area of operation of an urban bank should ordinarily be confined to the town or city where it has its head office. In metropolitan centres, the area of operation should be confined to contiguous municipal wards or zones, while in other urban or semi-urban centres covering municipal towns or tehsil headquarters without municipalities, the area of operation should cover the whole of the municipality or tehsil limits, respectively. The Committee on Problems of UCBs in Maharashtra (1976) did not favour an UCB having its area of operation beyond a district. An UCB was normally not permitted by RBI to open an office in rural areas falling within its area of operation unless there was a large non-agricultural population. Further, permission to UCBs to open branches in states other than the one in which they were registered was granted only in exceptional circumstances. RBI had also taken a view that an UCB should prove that its existing membership had definite trade and commercial links in the places where the new branch was to be opened and that nonexistence of its branch has resulted in diversion of substantial business which, otherwise, would have accrued to it. UCBs were also not ordinarily allowed to extend their jurisdiction to cover the entire state and particularly beyond the boundaries of a state as these institutions were expected to serve in geographically compact areas not usually extending beyond the municipal limit of the city or town, so as to ensure close supervision as well as active participation by members in their management. This alone, it was argued, will enable banks to utilise a greater portion of their resources for the economic development of the local community and building up integrated and balanced growth of the region.

4.17 Marathe Committee had examined this issue and suggested extension of area of operation of UCBs organised in semi- urban/ urban centres to peripheral rural areas so as to finance non-agricultural credit needs of these areas. It had also recommended that the area of operation of scheduled urban cooperative banks should be coextensive with that of the territorial jurisdiction of the state of its registration. Accordingly, policy approach in this regard has been liberalised substantially since then.

### **Present Policy on Area of Operation**

4.18 The existing policy regarding area of operation is:

(i) UCBs organised in metropolitan centres or cities may extend their area of operation to

the entire limits of the city including the urban agglomeration thereof and defined peripheral areas appertaining thereto. UCBs organised in urban/semi-urban centres may extend their area of operation to the entire district of their registration inclusive of rural areas without seeking prior approval of RBI.

(ii) With prior approval of RBI, UCBs may extend their area of operation to neighbouring district(s) or to the entire state of their registration.

(iii) With prior approval of RBI, UCBs with deposits of Rs.50 crores and above may extend their area of operation even beyond the state of registration.

4.19 As a result of above policy, a large number of UCBs have extended their area of operation to more than one district. Many, particularly scheduled UCBs, have expanded their area of operation to the entire state of their registration and even beyond the state of registration in some cases.

### **Approach of the Committee**

4.20 There have been divergent views on the question of extension of area of operation of UCBs to distant places. A view has emerged that by extending their area of operation to distant places, UCBs lose their basic cooperative character which gives them their identity viz., local feel, compact area of operation and mutual help, etc. Therefore, expansion beyond district or state may dilute the basic character of cooperation. Votaries of limited expansion argue that UCBs are expected to function more like local area banks rather than all-India statured commercial banks. Another view is that cooperation being a state subject, UCBs should normally restrict their operations within the state of registration. The advocates of expansion of area of operation, however, feel that normally, membership/clientele of an UCB consists of people having common interest and/or people common to an area/ society/ethnic group. Such people of common interest may spread over different parts of a state or even different parts of the country. In such cases, an UCB may naturally like to spread to different parts of the state/country to serve its members in those places. An argument has also been put forth that banks with strong financial strength and better management skills, if allowed to extend their area of operation, may also be able to assist a weak UCB by merging such weak banks with itself or by taking over its management. It has come to the Committee's notice that some UCBs have already done this.

4.21 Proponents of expansion of area of operation feel that limited area of operation may act as a hindrance to the growth of UCBs. It is also said that the area of operation should have relevance to financial stability of the institution, its internal control system, its turnover, its human resource potential and its capacity to provide service to its far-flung clientele.

4.22 The Committee had deliberated at length over the arguments putforth by the votaries of expansion of area of operation and its critics. It recognises that UCBs are formed generally by persons who have a common identity and a common need and who reside in a single geographical location. There is, therefore, need for confining the operation of an UCB initially to a single district. However, persons residing in adjoining districts can also have a common identity and need. The Committee is of the view that while a cooperative society can preserve its

cooperative character and principles in small area of operation, this would, however, be more true and relevant to cooperative units or cooperative credit societies than those which are doing banking business. Activities relating to trade and commerce and its ancillary banking cannot be restricted to limited geographical area since these activities normally extend to far off places without any barriers. In the liberalised environment now prevailing in the financial and banking sectors, there is not much distinction between commercial and urban cooperative banks so far as their functioning is concerned. The international experience also shows that cooperative banks are not averse to extend their area of operation beyond the place of origin. For instance, RABO Bank of Nederland and Cooperative Bank Plc. U.K. have world-wide and nation-wide presence, respectively. Global and country wide lateral expansion of these institutions did not diminish their cooperative character. Well managed major urban cooperative banks now compete effectively with other players in the banking field. Therefore, putting artificial restrictions on the area of operation on one segment of players in the banking field would not have much justification. In non-credit cooperative segment, also, entities like IFFCO have been effectively functioning all over the country. Developments in telecommunication network and information technology have considerably narrowed down the geographical distance between places and people. Therefore, geographical distance should not come in the way of mutual help and cohesion among members spread over different places.

4.23 Notwithstanding different view points, it is agreed by both the advocates and opponents of expansion of area of operation that indiscriminate expansion of area of operation of UCBs, particularly smaller ones, is not desirable. The smaller banks may not have the requisite skills or internal control systems to meet the additional responsibility cast by an increased span of control. Therefore, extension of area of operation to far off places within as also beyond the state of jurisdiction should be allowed only in the case of well managed major banks which satisfy certain additional eligibility criteria regarding level of owned funds, internal control systems and quality of management etc. Therefore, as the area of operation is extended, the need for greater financial strength should be recognised. The Committee, finds some merit in the argument that UCBs should be allowed to extend their area of operation to rural areas. However, unrestricted expansion of such operation may not be desirable. The Committee, therefore, feels that while UCBs must necessarily be registered in an urban centre, they may be allowed to open a branch at a rural centre.

### **Recommendations**

4.24 The Committee, therefore, recommends that;

- (i) newly established urban cooperative banks may be allowed to operate in the whole of the district of their registration and its adjoining districts.
- (ii) an UCB which desires to open a branch in a district other than the district in which it is registered, but within the same state, must have a networth which is not less than entry point capital prescribed for the highest category centre in that state
- (iii) an UCB which desires to open a branch in a state other than the state in which it is registered, must have a networth of not less than Rs.50 crores (which is 50% of the



minimum capital required for a new private sector bank).