

**REPORT OF THE
HIGH POWERED COMMITTEE
ON URBAN CO-OPERATIVE BANKS (UCBs)**



JUNE 2015

**RESERVE BANK OF INDIA
MUMBAI**



भारतीय रिज़र्व बैंक
RESERVE BANK OF INDIA
www.rbi.org.in

Deputy Governor

Letter of Transmittal

Date: July 30, 2015

Dr. Raghuram G. Rajan
Governor
Reserve Bank of India
Mumbai

Dear Sir,

Report of the High Powered Committee on Urban Co-operative Banks (UCBs)

I have immense pleasure in submitting the Report of the High Powered Committee on Urban Co-operative Banks (UCBs), appointed vide memorandum dated January 16, 2015. The report has examined various issues with regard to size and complexity of business of UCBs, conversion of UCBs into joint stock bank and modalities of implementation of the recommendations of expert committee on licensing of new UCBs (Chairman: Shri Y. H. Malegam). The report has benefitted immensely from the sagacity and expertise of the esteemed members of the Committee.

On behalf of the members of the High Powered Committee, and on my personal behalf, I sincerely thank you for entrusting this responsibility to us.

With regards

Yours Sincerely,

Sd/-

R. Gandhi
Deputy Governor & Chairman
High Powered Committee on UCBs



भारतीय रिज़र्व बैंक
RESERVE BANK OF INDIA

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EXECUTIVE ORDER

Dated: January 16, 2015

High Powered Committee on Urban Co-operative Banks

In the 31st meeting of Standing Advisory Committee on Urban Co-operative Banks held on October 20, 2014, a view was expressed that the draft vision document on Urban Co-operative Banks (UCBs) published by RBI in 2005 needs to be revisited particularly with regard to facilitating further growth of urban cooperative banking sector. At the same time, given the limited legal powers and resolution options, there is a need to consider whether unrestricted growth of a UCB would be in the interest of the depositors. Further, the recommendations of Expert Committee on licensing of new UCBs (Chairman Shri Y.H.Malegam) need examination from the point of view of opportune time for grant of license and the modalities of taking forward these recommendations. Accordingly the Reserve Bank of India hereby constitutes a High Powered Committee with the following terms of reference:

- (i) What lines of business (that commercial banks undertake) can be permitted for UCBs and what should be the benchmark in terms of size of business, capital requirement, regulatory regime etc.
- (ii) In view of the limited legal powers and resolution options, what should be the appropriate size upto which a UCB may be able to grow without undue risks to the system, under the current regulatory framework

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- (iii) When enabling legal framework is in place for conversion of a co-operative bank into a joint stock bank, what should be the criteria for allowing voluntary conversion by a UCB? What should be the benchmarks in terms of asset size, capital etc. for mandatory conversion of UCB to a Joint Stock bank?
- (iv) Examine whether the time is opportune to give license to new UCBs as per the recommendations of the Expert Committee on Licensing of New UCBs (Malegam Committee) and if so the modalities of taking forward the recommendations of Malegam Committee.
- (v) Determine the modalities of implementing the suggestion of the Malegam Committee that 50 per cent in value of deposits should be held by voting members to assure that confidence regarding proper management is generated among investors. Alternatively propose a feasible structure that puts majority voting in the hands of contributors of funds
- (vi) Any other matter incidental to the above

2. The constitution of the Committee will be as under:-

Shri R Gandhi, Deputy Governor, Reserve Bank of India - Chairman

Shri M.A.Narmawala, Commissioner for Co-operation & Registrar of Co-operative Societies, Gujarat

Shri M.V.Tanksale, Chief Executive, Indian Banks Association

Dr. M. L. Abhyankar President, NAFCUB

Shri S.K.Banerji, Managing Director, Saraswat Cooperative Bank Ltd

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Shri D Krishna, Former Chief Executive, NAFCUB

Smt Suma Varma, PCGM DCBR, Reserve Bank of India will be the
Member Secretary

Shri Joseph Raj, Joint Legal Adviser, Legal Department, Reserve Bank of
India shall be a permanent invitee.

3. The Committee will submit its report within three months from the date of
its first meeting. Department of Co-operative Bank Regulation will provide the
necessary secretarial assistance to the Committee.

Sd/-
(Dr. Raghuram G. Rajan)
Governor

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Executive Summary

The Banking Regulation Act, 1949 was made applicable to primary co-operative banks commonly known as Urban Co-operative Banks (UCBs) w.e.f. March 1, 1966 and to review the performance of these banks the Reserve Bank constituted different committees and working groups from time-to-time.

2. The Reserve Bank pursued a liberal licensing policy, especially pursuant to the recommendations of the Marathe Committee, which had suggested dispensing the 'one-district, one-bank' approach. As a result, the number of UCBs had increased from 1311 in 1993 to 1926 by March 2004. However, nearly one-third of these newly licensed UCBs became financially unsound within a short period of time. The Reserve Bank has taken several steps to improve the financial soundness of the UCBs. The Reserve Bank of India entered into Memoranda of Understanding (MoUs) with all State Governments and the Central Government since 2005. The MoUs facilitated coordination of regulatory policies and actions through the mechanism of TAFCUBs, a comprehensive set of capacity building initiatives and measures to bring in efficiency through adoption of technology.

3. As a result of the new initiatives and sustained efforts by RBI, the number of financially weak banks in the UCB sector has declined. Further, due to consolidation in the sector on account of closures and mergers, the number of UCBs came down from 1770 as at end-March 2008 to 1589 as on March 31, 2014 and further to 1579 by end-March 2015. The sector has recorded growth and financial strength after consolidation. The deposits and advances of UCBs increased from ₹ 1398.71 billion and ₹ 904.44 billion as at end-March 2008 to ₹ 3155.03 billion and ₹ 1996.51 billion, respectively, as at end-March 2014. The Gross Non Performing Assets (NPAs) decreased from 15.5% to 5.7% in the same period. However, this growth was not uniform across the UCB sector as a few UCBs grew exponentially during the period. In the process, some UCBs acquired the size of smaller commercial banks.

4. Thus, the UCB sector has traversed a long distance over the years. As UCBs form an important vehicle for financial inclusion and facilitate payment and settlement, it

may be appropriate to support their growth and proliferation further in the background of the differentiated bank model. However, the question remains whether unrestrained growth can be allowed. And keeping in view the restricted ability of UCBs to raise capital, lack of level playing field in regulation and supervision and absence of a resolution mechanism at par with commercial banks, in what form this unrestrained growth should be allowed.

5. UCBs now have high aspirations of competing with commercial banks and they expect RBI to provide relaxations in various regulatory restrictions. However, due to the weak resolution regime with respect to UCBs and non-availability of powers to RBI to regulate and supervise UCBs at par with commercial banks, RBI faces constraints in making such relaxations. Thus it becomes necessary to ensure that UCBs balance their growth ambitions in keeping with the risks that they undertake and the risk mitigation measures that are in their control. The growth of the sector therefore has to be in a carefully calibrated manner, consistent with the legal framework and regulatory parameters and their limitations.

6. A study was conducted on behalf of the committee to ascertain the range of loans granted by scheduled and non-scheduled UCBs. The study shows diametrically opposite trends in the range of loans granted by the two types of co-operative banks. While the scheduled banks granted 59.6% of the total loans in the largest loan size ranges of ₹ 1-5 crore and above ₹ 5 crore, non-scheduled banks catered to the small loan segments upto ₹ 10 lakh in a substantial way as this segment constituted 59.5% of the loans granted by this component of UCBs. The study further supports the premise that large MS-UCBs have aligned their business models and goals with those of commercial banks while availing of the concessions granted to the sector.

7. A comparison of regulatory parameters prescribed for UCBs and Small Finance Banks (SFBs) as against the list of activities permitted to them shows an interesting result. SFBs despite having stringent capital requirements of ₹ 100 crore networth and a CRAR of 15% are not permitted to undertake a host of activities which UCBs are currently allowed with lesser capital requirements starting from ₹ 25.00 lakh.

8. Though UCBs were set-up as small banks offering banking services to people of small means belonging to the lower and middle classes, a well laid out transition path is required for at least the larger UCBs to convert themselves into universal/ niche commercial banks due to the changing financial landscape in the country and providing further growth opportunity to well managed UCBs. The major considerations to be kept in mind are the aspirations of large UCBs, conflicts of interest, decline in cooperativeness, regulatory arbitrage, limitations on raising capital, limited resolution powers of RBI, the capital structure of UCBs and opportunities for growth that will accrue after such conversions.

9. As conversion of UCBs into commercial banks requires certain amendments in the provisions of the Co-operative Societies Acts of all states which is a long drawn process, the Committee recommends that only UCBs which are registered under Multi-state Co-operative Societies Act, 2002 may be considered for conversion to commercial banks. The new provisions of Section 366 of the Companies Act, 2013 have already come into force in terms of which definition of company includes, among others, co-operative societies. As such the issue of conversion of a co-operative society into a joint stock bank has been addressed. However, amendments to the Multi-State Co-operative Societies Act will still be needed; these have already been suggested by the RBI to Government of India (GoI).

10. **Business Size and Conversion of MS-UCBs into joint stock bank:** The Committee feels that a business size of ₹ 20,000 crore or more may be the threshold limit beyond which a UCB may be expected to convert itself into a commercial bank. This may necessitate some transition facilities also. The conversion need not be *de jure* compulsory and large UCBs can continue the way they are operating currently in terms of balance sheet/asset size. However, this will be subject to the regulatory guidelines requiring that the types of businesses they undertake remain within the limits of plain vanilla products and services and hence, growth will be at a much slower pace. Their expansion in terms of branches, area of operations and business lines may thus be carefully calibrated to restrict unrestrained growth.

11. Conversion of other UCBs into SFBs: As per the Committee smaller UCBs voluntarily willing to convert to SFBs can do so irrespective of the threshold limit provided they fulfil all the eligibility criteria and selection processes prescribed by RBI and further provided that the SFBs licensing window is open .

12. Issue of fresh licences: The Committee unanimously recommends that licenses may be issued to financially sound and well-managed co-operative credit societies having a minimum track record of 5 years which satisfy the regulatory prescriptions set by RBI as licensing conditions. With regard to the concern of providing banking access in unbanked areas, the Committee recommends that RBI may put in place an appropriate set of incentives for existing banks to open branches there.

13. Board of Management (BoM) in addition to Board of Directors (BoDs): The Committee recommends that the concept of BoM as put forward by the Malegam Committee has to be one of the mandatory licensing conditions for licensing of new UCBs and expansion of existing ones.

