

Conversion of Cooperative Credit Societies Into Urban Cooperative Banks

Introduction

7.1 Cooperative credit structure in India is characterised by a plethora of institutional segments. Leaving aside the agricultural cooperative credit institutions, in the urban cooperative credit fold itself, there are 3 types of institutions recognised by the Banking Regulation Act 1949 (As Applicable to Cooperative Societies). As discussed else where in the Report, these are

- (i) primary credit societies, who virtually function like banks, but whose networth is less than Rs.1 lakh; who are not members of the payment system and to whom deposit insurance is not extended,
- (ii) primary cooperative banks, popularly called Urban Cooperative Banks, whose net worth is Rs.1 lakh and above; who are recognised as banks, are members of payment system and who enjoy deposit insurance
- (iii) cooperative credit societies, who confine their activities to their members alone and who do not perform banking functions. In this chapter, the Committee deals with these cooperative credit societies.

7.2 Under the provisions of Section 5(ccii) of Banking Regulation Act, 1949 (AACCS), a cooperative credit society is defined as a cooperative society, "the primary object of which is to provide financial accommodation to its members and includes a cooperative land mortgage bank." This type of institutions are thrift societies. The distinction between a primary credit society and a cooperative credit society is with reference to their nature of business. The primary object or principal business of a primary credit society is the transaction of banking business. When its paid up capital and reserves attain the level of Rs.1 lakh, a primary credit society automatically becomes a primary cooperative bank. However, even after a primary credit society becomes a cooperative bank, it has to apply to RBI for a licence to carry on banking business. But it can carry on banking business until it is granted a licence or notified that a licence cannot be granted to it.

7.3 The Madhava Das Committee ¹⁹ had suggested that there is a need to stop the practice of primary credit societies commencing banking business without first obtaining licence from RBI. It also recommended that the primary credit societies should not be allowed to use the word 'bank', 'banker' and 'banking' as part of their name to enable the public to distinguish between such societies and banking institutions coming under the purview of B.R.Act,1949 (AACCS). It had also listed the corresponding legislative amendments required to give effect to these recommendations. Regarding the existing primary credit societies, that Committee was of the view that such societies may be allowed a maximum period of 4 years from the date of coming into force of the amended provisions of the B.R.Act,1949. During the intervening period, till such amendments are carried out in the statute, the societies should either reach the level of prescribed viability standards, so as to qualify for the licence or take suitable steps to go out of the purview of B.R.Act,1949 (AACCS).

7.4 The Marathe Committee ²⁰ had recommended that primary credit societies, which attained

the revised entry point norms before 30 June 1993, be considered for inclusion in the list of functioning primary cooperative banks as a one time measure. Such societies should, thereafter, be taken up for inspection and considered for issue of licence on the merits. The Committee also suggested that after the expiry of the cut off date of 30 June 1993, the primary credit societies, which do not satisfy the revised entry point norms should discontinue the banking business and the concerned State Government should initiate necessary steps in this regard.

7.5 RBI had examined this recommendation in the light of the provisions of sections 5 (ccv) and 22 of B.R.Act,1949 (AACS). It was felt that under the existing provisions, a primary credit society having owned funds of Rs.1 lakh and which applied for issue of licence to RBI, may be allowed to carry on banking business, till the licence is refused. Further leaving a large number of primary credit societies outside the purview of B.R.Act,1949 (AACS) would have adversely affected the interests of the depositors. Hence, it was not considered feasible by Reserve Bank of India to have a cut off date for conversion of such societies into urban cooperative banks.

RBI Policy Stance on Cooperative Credit Societies

7.6 On receipt of requests from few cooperative credit societies for conversion into urban cooperative banks in 1996, Reserve Bank of India had examined the issue, in the context of its policy posture of granting banking status to primary credit societies. It was felt that denying conversion to well run cooperative credit societies into urban banks while permitting conversion of primary credit societies in to UCBs was unfair . RBI, therefore, decided that cooperative credit societies may be allowed to convert into UCBs, if these societies:

- (a) have amended their by-laws to the effect that their primary object is the transaction of banking business and they accept deposits from the public;
- (b) have attained the entry point norms for organisation of new urban cooperative banks;
- and
- (c) their methods of operation are not detrimental to the interests of the depositors.