14. Entry Point Norms: The Committee also feels that licenses may be issued to well-managed co-operative societies which satisfy the following capital requirements:

- (a) To operate as a Multi State Urban Co-operative Bank- ₹ 100 crore
- (b) To operate beyond two districts and as a State level UCB - ₹ 50 crore
- (c) To operate as District level UCB (upto 2 districts) - ₹ 25 crore
- (d) In case of conversion of co-operative credit societies in unbanked areas and in the north-east, suitable relaxation may be made by RBI.

15. Depositors as voting members: It was concluded that depositors ought to have a say on the Boards of UCBs. For this, a majority of the board seats be reserved for depositors by making suitable provisions in the bye-laws.

16. Suggestions:

The committee, during deliberations on the specific terms of reference also had occasion to briefly discuss, some issues that have relevance to the sector but did not pursue them in detail both because they were not specifically relevant to the aspects that the Committee was looking into and also because that would have delayed the conclusion of the report. The Committee therefore has not dealt with them in this report but feels it necessary to highlight them so that they can be taken forward in an appropriate manner and time as determined by the Bank. These are:

- (i) At present, no powers are available with RBI for constituting boards of UCBs, removal of directors, supersession of BoDs, auditing of UCBs and winding up and liquidation of UCBs. However, such powers for commercial banks are vested with RBI. There are certain sections in the BR Act 1949 such as provisions of Section 10A (professional BoD), 10B (removal of a whole time chairman), 30 (audit), 44 (winding-up of banks), 44A (amalgamation of banking companies) and 45 (suspension of business) which were not replicated while amending Section 56 of the BR Act, 1949. These amendments can be incorporated in Section 56 of the Act *ibid* for effective regulation and supervision of UCBs. In addition to these, the committee identified and deliberated in detail on the problems and issues afflicting the sector including restricted ability of UCBs to raise capital resources and to handle risks, lack of RBI's powers for supervision and regulation of UCBs at par with commercial banks, lack of powers for compulsory/voluntary merger etc. apart from the basic fault lines in the structure of the urban co-operative banking sector. However, in view of the limited terms of reference and the given time frame of the committee, the long term solution to all the problems could not be covered under the recommendations.
- (ii) **Resolution Mechanism:** The resolution regime for UCBs exists in a rudimentary form in as much as it ensures pay-outs to small depositors by DICGC while large depositors' interests are not taken care of fully in the event of cancellation of the licence of a bank. As belated action accentuates problems of resolution, any prompt corrective action framework should require supervisory action at the initial stages. As time is

of essence in any resolution framework, there is a need to review the existing supervisory action, revisiting existing guidelines on mergers, revision in instructions on restructuring negative net-worth UCBs including revisiting instruments for augmenting capital for UCBs. Moving forward, it is necessary to start with the requirement that UCBs need to frame their recovery and resolution plans within the current legal framework when they are operating on sound lines. There is also a need to empower the RBI for implementing resolution techniques without involving other regulators such as RCS and CRCS. There should be a regulatory set up to provide legal backing for RBI to play a central role in the winding up of the banking business of UCBs without the intervention of the authorities under the co-operative societies' laws. The possibility of winding up the banking business of UCBs by RBI directly by appointing DICGC as the liquidator for liquidating the banking business of a UCB may also be explored.

- (iii) **Umbrella Organisation:** The concept of having an Umbrella Organization for UCBs in India has been mooted for a long time. In fact the Malegam Committee deliberated on the issue in detail. Some of the members referred to the structure of Rabobank running successfully abroad. The Committee feels that a prerequisite for such a successful umbrella organisation is inherently sound and well-run member institutions. However, the question remains whether the Rabobank kind of model is possible under existing laws in India.

Thus, although such a structure has long been envisaged, certain legal hurdles are precluding its implementation.

The Committee recommends that given the importance of the issue RBI may expedite a decision on the structure of the urban co-operative banking system and appropriate Umbrella Organization/s.

Chapter 1

Introduction

1.1 Mahatma Gandhi once said: 'Suppose I have come by a fair amount of wealth – either by way of legacy, or by means of trade and industry – I must know that all that wealth does not belong to me; what belongs to me is the right to an honourable livelihood, no better than that enjoyed by millions of others. The rest of my wealth belongs to the community and must be used for the welfare of the community'. This forms the essence of the co-operative movement which is based on the same principles of community camaraderie, mutual help, democratic decision making and open membership.

1.2 The Primary (Urban) Co-operative Banks popularly known as Urban Co-operative Banks (UCBs) were brought under the regulatory ambit of RBI by extending certain provisions of the Banking Regulation Act, 1949 (BR Act) effective from March 1, 1966. UCBs are at the base level of the banking system in India providing basic banking facilities to people of small means particularly urban poor. The UCB sector is unique in the sense that there is a significant degree of heterogeneity among the banks in this sector in terms of size, geographical distribution, performance and financial strength. The sector has unit banks, multi-branch UCBs operating within a state and multi-state UCBs with the area of operation in more than one state.

1.3 There has been a phenomenal growth in the UCB sector since 1966 in terms of the number of banks, branches, size of business (deposits+ loans and advances) and geographical outreach. The Reserve Bank has been reviewing the performance of the UCB sector from time to time and also constituted certain committees and working groups to look into regulatory issues concerning UCBs, including the licensing policy. These committees included the Madhava Das Committee (1978), the Marathe Committee (1991), the Madhava Rao Committee (1999) and the Malegam Committee (2010). The Working Groups (WG) constituted include WG to examine issues relating to augmenting capital of UCBs under the Chairmanship of Shri N S Vishwanathan (2006), WG on Information Technology (IT) Support to UCBs

under the Chairmanship of Shri R Gandhi (2007) and WG on Umbrella Organisations for UCBs under the Chairmanship of Shri V S Das (2008).

Evolution of the Urban Bank Sector:

1.4 Although, India is considered to have one of the oldest community-banking movements in the world with UCBs starting way back in 1889, the real growth picked up after this sector was brought under the purview of the BR Act in 1966. The evolution may be broadly divided into three phases - the growth phase, crisis phase and consolidation phase.

Growth Phase (1966-2003)

1.5 In 1966, there were about 1100 UCBs with deposits and advances of ₹ 1.67 billion and ₹ 1.53 billion respectively. The Reserve Bank pursued a liberal licensing policy, especially pursuant to the recommendations of the Marathe Committee, which suggested dispensing the 'one-district, one-bank' approach. This shifted the stance of the policy to assess the 'need and potential' in an area for mobilising deposits and purveying of credit for a new UCB. In 1993, before the liberalisation of the bank licensing policy, there were 1311 UCBs having deposits and advances of ₹ 111.08 billion and ₹ 87.13 billion, respectively, which increased to 1926 UCBs with deposits and advances of ₹ 1020.74 billion and ₹ 649.74 billion, respectively by end-March, 2004. This is because after the liberalisation of licensing norms in May 1993, 823 bank licences were issued up to June 2001.

Crisis Phase (2003-2008)

1.6 However, it was observed that nearly one-third of the newly licensed UCBs became financially unsound within a short period. In the light of the experience and the prevailing financial health of the UCB sector after the Madhavpura Mercantile Co-operative Bank episode, it was announced in the Annual Policy Statement 2004-05 that the Reserve Bank would consider issuance of fresh licences only after a comprehensive policy on UCBs, including an appropriate legal and regulatory framework for the sector, was put in place. No fresh licences have been issued

thereafter for setting up new UCBs, although the existing applications received from unlicensed UCBs were disposed of.

1.7. The number of UCBs declined from 1926 as at end- March 2004 to 1770 by end- March 2008. The deposits and advances of urban banks increased only marginally during the same period from ₹ 1020.74 billion and ₹ 649.74 billion to ₹ 1398.71 billion and ₹ 904.44 billion, respectively.

1.8. The Reserve Bank took several steps to strengthen the sector during this period. In order to improve the financial soundness of the UCB sector, the Reserve Bank of India has been entering into Memoranda of Understanding (MoU) with all State Governments and the Central Government since 2005. The MoUs facilitated coordination of regulatory policies and actions through the mechanism of TAFUBs, a comprehensive set of capacity building initiatives, and measures to bring in efficiency through adoption of technology. This phase also ushered in voluntary consolidation in the sector by the merger of non-viable UCBs with financially sound and well-managed ones.

1.9 The RBI introduced the Graded Supervisory Action (GSA) framework in 2003 in lieu of classification of UCBs into Weak and Sick UCBs. Accordingly, UCBs were classified into four grades - Grade I, II, III and IV depending on their financial conditions. GSA envisaged supervisory measures to be taken with respect to UCBs classified in Grade III and IV when certain levels of CRAR, net NPA, profitability or default in CRR/SLR were breached. UCBs were subjected to supervisory action such as prohibition from expansion of Area of Operation, opening new branches, prescribing lower exposure limits and restrictions on dividend based on this classification. With the introduction of Rating Model, GSA was replaced by Supervisory Action Framework (SAF) in 2012 wherein supervisory action was initiated based on various trigger points such as CRAR, gross NPA, CD ratio, profitability and concentration of deposits. SAF was reviewed and modified in 2014 by advancing the trigger points for imposing directions and cancellation of licence.

Consolidation Phase (2008 onwards)

1.10. As a result of the new initiatives and sustained efforts by RBI, the number of financially weak banks in the UCB sector declined. Further, due to consolidation in the sector on account of closure and merger, the number of UCBs came down from 1770 as at end-March 2008 to 1589 as on March 31, 2014 and further to 1579 by end-March 2015. However, the deposits and advances of urban banks increased from ₹ 1398.71 billion and ₹ 904.44 billion as of end-March 2008 to ₹ 3155.03 billion and ₹ 1996.51 billion, respectively, as on end-March 2014. Incidentally, mergers of as many as 119 UCBs have been effected till date after 2005.

Banking Structure in India:

1.11 RBI came out with a discussion paper on the Banking Structure in India – The Way Forward in 2013. The paper envisaged a four-tier banking structure consisting of International Banks in Tier I, National Banks in Tier II, Regional Banks in Tier III and Local Banks in Tier IV respectively. The paper brought to the fore a case for reorienting the existing banking structure to make it more dynamic and amenable to meet the needs of the economy and suggested basic building blocks of the reorientation exercise which, *inter alia*, included conversion of UCBs which met the necessary criteria into commercial banks or LABs/small banks.

Need for another Committee?

1.12 It is evident that the UCB sector has come a long way. UCBs are an important segment of the banking system as they play a vital role in mobilising deposits and purveying credit to people of small means. As they form an important vehicle for financial inclusion and facilitate payment and settlement, it will be appropriate to support their growth and proliferation further in the background of the differentiated bank model. However, the question remains whether unbridled growth can be allowed and if so, in what form it should take, keeping in view the restricted ability of UCBs to raise capital, lack of a level playing field in regulation and supervision and the absence of a resolution mechanism at least on par with commercial banks.

1.13 Till 2000, growth of UCBs was measured in terms of spread of branches thus setting geographical expansion as a benchmark. The absolute size of a UCB was not considered a parameter. However, the natural ambition of the UCBs has now changed and with the growth in the size and complexity of business in some of the large UCBs, there is demand for an enabling environment for growth and undertaking of business akin to commercial banks. Such aspirations are reflected in the requests received from UCBs such as permission to be a part of the food credit consortium, for lending against regulatory assets, lending to big infrastructure projects, investing in securitised assets, becoming trading members in the currency derivative segment and trading in derivatives/ overnight index futures and swaps. With the passage of time, the aspirations of UCBs have grown and some of them have expressed a desire to convert to commercial banks.

1.14 In the 31st Standing Advisory Committee (SAC) on UCB held in October 2014, a view was expressed that the vision document published by RBI in 2005 needs to be revisited particularly with regard to facilitating further growth of the UCB sector. It was observed that large UCBs aspire to conduct businesses like commercial banks, without being subject to same regulatory and supervisory framework. Given the limited legal powers and resolution options with RBI, there is a need to consider whether unrestricted growth of a UCB will be in the interests of depositors. It was also felt that the recommendations of the Malegam Committee needed further examination with regard to the appropriate time for issuing of licences and examining the modalities for taking them forward.

1.15 Consequently, it was decided to constitute a High Powered Committee on UCBs under the Chairmanship of Shri R Gandhi, Deputy Governor, RBI and other experts in the sector to study these issues in detail and suggest a way forward.

Terms of reference:

1.16 The High Powered Committee has the following terms of reference:

- i. What lines of business (that commercial banks undertake) can be permitted for UCBs and what should be the benchmark in terms of size of business, capital requirement, regulatory regime etc.
- ii. In view of the limited legal powers and resolution options, what should be the appropriate size upto which a UCB may be able to grow without undue risk to the system, under the current regulatory framework.
- iii. When an enabling legal framework is in place for conversion of a co-operative bank into a joint stock bank, what should be the criteria for allowing voluntary conversion by a UCB? What should be the benchmarks in terms of asset size, capital, etc., for mandatory conversion of a UCB to a Joint Stock bank?
- iv. Examining whether the time was opportune to give licenses to new UCBs as per the recommendations of the Expert Committee on Licensing of New UCBs, (Malegam Committee) and if so the modalities of taking forward the recommendations of the Malegam Committee.
- v. Determine the modalities of implementing the suggestion of the Malegam Committee that 50 per cent in value of deposits should be held by voting members to assure that confidence regarding proper management is generated among investors. Alternatively proposing a feasible structure that puts majority voting in the hands of contributors of funds.
- vi. Any other matter incidental to the above.

Composition of the Committee:

1.17 The Committee comprises of the following members:

- | | |
|-----------------------|----------|
| 1. Shri R Gandhi | Chairman |
| Deputy Governor | |
| Reserve Bank of India | |

- | | |
|---|------------------|
| 2. Shri M.A. Narmawala
Commissioner for Co-operation & Registrar of Co-operative Societies
Gujarat | Member |
| 3. Shri M.V. Tanksale
Chief Executive
India Bank's Association (IBA) | Member |
| 4. Dr. M. L. Abhyankar
President
The National Federation of Urban Co-operative Banks and Credit Societies Ltd.
(NAFCUB) | Member |
| 5. Shri S.K. Banerji
Managing Director
Saraswat Co-operative Bank Ltd, Mumbai | Member |
| 6. Shri D. Krishna
Former Chief Executive
NAFCUB | Member |
| 7. Smt Suma Varma
Principal Chief General Manager
Department of Co-operative Bank Regulation
Reserve Bank of India, Central Office | Member Secretary |

Permanent Invitees:

- | | |
|--|-------------------|
| 1. Shri N S Vishwanathan
Executive Director
Reserve Bank of India | Permanent Invitee |
| 2. Shri Joseph Raj
Joint Legal Adviser
Legal Department, Reserve Bank of India | Permanent Invitee |

Approach/ Methodology:

1.18 The High Powered Committee held six meetings in Mumbai between March 2015 and June 2015. The details of the meetings are given in Annex-I. Further, the Committee interacted with representatives of the State Federations of Gujarat, Telangana and Andhra Pradesh. Representatives of State Federations of Maharashtra and Karnataka, who were also invited for an interaction with the Committee, could not attend the meeting. However, they conveyed their views in writing. The National Federation of Urban Co-operative Bank and Credit Societies Ltd. (NAFCUB) also wrote to the CEOs/Chairmen of all the State Federations asking for their views on the terms of reference of the Committee but did not elicit any response from them. The Committee deliberated on the various issues relating to its terms of reference. Various presentations were made to the Committee by Shri P K Arora, Chief General Manager and Dr S K Kar, General Manager, RBI and the issues raised were discussed in detail. The major findings and the recommendations of the Committee are discussed in the chapters that follow.

Structure of the Report:

1.19 The Report has five chapters apart from Executive Summary. Chapter 1 provides an introduction outlining the background and evolution of the sector leading to the constitution of the present Committee. Chapter 2 reflects on the deliberations on the lines of business that can be permitted to UCBs and the appropriate size up to which UCB may be allowed to grow without undue risks to the system under the current legal and regulatory framework and resolution options. Chapter 3 discusses the option of conversion of UCBs into joint stock banks and the criteria for voluntary conversion by a UCB. Chapter 4 examines whether the time is opportune for licensing of new UCBs as per the recommendations of the Malegam Committee. It also covers the feasibility for making depositors voting members. Finally, the recommendations and suggestions of the Committee are covered in Chapter 5.

Acknowledgments:

1.20 The Committee acknowledges the contribution of Shri P K Arora, Chief General Manager, DCBR, Central Office in making various presentations to the Committee, providing secretarial assistance, drafting and completion of the report.

1.21 Drafting and secretarial assistance was provided by Dr S. K. Kar, General Manager, Smt Reeny Ajith, General Manager, Shri Anish Kumar, Assistant General Manager, Shri Akhilesh Gokhale, Manager and Shri Tushar Jadhav, Manager, RBI. The logistics for the meetings were arranged and supervised by Smt Soma Acharya, Assistant General Manager and Kum. Ritu Khatri, Manager, Reserve Bank of India. The necessary data for the report was provided by Shri Bhaskar Birajdar, Assistant Adviser. The Committee acknowledges the contributions and expresses its thanks to all these officers who worked relentlessly for the completion of the task of the Committee in time.

Chapter 2

Size and Complexity of Business-UCBs

2.1 Ever since the UCBs were brought under the purview of the BR Act, 1949 effective March 1966, they have been growing in size, scale and complexity of business. The total deposits and advances of the UCB sector which together constitutes its business size grew from ₹ 1398.71 billion and ₹ 904.44 billion as on March 2008 to ₹ 3155.03 billion and ₹ 1996.51 billion as on March 2014 registering a growth of 125.6% and 120.7% respectively. However, this growth was not uniform across the UCB sector as a few UCBs grew exponentially during the period. As such, some UCBs have shown such unprecedented growth in their balance sheet size over the years, that they have acquired the size of commercial banks.

2.2 The global financial crisis of 2007 brought into debate the concept of “Too big to fail”. The world over, the debate started revolving around the size of the financial entity which might pose undue risk to the system and what additional regulatory prescriptions they might be subjected to. In the commercial banking space, this gave birth to new financial entities such as G-SIBs (Global- Systematically Important Banks) and D-SIBs (Domestic-Systematically Important Banks). Regulators also prescribed higher capital requirements for such systemically big and important financial entities. Considering that some UCBs have acquired the size akin to commercial banks, they may pose a risk to the system due to their scale and complexity of business. In view of this, the time was opportune to reflect on the appropriate size up to which a UCB may be allowed to grow without undue risk to the system. This became all the more relevant due to the weak resolution regime with respect to UCBs. In case of commercial banks, the present regulatory and legal framework provides reasonable power to RBI for an early resolution. However, this is not true in case of UCBs, where the resolution powers lie with the State Government/ Central Government.

2.3 Considering the restricted legislative powers, the Reserve Bank has drawn up a somewhat different regulatory framework for UCBs. This recognises the limitations of the sector and is also largely consistent with the general needs of the clientele of the UCBs. However, with the growth in their balance sheets and ability to attract

relatively larger borrowers, some of the UCBs now have high aspirations to compete with commercial banks and they expect RBI to provide a regulatory framework akin to that for commercial banks. Thus it becomes necessary to ensure that UCBs balance their growth ambitions commensurate with the risks that they undertake. The growth of the sector also has to be consistent with the legal framework and regulatory parameters. Keeping history in mind and the time required for resolving an issue with UCB vis-a-vis a Commercial Bank at least with regard to depositors, RBI has been wary of allowing the unrestrained growth of UCBs.

Growth of UCBs:

2.4 The regulatory approach to UCBs has been tailored recognising their role and mandate for providing financial services to the less privileged sections of the population. UCBs are, therefore, regulated under the less stringent BASEL I norms as opposed to BASEL II and III norms applicable to commercial banks. Although co-operatives are intended to remain small with their activities limited to their membership, a license to carry on the banking business provides the UCBs easy access to public deposits. With the liability of members (shareholders) restricted to membership shares, the owners become the users of resources predominantly contributed by non-members leading to an inherent conflict of interest that needs to be moderated through regulation and supervision.

2.5 The Committee observed that the sector has witnessed reasonable growth over the last few years (Table 2.1):

Table: 2.1

(₹ In billions)

As on March 31,	Total No of UCBs	Deposits	Advances
2008	1770	1398.71	904.44
2009	1721	1570.42	962.34
2010	1674	1831.50	1124.36
2011	1645	2118.80	1364.98
2012	1618	2386.41	1577.93
2013	1606	2768.30	1810.31
2014	1589	3155.03	1996.51

While the number of UCBs declined from 1770 in 2008 to 1589 in 2014, there was consistent growth in deposits and advances from ₹ 1398.71 billion and ₹ 904.44 billion in 2008 to ₹ 3155.03 billion and ₹ 1996.51 billion respectively in 2014, recording a CAGR of 14.52% and 14.11% respectively.