7.7 The Registrars of Cooperative Societies were advised by Reserve Bank of India in September, 1996 regarding the procedure to be adopted by them before such proposals were forwarded to Reserve Bank of India. Before transmitting the proposal of a society intending to convert itself into a primary cooperative bank, the Registrar of Cooperative Societies is required to ascertain whether the society has satisfied the entry point norms on the basis of the latest audited balance sheet. The Registrar of Cooperative Societies is also expected to satisfy himself that the overall methods of operation of the society, as revealed by the audit, are satisfactory. A scrutiny of the affairs of the applicant society is carried out by RBI to determine whether :

- (a) the society is or will be in a position to pay its present or future depositors in full as and when their claims accrue;
- (b) the affairs of the society are not being, or are not likely to be conducted in a manner detrimental to the interests of its present or future depositors,
- (c) the general character of the proposed management of the society will not be prejudicial

to the public interest or to the interest of its depositors,
(d) the proposed cooperative bank has adequate capital structure and earning prospects, and
(e) the public interest will be served by the grant of a licence to the society for carrying on banking business in India,

7.8 A society which satisfies the above criteria and other prescribed parameters in this regard is granted 'in principle' approval for conversion to an urban cooperative bank. The society is then required to amend its by-laws on lines of the model by-laws and, thereafter, apply to Reserve Bank of India for issue of a licence under Section 22 of B.R. Act, 1949 (AACS). The request of the society for issue of licence is considered by RBI in the usual course. Once a licence is granted by the Reserve Bank to the society, it formally gets converted into an urban cooperative bank and may commence banking business. After adoption of this policy since 1996, Reserve Bank of India have allowed conversion of 26 cooperative credit societies into urban cooperative banks.

7.9 But after 2 years of administration of this policy, a question arose as to whether conversion of cooperative credit societies should at all be allowed in overbanked areas. As discussed in [chapter III](#), under the present policy dispensation, an area is considered over banked if the Average Population Per Bank Office (APPBO) is less than 10000. For computing APPBO, only the presence of urban banking network is taken into account. However, as discussed in [para 3.6](#) of the report, the adequacy or other-wise of banking facilities at a given centre cannot be gauged only on the basis of APPBO. The Committee, in its recommendations for granting licence to new urban cooperative banks ([para 3.8](#)) has not given any weightage to this criterion. Hence APPBO is not considered to be of any relevance.

Approach of the Committee

7.10 During interaction with the Committee, a large cross section of urban cooperative banks' representatives, federations, and some state governments have supported continuance of existing RBI policy of conversion of cooperative credit societies into UCBs. Their argument flowed from the fact that a well run cooperative credit society's conversion as UCB may reduce the regional imbalance in the spread of urban banking movement. The argument that conversion of a cooperative credit society would dilute the basic cooperative character is also unacceptable since, the quintessential traits of cooperation such as self-help, mutual trust, and democratic spirit continue to guide and govern an urban cooperative bank's functioning. However, the Committee feels that granting licence to a cooperative credit society which has paid up capital and reserves as low as Rs.1 lakh may provide a backdoor entry in to urban banking fold. The Committee is, therefore, of the view that both primary credit societies and cooperative credit societies may be allowed to function as cooperative banks only if they satisfy the entry point capital norms.

Recommendations of the Committee

7.11 Having weighed the pros and cons of conversion of cooperative credit societies in to UCBs, the Committee recommends that the present policy of Reserve Bank of India regarding conversion of cooperative credit societies into urban cooperative banks may be continued, subject to compliance with the following conditions:

- i) that their networth is not less than entry point capital prescribed for organisation of new urban cooperative banks and the membership has reached the prescribed level;
- ii) they have been earning profits in each of the last 3 consecutive years;
- iii) their methods of operations are not detrimental to the interests of the depositors; and
- iv) they have earned 'A' audit rating successively during the last 3 years

19. The Report of Committee on Urban Cooperative Banks, 1978

20. The Report of the Committee on Licensing of New Urban Cooperative Banks (1992).