List of large UCBs by business/assets size:

2.6 A comparison of the business (deposits+advances) of the top ten UCBs with the bottom ten commercial banks (excluding foreign banks) is given in Table 2.2:

Table 2.2 : Deposits, Advances and Assets of top ten UCBs and bottom ten Private Sector Banks
(As on March 31, 2015*)

(Amount in ₹ billion)

Top 10 UCBs	Deposits	Advances	Total Assets	Bottom 10 PrSBs	Deposits	Advances	Total Assets
Saraswat Co-operative Bank Ltd.,	271.71	177.98	348.28	Karur Vysya Bank	446.90	366.91	532.13
Cosmos Co-operative Urban Bank Ltd.	158.35	111.60	190.89	Karnataka Bank	460.09	319.95	518.07
Shamrao Vithal Co-operative Bank Ltd.	124.68	79.54	144.74	Tamilnad Mercantile Bank	256.50	195.45	291.71
Abhyudaya Co-operative Bank Ltd., Mumbai	97.61	57.46	117.57	City Union Bank	240.75	180.89	277.09
Bharat Co-operative Bank Ltd., Mumbai	77.58	52.53	89.35	Ratnakar Bank	170.99	145.30	271.07
TJSB Sahakari Bank	71.80	44.08	88.01	Lakshmi Vilas Bank	219.64	165.13	247.47

Punjab & Maharashtra Co-operative Bank Ltd.	68.70	48.79	79.86	DCB Bank	126.09	105.58	161.36
Janata Sahakari Bank Ltd., Pune.	70.70	47.51	79.69	Catholic Syrian Bank	144.74	96.95	157.90
Kalapur Commercial Coop.Bank Ltd.	47.56	27.29	62.92	Dhanlaxmi Bank	123.79	81.52	145.89
NKGSB Co-operative Bank Ltd.,	53.35	36.37	61.82	Nainital Bank	53.44	25.96	59.41

Note: Top and bottom banks are based on their total asset size.

**The data is extracted from off-site returns submitted by the banks and is unaudited*

2.7 The Committee observed that some of the UCBs were larger than the smaller commercial banks in terms of deposits, advances and total assets.

Profile of range of loans granted by UCBs:

2.8 A study was conducted on behalf of the Committee to ascertain the profile of range of loans granted by UCBs for both scheduled and non-scheduled UCBs. The findings are given in Tables 2.3 and 2.4.

Table 2.3 Scheduled Banks

S.No	Range of loan	Scheduled banks (50 banks)			
		No. of account	No of account % of total	Amount (In ₹ lakh)	Amount % of total
1	Upto ₹ 5 lakh	569855	53.02	765610.01	10.75
2	₹ 5-10 lakh	276314	25.71	442240.67	6.21
3	₹ 10-15 lakh	171148	15.92	267872.06	3.76
4	₹ 15-20 lakh	14166	1.32	216793.44	3.04
5	₹ 20-25 lakh	9308	0.87	175511.01	2.46
6	₹ 25-50 lakh	15320	1.43	491820.30	6.90
7	₹ 50-1 crore	8017	0.75	519059.95	7.28
8	₹ 1-5 crore	8150	0.76	1669339.23	23.43
9	Above ₹ 5 crore	2417	0.22	2577153.95	36.17
	TOTAL	1074695	100.00	7125400.62	100.00

Table 2.4 Non-Scheduled Banks

S.No	Range of loan	Non-Scheduled banks (1529 banks)			
		No. of account	No of account % of total	Amount (In ₹ lakh)	Amount % of total
1	Upto ₹ 5 lakh	5768074	93.56	5358773.33	47.46
2	₹ 5-10 lakh	248762	4.03	1360859.24	12.05
3	₹ 10-15 lakh	56167	0.91	632944.54	5.60
4	₹ 15-20 lakh	27679	0.45	434317.49	3.84
5	₹ 20-25 lakh	18072	0.29	379998.28	3.36
6	₹ 25-50 lakh	27670	0.45	891561.46	7.90
7	₹ 50-1 crore	11722	0.19	739277.95	6.55
8	₹ 1-5 crore	6814	0.11	1207918.22	10.70
9	Above ₹ 5 crore	436	0.01	286551.23	2.54
	TOTAL	6165396	100.00	11292201.74	100.00

2.9 The study showed diametrically opposite trends in the range of loans granted by scheduled and non-scheduled UCBs. While the scheduled banks granted 59.6% of the total loans in the larger loan ranges of ₹ 1-5 crore and above ₹ 5 crore, non-scheduled banks catered to the small loan segment upto ₹ 10 lakh in a substantial way as this segment accounted for 59.5% of loans granted .

2.10 Thus it is apparent that financial inclusion by way of credit to a larger number of small borrowers is more visible in the case of non-scheduled banks including unit banks. The study further supported the premise that large MS-UCBs have aligned their business models and goals with those of commercial banks while availing the concessions granted to the sector.

A comparison with Small Finance Banks (SFBs):

2.11 RBI issued guidelines for licensing of Small Finance Banks (SFBs) in the private sector on November 27, 2014 with the objective of furthering financial inclusion by (i) provision of savings vehicles primarily to unserved and underserved sections of the population, and (ii) supply of credit to small business units; small and marginal farmers; micro and small industries; and other entities in the unorganised sector, through high technology-low cost operations.

2.12 A minimum paid-up-capital of ₹ 100 crore has been prescribed for SFB with a minimum regulatory CRAR of 15%. Further, 75% of their assessed net bank credit (ANBC) will go towards priority sector lending and 50% of the loan portfolio will constitute loans upto ₹ 25.00 lakh. The single and group borrower exposure limit has been fixed at 10% and 15% of their capital funds respectively. These regulatory prescriptions are more stringent than that for UCBs. The minimum entry capital for setting up a uni-state UCB in a metropolitan city has been fixed at ₹ 5.00 crore, the minimum regulatory CRAR at 9%, priority sector lending constitutes 40% of ANBC and single and group borrower exposure limits have been fixed at 15% and 40% of capital funds respectively without any monetary ceiling.

List of activities permitted to UCBs:

2.13 A comparison of regulatory parameters prescribed for UCBs and SFBs as against the list of activities permitted to them shows an interesting result. SFBs despite having more stringent capital requirements of ₹ 100 crore networth and CRAR of 15%, are not permitted to undertake a host of activities which the UCBs are currently allowed with lesser capital requirements starting from ₹ 25.00 lakh.

2.14 Scheduled UCBs are eligible to undertake foreign exchange businesses as Authorised Dealers, category I. There is no requirement for UCBs to open 25% of their branches in unbanked rural centres. UCBs are permitted to open specialised branches, undertake intra-day short selling in Government securities, have access to LAF, membership to NDS-OM, open currency chest, provide mobile and internet banking and issue credit cards, among others.

2.15 The Committee examined the activities that commercial banks were permitted but not UCBs. It was observed that due to the limited capacity to raise capital, lack of corporate governance, lack of a level playing field in regulation and supervision at par with commercial banks, all products/lines of businesses were not permitted to UCBs which the commercial banks undertake.

Appropriate size upto which UCB may be allowed to grow:

2.16 The deliberations on the size up to which UCBs may be allowed to grow revolved around two criteria --Capital Funds and Business Size (Deposits + Advances).

2.17 Capital Funds: It was envisaged that those UCBs with capital funds above ₹ 500 crore may be converted into scheduled commercial banks. UCBs with capital funds in the range of ₹ 100 crore to ₹ 500 crore may be granted facilities akin to Small Finance Banks in the private sector. However, as discussed earlier, at present UCBs are permitted to undertake a host of activities which SFBs are not allowed to, with more stringent regulatory prescriptions. The issue of mandatory versus voluntary conversion was also deliberated upon in detail.

2.18 Business Size: After detailed deliberation, it was decided to recommend that a threshold/benchmark of a ₹ 20,000 crore business size can be considered for voluntary conversion of multi-state UCBs into scheduled commercial banks to ensure uniform regulation. This business size is appropriate as the biggest UCB should not end up being the smallest commercial bank. Further, a proper transition period should be provided to UCBs for conversion into commercial banks. UCBs not willing to convert to SCBs may be permitted to offer the services/products that they are currently offering to their clientele.

Recommendations of the Committee

2.19 Ideally, the Reserve Bank would like the UCBs to grow in the co-operative movement space. However, due to lack of a level playing field in regulation and supervision of UCBs and the absence of full powers to RBI at par with the powers of commercial banks, the Committee, after due deliberations, recommends the following courses of action:

- A business size of ₹ 20,000 crore or more may be the threshold limit beyond which a UCB may be expected to convert to a commercial bank. This may necessitate some transition arrangements also. The conversion need not be *de jure* compulsory and large UCBs can continue the way they operate currently in terms of balance sheet/asset size. However, they would not be permitted to extend all the business/activities/services/products currently offered by commercial banks, unless they convert to commercial banks.
- Such UCBs, if they so desire, may continue within the co-operative sector even beyond the threshold limits mentioned earlier subject to the conditions that regulatory guidelines may require that the type of business may have to remain within the limits of plain vanilla products and services and expect to grow at a much slower pace. Their expansion in terms of branches, areas of operations and business lines may be carefully calibrated to restrict unrestrained growth.

During conversion, a transition period should be provided to UCBs to iron out any difficulties in the process.

Chapter 3

Conversion of UCB into joint stock bank

3.1 As discussed in the last chapter, large Multi-State Urban Co-operative Banks (MS-UCBs) having a presence in more than one state, dealing in forex and participating in the money market and payment systems could be systemically important. Their failure may have a contagion effect and unsettle the UCB sector. The systemic risk could be minimised if the large UCBs convert themselves into commercial banks as the statutory framework and prudential regulations with respect to commercial banks are more stringent and structured than those for UCBs.

3.2 The weak corporate governance of UCBs has been a major factor that is plaguing the sector and has led to the liquidation of many UCBs. Co-operation being a state subject, RBI does not have adequate control on the management of UCBs. The provisions on management included in Section 10 A of the BR Act, 1949 are not applicable to UCBs. The criteria for CEOs/board members as envisaged in Section 10B of the Act are not prescribed for UCBs. The 97th Constitutional Amendment has tried to infuse some professionalism in the boards of UCBs, but professional management on the lines of commercial banks remains a far cry in the current setup. Hence, their conversion to commercial banks will provide a way for better corporate governance in banking institutions in India.

3.3 At present, no powers are available with RBI for constituting boards of UCBs, removal of directors, supersession of BoDs, auditing of UCBs and winding up and liquidation of UCBs. However, such powers for commercial banks are vested with it. There are certain sections of the BR Act 1949 such as provisions of Section 10A (professional BoD), 10B (removal of whole time chairman), 30 (Audit), 44 (winding-up of banks), 44A (amalgamation of banking companies) and 45(suspension of business) which are not replicated in Section 56 of the BR Act, 1949, which sets out the BR Act as applicable to co-operative societies. Further, there are impinging powers in various state co-operative societies Acts with regard to banking activities in the areas of capital, reserve fund, recovery of NPAs, write-offs, OTS and for initiating action against the management of UCBs. These provisions together with

the absence of a sound resolution regime constrict the RBI's abilities to regulate and supervise UCBs.

3.4 The Committee appreciated that UCBs have high aspirations to compete with commercial banks and that they expect RBI to provide relaxations in various regulatory restrictions. However, weak resolution regimes with respect to UCBs and inadequate powers with RBI to regulate and supervise UCBs at par with commercial banks act as a hindrance in providing such relaxations. It is, therefore, necessary to ensure that UCBs balance their growth aspirations commensurate with the risks that they undertake. Hence, beyond a point of growth, conversion of UCBs into a joint stock banks could be a solution. Further, UCBs may need a transition period for conversion to commercial banks. In this background, the Committee deliberated whether the large sized MS-UCBs beyond a particular threshold should be converted to universal banks and whether the other UCBs fulfilling the eligibility criteria of SFBs should be converted to SFBs.

Reasons for allowing conversion of UCB into joint stock bank:

3.5 Though UCBs were set-up as small banks offering banking services to people of small means belonging to lower and middle classes, the Committee notes that there is an immediate need to chart a future path for the UCBs including a well laid out transition path to convert themselves into universal/niche commercial banks. This transition is required due to the changing financial landscape in the country and also for giving an opportunity to well-run UCBs to play a major role going forward.

3.6 The Committee deliberated on the following reasons to provide a transition avenue to UCBs and considered the desirability of converting UCBs into joint stock banks:

- i) **Aspirations of large UCBs:** A UCB being a self-help and mutual benefit organisation, in-depth knowledge about its members and business is the cornerstone of the edifice. UCBs are large in numbers, but have a very small market share (about 3%). There were severe restrictions on the expansion of their area of operations. However, with the liberalisation of

the banking policy over the years, some UCBs have grown in size and their area of operations has also expanded. Some of the UCBs aspire to conduct business like private sector commercial banks and their level of operations are well comparable to them although UCBs are not subject to a similar regulatory and supervisory framework. Such UCBs have also spread their wings to a large number of states. In fact there are 51 Multi state UCBs (including Salary Earners Bank) as on date. With such phenomenal growth, the aspirations of UCBs have also grown and some of them have already expressed a desire to convert to commercial banks.

- ii) **Conflict of interest:** A licence to carry on the banking business under the provisions of the BR Act provides UCBs unlimited access to public deposits for the benefit of their members. With limited liabilities of members (shareholders) restricted to membership shares, the owners become the users of resources, predominantly contributed by non-members (members of the public), leading to a conflict of interest that needs to be moderated through regulation and supervision.

- iii) **Decline in co-operativeness:** As UCBs become larger and spread into more states, the familiarity and bonding amongst their members diminishes and commercial interests of the members overshadow the collective welfare objective of the banks. In this connection, a study was conducted by RBI on co-operativeness of co-operative banks which found that the co-operative character of the banks is on a decline as evident from low attendance in AGMs, restrictive practices in admitting new members, low voting turnouts for elections to new managements, re-election of the same management or their family members, unanimous elections and lack of meaningful discussions in AGMs. Thus the UCBs are losing their co-operative character. In the process, some of them have also become 'too big to be co-operatives'. Collective ownership, open voluntary membership and democratic management no longer suit their size and competition and complexities in the business force them to explore alternate forms of ownership and governance structures to grow further. Corporatisation could be the best alternative for large sized MS-UCBs.

- iv) **Regulatory Arbitrage:** A regulatory approach for UCBs has been tailored recognising the role that they have played in providing financial services to the less privileged. Thus, UCBs are currently regulated under the less stringent Basel I norms as opposed to Basel II and III norms applicable to commercial banks. Regulatory arbitrage may create incentives for large MS-UCBs to have greater leverage. At the same time, applying these stringent norms may render many of the small UCBs short of capital and with limited avenues to raise capital, they may become unsustainable. Equally, if they are working in the co-operative fold and remain within a reasonable size, such stringent norms may not be necessary either.

- v) **Limited Resolution Powers of RBI:** It may be recalled that failure of the Madhavpura Mercantile Co-operative Bank Ltd. (MMCB) in 2001, caused severe damage to the sector. Nevertheless, the bank had to be kept alive for a decade before cancellation of its licence on June 4, 2012, as Reserve Bank does not have full powers for resolution of issues that deal with UCBs. It has no powers for moratorium, amalgamation, supersession and liquidation and in the absence of resolution powers at par with commercial banks, RBI faces constraints when these banks grow.

- vi) **Capital Structure:** The capital of UCBs (including MS-UCBs) consists of membership shares and statutory and other reserves (profits ploughed back in the business). The membership shares do not have all the attributes of equity and more importantly 'permanency/perpetuity'. The shares can be redeemed. Further, the resource raising abilities of UCBs are limited. There are ambiguities on treatment of shares of co-operative banks as Common Equity-Tier I as per the Basel III requirements. Thus, the availability of capital to cover the losses on a going concern basis is doubtful. Therefore, conversion of large MS-UCBs into joint stock companies could be a way out.

- vii) **Opportunities for growth:** Some of the MS-UCBs are very large vis-a-vis their peers and are comparable to some of the old private sector banks in

terms of size and spread. However, being in the co-operative sector, they are not permitted to undertake certain kinds of businesses (investments in the shares of companies, government business) and regulations are tighter in some cases (unsecured loans). There is no level playing field between UCBs and commercial banks. Though this could be justified in view of softer regulation for UCBs and the constrained legislative framework, large MS-UCBs, which are willing to accept regulations on par with commercial banks, conversion could be an option for carrying on full-scale banking.

Alternative Models to corporatization:

3.7 The Committee also deliberated on an alternative model wherein the necessary conversion of UCBs to commercial banks may not be required and thus the co-operative character of the UCBs could be preserved. The model envisaged splitting of a UCB once it reached a certain threshold. The splinters thus formed will be under the overall control of the NBFC (parent body) that will have cross ownership with the splinter banks created in due process. It was proposed that the existing top ten UCBs may initially be considered for restructuring. The proposed NBFC will be a public limited company and will have an initial share capital of 25% of free reserves of existing bank taken as contributions from the newly registered UCBs in the cluster. All the existing branches of a large multi-state UCB will be grouped into 4-10 groups based on a number of considerations which may be specific to an individual bank. Each group comprising of a number of branches of the original bank will form one UCB. Every bank will have a common brand as part of its name (example- a cluster of banks formed from 'xyz' bank can have names Diamond xyz, Emerald xyz etc.). The corresponding parent NBFC will also be known by the same brand name.

3.8 The model was discussed in detail and it was observed that the conversion of a UCB into splinters and the subsequent formation of a group would not be a voluntary action and for such transmission, regulatory prescriptions are required to be specified. It was deliberated that this alternative model may not be the best step forward due to a number of issues in implementation such as round tripping of

capital between NBFC and UCBs, corporate governance issues, voting rights and lack of a legal framework.

Corporatization of Co-operatives- Alagh Committee:

3.9 The Committee also examined whether the Alagh Committee's report on the corporatisation of producers co-operatives can be used for corporatisation of UCBs as this will ensure that their co-operative character remains. The Committee noted that Alagh Committee was set up to draft a legislative framework to enable formation of producer co-operatives into companies in 1999 and it submitted its report in 2000 to the Government. As a result of the recommendations of the Committee, the Companies Amendment Act, 2002 was passed which introduced Part IX A to the Companies Act, 1956 relating to producer companies. This amendment enabled the incorporation of co-operatives as producer companies and conversion of the existing co-operatives into companies. Ten or more producer individuals or producer institutions desirous of forming a company with objectives specified in Section 581B of the Act may form a producer company.

3.10 Under the Act, in case the membership of a producer company consists of only individual members, the voting rights shall be based on a single vote for every member. Further, conversion of inter-state co-operatives to producer companies is purely voluntary. Member's equity may not be publicly traded but transferred as per a resolution of the BoD of the producer company. Conversion option by an inter-state co-operative society to a producers company can be exercised only if two-third of the members of the concerned society votes in favour of the resolution. It was also stated that the objectives of the producers company as mentioned in Section 581B of the Companies Act, 1956 were financing of procurement, processing, marketing and extending credit facilities for the activities mentioned in the section and did not specifically include 'banking' as defined by Section 5(ccv) of the Banking Regulation Act, 1949 (AACS).

3.11 In view of this, the Committee concluded that these provisions did not provide the basis for conversion of a UCB into a joint stock bank. Moreover, Companies Act, 1956 was repealed and the provisions of Section 366 of the Companies Act, 2013 have already come into force in terms of which the definition of a company includes, among others, a co-operative society. As such the issue of conversion of a co-operative society into a joint stock bank has been addressed.

Legal Amendments Required:

3.12 The Committee considered whether the current legislative framework was adequate to facilitate conversion of UCBs to commercial banks. The Committee observed that Development Co-operative Bank which was registered as a co-operative bank was converted to a commercial bank and rechristened Development Credit Bank Ltd. in 1995. The conversion was carved out under the provisions of Part IX of the Companies Act, 1956 and MSCS Act, 1984 (since replaced by the MSCS Act, 2002). Part IX of the Companies Act, 1956 mentions companies which can be registered under the Act and the procedure for their registration. The conversion of the Development Co-operative Bank was challenged in the Bombay High Court. However the court upheld the conversion. The court *inter alia* opined that for registration under Part IX, the word 'company' in Section 566 may include within its purview a co-operative society registered under the Multi-State Societies Act.

3.13 It is, however, observed that the decision of the Bombay High Court cannot be a binding precedent, as the court has not gone into the legality of conversion. The MSCS Act, 2002, does not empower the Central Government to exempt any MS-UCB from any provisions of the Act, the route under which the conversion of the Development Co-operative Bank had been permitted by the Central Registrar of Co-operative Societies. Further, the court had not considered it to be a fit case for interference since the certificate of incorporation issued by the Registrar of Companies is conclusive proof of incorporation of a company, and it can be removed only through liquidation; also no public interest was involved, as the bank had made remarkable progress post-conversion.

3.14 In view of this, RBI had already suggested to the Government of India that Part IX of the Companies Act, 1956 may be amended to specifically permit a Multi-State Co-operative Bank to register as a company. Section 366 of the Companies Act, 2013 takes care of this requirement.

3.15 As a corollary to the amendment proposed earlier, the Committee observed that Section 17 and Sub-section (1) of Section 121 of the Multi-State Co-operative Societies Act, 2002 also needs to be amended on the following lines:

Section 17 may be amended as under:

“Introduction of New Subsection (11) to Section 17 as per MSCS (Amendment) Bill, 2010 wherein the Central Government may, for reasons to be recorded in writing, notwithstanding anything contained in this Act, issue fresh directions on matters relating to winding up or conversion into a legal entity, as it deems fit.”

Sub-section (1) of Section 121 may be inserted as under:

“Provided that nothing contained in this Sub-section shall be deemed to affect the rights of a Co-operative Society registered or deemed to have been registered under this Act to apply for conversion to a company registered under the Companies Act, 1956 subject to the conditions laid down in or under this Act or in or under that Act”

3.16 Incidentally, the Multi-State Co-operative Societies (Amendment) Bill, 2010 introduced in Lok Sabha on November 15, 2010 has not yet been passed by Parliament. It has been proposed in the Bill that Sections 17 and 121 of the Act be amended to provide for conversion of a multi-State co-operative society into any other legal entity and for transfer of assets and liabilities in whole or in part to such legal entity with the approval of the Central Registrar. RBI has already taken up the matter with the Government of India and amendments to Sections 17 and 121 of the MSCS Act, 2002 as proposed in the MSCS (Amendment) Bill, 2010, when passed, may provide adequate legal basis for conversion of MS-UCBs to commercial banks.

3.17 As conversion of UCBs into commercial banks requires requisite amendments in the provisions of the Co-operative Societies Acts of all states which is a long drawn out process, the Committee recommends that only UCBs which are registered under the Multi-state Co-operative Societies Act, 2002 may be considered for conversion to commercial banks.

3.18 The Committee also deliberated on the eligibility conditions such as entry point capital requirements for conversion of UCBs into joint stock banks at ₹ 500 crore, CRAR of 12% or more, gross and net NPAs at less than 7% and not more than 3% respectively, compliance with CBS implementation, regulatory compliance with CRR/SLR, KYC/AML standards and FEMA regulation and agreed that UCBs should fulfil the criteria of FSWM in addition to these criteria to be eligible for conversion. RBI may prescribe suitable guidelines in this regard.

Conversion of Large MS-UCBs into commercial banks:

3.19 The expert committee on UCB under the chairmanship of Shri Y H Malegam had proposed an entry point capital of ₹ 5 crore for UCBs in metropolitan area whereas entry point capital requirements for opening a small and payment bank has been proposed at ₹ 100 crore and that of a commercial banks at ₹ 500 crore. Further, as per extant guidelines, the promoters of small finance banks and payment banks are required to set up non-operative holding companies (NOHC) for holding the shares of the banks. However, this may not be required in case of multi-state UCBs as they are licensed banks and can be directly converted into commercial banks after registration as companies after proposed amendments in the MSCS Act, 2002.

3.20 The Committee considered whether at some stage there should be a regulatory mandate for conversions of UCBs into commercial banks. The Committee also noted that it may be in the best interests of a large UCB to convert itself into a commercial bank as this will help increase shareholder wealth and at the same time customers will benefit by the UCB's ability to offer newer products. However, if a UCB wants to remain within the sector, it need not be forced to become a commercial bank though given the limitations of the legislative and regulatory framework, there could be concerns about allowing unrestrained growth within the co-operative framework. Taking these aspects into consideration, the Committee is of the view that conversion of UCBs to commercial banks should not be mandatory but should be a voluntary exercise. This will prevent an exodus of strong banking entities from the co-operative sector which want their co-operative character to continue. Thus as

discussed in Chapter 2, large MS-UCBs with business size of over ₹ 20,000 crore may be provided a window to convert to commercial bank voluntarily. This may necessitate some transition arrangements also.

3.21 The Committee, however, feels that while the conversion need not be *de jure* compulsory and large UCBs can continue the way in which they operate currently in terms of their balance sheet/asset size, the enabling conditions for conversion should be more lucrative, giving enough of a nudge for the UCBs to move in that direction. In the same vein, UCBs desiring to continue within the co-operative sector, even beyond the threshold limits mentioned earlier, may be subjected to regulatory guidelines that may require the type of businesses they conduct to remain within the limits of plain vanilla products and services. Their expansion in terms of branches, area of operations and business lines may be carefully calibrated to restrict their unrestrained growth.

Conversion of other UCBs into Small Finance Banks:

3.22 The Committee considered whether the UCBs that do not meet the minimum requirements stipulated in para 3.20, should be completely shut off from converting into joint stock banks. Existing Non-Banking Finance Companies (NBFCs), Micro Finance Institutions (MFIs), and Local Area Banks (LABs) that are owned and controlled by residents can opt for conversion to small finance banks. The minimum paid-up equity capital for small finance banks is ₹ 100 crore. The Committee concluded that UCBs which are still not large enough but aspire to roll out all the products which are currently permissible for commercial banks may be allowed to convert to SFBs in order to get a pan-India presence.

3.23 UCBs voluntarily willing to convert to Small Finance Banks can do so irrespective of the threshold limit provided they fulfil all the eligibility criteria and the selection process prescribed by RBI and further provided that the new licensing window is open.

Chapter 4

Recommendations of the Malegam Committee- Modalities of Implementation

4.1 The decision of the Reserve Bank to set up a Committee comprising of all stakeholders for studying the advisability of granting licenses under Section 22 of the Banking Regulation Act, 1949 (AACS) to new UCBs was announced in the Annual Policy Statement for 2010-11. Further, as per the announcement made in the Second Quarter Review of Monetary Policy 2010-11, the scope of the Committee was extended to look into the feasibility of an umbrella organisation for the UCB sector. The Committee was constituted in December 2010 under the chairmanship of Shri Y. H. Malegam (Director – Central Board of RBI) with representatives from all stake holders such as NAFCUB, RCS, UCBs, academia etc. The terms of reference of the Committee were:

- (i) To review the role and performance of UCBs over the last decade especially since the adoption of the vision document in 2005;
- (ii) To review the need for organising new UCBs in the context of the existing legal framework for UCBs, the thrust on financial inclusion in the economic policy and proposed entry of new commercial banks into the banking space;
- (iii) To review the extant regulatory policy on setting up of new UCBs and lay down entry point norms for new UCBs;
- (iv) To examine whether licensing could be restricted only to financially sound and well managed co-operative credit societies through the conversion route;
- (v) To make recommendations relating to the legal and regulatory structure to facilitate the growth of sound UCBs especially in the matter of raising capital consistent with co-operative principles;
- (vi) To examine the feasibility of an umbrella organisation for the urban co-operative banking sector; and
- (vii) To examine other issues incidental to licensing of UCBs and make appropriate recommendations.

4.2 The Malegam Committee submitted its report on August 18, 2011 which was put up on RBI's website on September 7, 2011 for soliciting public comments /

suggestions till October 31, 2011. The major recommendations of the Malegam Committee were:

(i) Need to set up new UCBs: Considering the useful role played by UCBs in catering to the needs of persons with small means, new UCBs may be set up in those regions where their representation is inadequate, provided their governance is strengthened and they are adequately supervised.

(ii) Minimum Entry point capital prescription: The Malegam Committee recommended lower entry point share capital for opening new banks in states and districts which were unbanked or inadequately banked and in centres which had a population of less than 5 lakh and higher minimum capital requirements for UCBs to operate in other centres. The newly organised UCBs may become multistate after five years of successful operations. The minimum capital requirements ranged between ₹ 50 lakhs in the North Eastern States / unbanked districts to ₹ 500 lakhs for UCBs wishing to operate in more than one state after five years of successful operations. The recommendations of the Malegam Committee were accepted subject to a minimum networth of ₹ 50 crore to be achieved before becoming multi-state UCB. However, the minimum networth of ₹ 50 crore will not be insisted upon if a multi-state status is achieved via a merger route.

(iii) Area of operations of the new UCBs: The Malegam Committee recommended that the new UCBs can operate in unbanked districts or at centres having population below 5 lakh. It was decided to recommend to permit UCBs to be set up as unit banks only with the area of operations confined to a single district and permitted to expand gradually as per extant guidelines. UCBs set up in the north eastern region can operate in a few adjoining districts but within one state only.

(iv) Conversion of co-operative credit societies into UCBs: With regard to conversion of co-operative credit societies into UCBs, the Malegam Committee recommended that well managed co-operative credit societies meeting certain financial criteria like profits, capital adequacy, NPA proportion should get priority in granting licenses. Existing multi-state credit societies after becoming UCBs can

operate in more than one state. The minimum capital required for existing credit societies will be as per the norms stipulated or as per the RBI's per branch head room capital prescription, whichever is higher. The recommendation was accepted provided the existing co-operative credit societies satisfied the criterion before their application for license was considered.

(v) Organizational Structure of the proposed new UCBs: The Malegam Committee recommended that in the proposed organisational structure of the new UCBs, there will be a distinction between the ownership of the UCB as a co-operative society and its functioning as a bank. The proposed UCB will have a Board of Management (BoM) in addition to a Board of Directors (BoD). The BoD will be elected in accordance with the provisions of the respective Co-operative Societies Acts and will be regulated and controlled by RCS / CRCS. BoD will establish a Board of Management (BoM), consisting of persons with professional skills. The relationship between BoD and BoM will be similar to the relationship between the supervisory board and the executive board. BoD will be responsible for laying down the broad contours of strategy. BoM will be vested with the mandate to direct and control the day-to-day operations of the UCB within the limits set by the BoD. The Reserve Bank will have unfettered powers to control and regulate the functioning of the UCBs and of their BoMs and of the Chief Executive Officer (CEOs) in exactly the same way as it controls and regulates the functioning of the BoDs and the Chief Executives in the case of commercial banks. As these powers cannot be derived from existing statutes, these should be made a condition of the license, which will have legal enforceability. It was decided to endorse the recommendations of the Malegam Committee for having two boards for the new UCBs.

(vi) Constitution of Board of Management (BoM): The Malegam Committee recommended that at least 51 per cent of the members of the BoM should be persons who have special knowledge or practical experience in one or more of the matters specified in Sub-section 2 of Section 10A of the Banking Regulation Act, 1949. BoD members can be members of BoM provided they fulfil specified conditions. Members of the BoM can be paid such sitting fees as the BoD may decide subject to a ceiling to be specified by RBI. The CEO shall be responsible for the management of the whole or substantially the whole of the affairs of the UCB but

shall be subject to the control and direction of the BoM. The appointment of the CEO shall be subject to the prior approval of RBI. The maximum number of members in the BoM (say 12) should be prescribed by RBI. It was decided to endorse the recommendations of the Malegam Committee with respect to the composition of BoM. The provision relating to payment of sitting fees and maximum number of BoM can be provided in the bye-laws of the UCBs.

(vii) Conditions on which licenses will be granted to proposed new UCBs:

The Malegam Committee recommended that the RBI should have the powers to:

- Remove from office any member of the BoM or the CEO, supersede the BoM for a period not exceeding five years and appoint an Administrator in its place
- Direct the BoM to make such changes in the Management as considered necessary.
- Direct the BoM to introduce such aspects of technology as considered necessary.
- Audit of UCB to be carried out by a Chartered Accountant to be appointed by the BoM from out of a panel of approved auditors maintained by RBI subject to rotation after four years.
- The BoM to follow a code of corporate governance to be specified by RBI. Non-fulfilment of these conditions should be sufficient reason for cancellation of the license. RBI should retain the power to relax some of these conditions as and when it considers appropriate with regard to the size of the UCB, the cost of compliance or for other valid reasons.

It was decided to endorse the recommendations with respect to the proposed licensing conditions.

(viii) Application of new norms (constitution of BoM in addition to BoD, etc.) on existing UCBs: Similar conditions should be voluntarily accepted by the larger existing UCBs. Compliance with these conditions should be made a pre-requisite before granting licenses to existing UCBs for opening new branches. It was decided

to recommend to apply the proposed norms relating to constitution of BoM and appointment of CEO to existing UCBs with a grace period of five years. Restrictions will be imposed on all the expansion facilities on UCBs which do not adopt the new standards.

(ix) Umbrella Organizations: The Malegam Committee recommended the setting up of two separate Umbrella Organizations: a national level organisation which provides payments and settlement services and other services normally provided by central banks as also liquidity support to its members; and one or more organisations at the state level which provide management, IT, training and other services which the UCB sector needs. It was agreed that State Federations will be entrusted with the responsibility of providing services proposed to be delivered by the State Level Umbrella Organizations. The NAFCUB may provide support/ guidance / expertise where regional federations are weak / nonexistent. With regard to the national level umbrella organisation, it was decided to recommend to examine the structure of the proposed organisation in more detail by conducting a detailed study of the umbrella organisations operating in European countries so that a structure suitable to the requirements of UCBs in India could be created to discharge the functions as envisaged by the Malegam Committee.

(x) Grant of controlling powers to the depositors of the UCBs: The Malegam Committee suggested that at least 50% (in value) of deposits should be held by voting members so as to ensure that they have controlling powers.

4.3 Specific task of the HPC:

The specific task of this HPC is limited to two issues:

(i) Whether the time is opportune to give license to new UCBs as per the recommendations of the Expert Committee on Licensing of New UCBs, (Malegam Committee) and if so the modalities of taking forward the recommendations of the Malegam Committee; and

(ii) Determining the modalities of implementing the suggestion of the Malegam Committee that 50 per cent (in value) of deposits should be held by voting members to assure that confidence regarding proper management is generated among investors. Alternatively, proposing a feasible structure that puts majority voting in the hands of contributors of funds.

Deliberations of HPC on the Malegam Committee:

4.4 The HPC observed that though UCBs have been at the forefront of financial inclusion, even after liberalisation of branch licensing of UCBs in 2008 there are still 281 districts which do not have a UCB branch. The Committee also observed that UCBs were concentrated in Maharashtra, Karnataka, Gujarat, Tamil Nadu, Andhra Pradesh and Telangana and they were not present in the eastern region (83 districts), central region (73 districts), northern region (64 districts) and the north-eastern region (49 districts). In this context the Committee noted that while no new licences have been issued for more than ten years now, there were 51 UCBs with negative networth as on March 31, 2015 partly due to relaxed regulatory prescriptions and standards applied during the last round of licensing of new UCBs. Thus it needs to be examined whether the existing UCBs should be incentivised to open branches in unbanked areas or new UCBs should be set up in unbanked or under-banked areas as recommended by the Malegam Committee. If existing UCBs need to be incentivised, what should be the mode/manner of these incentives.

4.5 During the last decade, RBI has also put in place regulatory and supervisory initiatives for UCBs and has been pursuing the consolidation of the sector through mergers and non-disruptive exits of weak UCBs. Consequent on merger guidelines, about 119 mergers have been effected so far.

Setting up of new UCBs or conversion of existing societies into UCBs:

4.6 The Committee deliberated on the criteria to issue licenses and felt that new licenses should be issued to entities with sound capital adequacy, good quality staff to manage UCBs with BoDs/BoMs as envisaged in the Malegam Committee report, satisfying of Entry Point Norms and headroom capital requirements. The

recommendation of the Malegam Committee to give priority for licensing to existing sound co-operative credit societies was also considered.

4.7 The Committee feels that formation of new UCBs from scratch will be difficult as the UCB may incur losses in initial years and finding suitable promoters will be a herculean task. The Committee concurred with the view that large well- managed co-operative credit societies having a proven track record of say 5 years should be encouraged to convert to UCBs. The existing co-operative credit societies will have assessable track records and will be an indicator of the co-operative movement having already taken roots in a place. If a co-operative society is formed only with a view to obtaining a bank license, it will be difficult to ascertain the credentials of the promoters, more particularly where the co-operative movement has not been strong enough.

4.8 A view was expressed that since co-operative credit societies are not regulated they have wide branch networks. While they may have adequate capital to meet the regulatory risk weighted capital, because of their current branch networks, they may not be able to meet the headroom capital that is linked to the number of branches. A suggestion was made that either the headroom capital be waived or the society may be allowed to fold into the bank as many branches as the capital allows and keep the remaining branches within the society. This meant that the bank and the society would exist in parallel. The Committee deliberated on this but noted that such an arrangement would clearly lead to regulatory arbitrage, which cannot be allowed.

4.9 The Committee unanimously concluded that licenses may be issued to financially sound and well-managed co-operative credit societies having a minimum track record of 5 years which satisfy the regulatory prescriptions set by RBI as licensing conditions. It also opined that providing banking access in unbanked areas should be done by incentivising existing banks and left it to the RBI to decide on the mode thereof.

Board of Management in addition to Board of Director:

4.10 Weak corporate governance has been one of the major factors plaguing the sector and has led to bank failures / unsatisfactory growth of the sector. Co-operation being a state subject, RBI does not have adequate control on the management of these banks. The provisions of Section 10A of the BR Act, 1949 are not applicable to them. The criteria for CEO/Board members as envisaged in Section 10B of the Act are also not prescribed.

4.11 To address this problem, the Malegam Committee suggested a new organizational structure for UCBs consisting of a Board of Management, in addition to the Board of Directors. The idea was segregation of the ownership of a UCB as a co-operative society from its functioning as a bank. While the Registrar of Co-operative Societies will continue to exercise control and regulation of a UCB as a co-operative society, RBI will exercise control and regulation on its function as a bank. The Malegam Committee recommended it as one of the licensing conditions, with existing UCBs to constitute a BoM in addition to a BoD within a period of 5 years.

4.12 Pursuant to the recommendations of the HPC on Urban Co-operative Banks constituted by the RBI in 2001, presence of at least two professional directors on the board of UCBs was made mandatory. It was also made one of the enabling conditions for UCBs to be termed as Financially Sound and Well Managed (FSWM). However, it is observed that a large number of UCBs still do not have professional directors on their Board which has a negative bearing on their overall performance. The Constitution (97th Amendment) Act 2011 has tried to impart some professionalism in the boards of co-operative banks but professional management on the lines of commercial banks remains a far cry in the current set-up. Thus, the HPC believes that the concept of BoM put forward by the Malegam Committee has to be one of the licensing conditions for giving licenses to new UCBs. Similarly, constitution of the BoM should be a precondition for branch expansion and extending the area of operations of existing UCBs.

Entry Point Norms:

4.13 The Malegam Committee recommended Entry Point Norms (EPN) in terms of networth ranging from ₹ 50 lakh for UCBs operating in only one state to ₹ 500 lakh for UCBs which wish to operate in more than one state after five years of successful operations. As a period of 4 years has already elapsed since the recommendations, EPNs as recommended by the Malegam Committee needs a review. The Committee notes that apart from adjustment for inflation during the period, regulatory developments like capital requirements of a minimum of ₹ 100 crore for SFBs and payment banks had to be kept in mind in determining EPNs. SFBs will offer niche products with their area of operations extending to the whole of India. However, the UCBs are more of universal banks operating in designated areas of operations. Further, new generation UCBs should be CBS enabled from the beginning and this will entail a significant use of capital before the actual start of operations. This will automatically entail a higher networth prescription.

4.14 After detailed discussions the Committee concluded that EPNs should be linked to area of operations and not the presence in a district/state. This is all the more necessary because the issue of new licenses is proposed to be confined to existing co-operative societies. The Committee recommends that capital requirements will be based on EPNs, headroom capital per branch and overall regulatory capital. Accordingly it recommends that licenses may be issued to well-managed co-operative societies which satisfy the following capital requirements subject to head room capital requirements:-

- (i) To operate as a Multi-State UCB- ₹ 100 crore
- (ii) To operate beyond two districts and as a State level UCB - ₹ 50 crore
- (iii) To operate as a district level UCB (up to 2 districts) - ₹ 25 crore
- (iv) In case of conversion of co-operative credit societies in unbanked areas and in the North-East, suitable relaxations may be made by RBI.

4.15 The recommendation of Malegam Committee that 50 per cent (in value) of deposits should be held by voting members was deliberated by the Committee. It is

observed that such a step is necessary to assure that confidence regarding proper management is generated among depositors of the UCB, particularly in the absence of the benefit of market discipline. This will also help address the anomalous situation where borrowers, who create the risk, control the bank and the depositors who bear the risk do not. The following alternatives were examined by the Committee:

(i) Every depositor should be made a member: It was felt that in case of making every depositor a member, the threat of being taken over by unscrupulous groups exists. Additionally, due to the small size of their deposits, not every depositor may cast his vote thereby defeating the very purpose of the exercise. Further, the membership may continue despite withdrawal of deposits.

(ii) Top 50 depositors could be enrolled as members: A view was expressed that it may be against co-operative principles where only a select group of depositors was given preference over others.

(iii) Only non-borrowing members can cast their votes in the AGM: Currently borrowers are members of the society. They normally wield undue influence on the management of UCBs and can alter the loan terms for their own benefits. Similarly, if depositors are given control of a UCB, they may influence its board for higher interest rates. Thus, non-borrowing members can be considered a neutral group and the best bet for a UCB. This set of voters will be concerned with the long term interests of the UCB without making undue considerations for either borrowers or depositors alike. But for this to happen bye-laws of the societies need to be amended and such amendments should be in conformity with the provisions of the State Co-operative Societies Acts.

(iv) The Committee also deliberated whether certain seats on the board can be reserved for depositors having deposits above a particular threshold limit. This may seem to be an acceptable solution where a certain number of seats may be reserved for depositors only. This will ensure that depositors' interests are taken care of while at the same time ensuring minimum disruption of current practices.

The Committee, however, felt that any initiative for the involvement of depositors in the management can be successful only if the bye-laws of the UCB concerned are amended and they are found to be in conformity with the provisions of the concerned State Co-operative Societies Act.

4.16 Committee's Recommendation:

(i) New licenses may be issued to financially sound and well-managed co-operative credit societies having a minimum track record of 5 years.

(ii) Constitution of a BoM in addition to a BoD as envisaged by the Malegam Committee to be made one of the licensing conditions and also a condition for expansion of existing UCBs.

(iii) Area of operation and not the presence in a district/state will be the determining criterion. Capital requirements will be based on EPNs, headroom capital per branch and overall regulatory capital as under:

(a) To operate as a Multi State UCB- ₹ 100 crore

(b) To operate beyond two districts and as a state level UCB - ₹ 50 crore.

(c) To operate as district level UCB (upto 2 districts) - ₹ 25 crore

(d) In case of conversion of co-operative credit societies in unbanked areas and in the North-East, suitable relaxations may be made by RBI.

(iv) With regard to providing banking access, RBI may devise an appropriate scheme of incentives for opening branches in unbanked areas by existing banks.

(v) Depositors should have a say on the management of UCBs. For this a majority of the board seats should be reserved for depositors by making suitable provision in the bye-laws.

Chapter 5

Summary Recommendations and Suggestions

The Committee examined the various issues, took the opinion of banks, federations and other stakeholders and makes the following recommendations:

5.1 Business Size and Conversion of MS-UCBs into joint stock banks: The Committee feels that a business size of ₹ 20,000 crore or more may be the threshold limit beyond which a UCB may be expected to convert to a commercial bank. This may necessitate some transition facilities also. The conversion need not be *de jure* compulsory and large UCBs can continue the way they operate currently in terms of balance sheet/asset size. However, it will be subject to the regulatory guidelines requiring that the types of businesses that they undertake remain within the limits of plain vanilla products and services and their growth will be at a much slower pace. Their expansion in terms of branches, area of operations and business lines may thus be carefully calibrated to restrict unrestrained growth.

(paras 2.19, 3.20 and 3.21)

5.2 Conversion of other UCBs into SFBs: As per the Committee smaller UCBs voluntarily willing to convert to SFBs can do so irrespective of the threshold limit provided they fulfil all the eligibility criteria and selection process prescribed by RBI and further provided that the small finance banks licensing window is open .

(paras 3.22 and 3.23)

5.3 Issue of fresh licences: The Committee unanimously recommends that licenses may be issued to financially sound and well-managed co-operative credit societies having a minimum track record of 5 years which satisfy the regulatory

prescriptions set by RBI as licensing conditions. With regard to the concern of providing banking access in unbanked areas, the Committee recommends that RBI may put in place an appropriate set of incentives for existing banks to open branches there.

(para 4.9)

5.4 Board of Management in addition to Board of Directors: The Committee recommends that the concept of BoM put forward by the Malegam Committee has to be one of the mandatory licensing conditions for issuing licenses to new UCBs and in the expansion of existing UCBs.

(para 4.12)

5.5 Entry Point Norms: The Committee also feels that licenses may be issued to well-managed co-operative credit societies which satisfy the following capital requirements:

- (a) To operate as a Multi State UCB- ₹ 100 crore
- (b) To operate beyond two districts and as a state level UCB - ₹ 50 crore
- (c) To operate as district level UCB (upto 2 districts) - ₹ 25 crore
- (d) In case of conversion of co-operative credit societies in unbanked areas and in the North-East, suitable relaxations may be made by RBI.

(para 4.14)

5.6 Depositors as voting members: It was concluded that depositors ought to have a say on the boards of UCBs. For this, a majority of the board's seats be reserved for depositors by making suitable provisions in the bye-laws.

(para 4.15)

5.7 Suggestions:

The Committee, during deliberations on the specific terms of reference also had occasion to discuss some issues that have relevance to the sector but did not pursue them in detail both because they were not specifically relevant to the aspects that the Committee was looking into and also because that would have delayed the conclusion of the report. The Committee therefore has not dealt with these in this report but feels it necessary to highlight them so that they can be taken forward in an appropriate manner and time as determined by the Bank. These are:

- (i) At present, no powers are available with RBI for constituting boards of UCBs, removal of directors, supersession of BoD, auditing of UCBs and winding up and liquidation of UCBs. However, such powers for commercial banks are vested with RBI. There are certain sections in the BR, Act 1949 such as provisions of Section 10A (professional BoD), 10B (removal of a whole time chairman), 30 (Audit), 44 (winding-up of banks), 44A (amalgamation of banking companies) and 45(suspension of business) which were not replicated while amending Section 56 of the BR Act, 1949. These amendments can be incorporated in Section 56 of the Act *ibid* for effective regulation and supervision of UCBs. In addition to these, the Committee identified and deliberated in detail on the problems and issues afflicting the sector including restricted ability of UCBs to raise capital resources and to handle risks, lack of RBI's powers for supervision and regulation of UCBs at par with commercial banks, lack of powers for compulsory/voluntary mergers etc. apart from the basic fault lines in the structure of the urban co-operative banking sector. However, in view of the limited terms of reference and the given time frame of the Committee, the long term solution to all the problems could not be covered under the recommendations.

- (ii) **Resolution Mechanism:** The resolution regime for UCBs exists in a rudimentary form in as much as it ensures pay-outs to small depositors by DICGC while large depositors' interests are not taken care of fully in the event of cancellation of the licence of a bank. As belated action accentuates problems of resolution, any prompt corrective action framework should require supervisory action at the initial stages. As time is of essence in any resolution framework, there is a need to review the existing supervisory action, revisiting existing guidelines on mergers, revision in instructions on restructuring negative net-worth UCBs including revisiting instruments for augmenting capital for UCBs. Moving forward, it is necessary to start with the requirement that UCBs need to frame their recovery and resolution plans within the current legal framework when they are operating on sound lines. There is also a need to empower the RBI for implementing resolution techniques without involving other regulators such as RCS and CRCS. There should be a regulatory set up to provide legal backing for RBI to play a central role in the winding up of the banking business of UCBs without the intervention of the authorities under the co-operative societies' laws. The possibility of winding up the banking business of UCBs by RBI directly by appointing DICGC as the liquidator for liquidating the banking business of a UCB may also be explored.
- (iii) **Umbrella Organisation:** The concept of having an "Umbrella Organization" for UCBs in India has been mooted for a long time. In fact the Malegam Committee deliberated on the issue in detail. Some of the members referred to the structure of Rabobank running successfully abroad. The Committee feels that a prerequisite for such successful a umbrella organisation is inherently sound and well-run member institutions. However, the question remains whether the Rabobank kind of model is possible under existing laws in India. Thus, although such a structure has long been envisaged, certain legal hurdles are precluding its implementation.

The Committee recommends that given the importance of the issue RBI may expedite the decision on the structure of the urban co-operative banking system and appropriate Umbrella Organization/s.

Annex-I

Details of the meetings of the High Powered Committee on UCBs

The High Powered Committee on Urban Co-operative Banks (UCBs) held six meetings as per details given below:

Meeting No.	Date of Meeting	Place of Meeting	No. of Committee members, who attended the meeting out of total 9 members
First	March 30, 2015 (Monday)	Mumbai	Eight
Second	April 17, 2015 (Friday)	Mumbai	Seven
Third	May 08, 2015 (Friday)	Mumbai	Nine
Fourth	June 04, 2015 (Thursday)	Mumbai	Eight
Fifth	June 13, 2015 (Saturday)	Mumbai	Eight
Sixth	June 30, 2015 (Tuesday)	Mumbai	Nine

LIST OF ABBREVIATIONS

AACS	As Applicable to Co-operative Societies
AGM	Annual General Meeting
ANBC	Assessed Net Bank Credit
BoD	Board of Directors
BoM	Board of Management
BR Act	Banking Regulation Act, 1949
BR Act, 1949	Banking Regulation Act, 1949 (As Applicable to Co-operative Societies) (AACS)
CAGR	Compounded Annual Growth Rate
CEO	Chief Executive Officer
CRAR	Capital to Risk-Weighted Assets Ratio
CRCS	Central Registrar of Co-operative Societies
CRR	Cash Reserve Ratio
DCBR	Department of Co-operative Bank Regulation
D-SIB	Domestic-Systematically Important Bank
EPN	Entry Point Norm

FSWM	Financially Sound and Well Managed
HPC	High Powered Committee
Gol	Government of India
GSA	Graded Supervisory Action
G-SIB	Global- Systematically Important Bank
IBA	Indian Banks Association
IT	Information Technology
JLA	Joint Legal Advisor
LAB	Local Area Bank
MS-UCBs	Multi-State Urban Co-operative Banks
MSCS Act	Multi-State Co-operative Societies Act, 2002
MFIs	Micro Finance Institutions
MoU	Memorandum of Understanding
NAFCUB	National Federation of Urban Co-operative Banks and Credit Societies
NBFC	Non-Banking Finance Company
NDS-OM	Negotiated Dealing System- Order Matching
NOHC	Non-operative Holding Company

NPAs	Non-Performing Assets
RBI	Reserve Bank of India
RBI Act	Reserve Bank of India Act, 1934
RCS	Registrar of Co-operative Societies
SFBs	Small Finance Banks
SCBs	Scheduled Co-operative Banks
SLR	Statutory Liquidity Ratio
SAF	Supervisory Action Framework
TAFUCB	Task Force for Co-operative Urban Banks
UCBs	Urban Co-operative Banks
UO	Umbrella Organisation
WG	Working Groups