

Urban Cooperative Banks

Why in the News?

The **Reserve Bank of India (RBI)** has placed **New India Co-operative Bank Limited** under a **six-month moratorium**, limiting its ability to give loans, accept deposits, or allow withdrawals.

Details:

- The RBI stated that the action was taken due to concerns regarding the bank's **financial health and liquidity issues**.
- Additionally, the RBI has **dissolved the bank's Board of Directors** for a period of **12 months**, citing **inadequate governance practices** as the reason.

What are Cooperatives?

- **Definition:** A cooperative is a group formed voluntarily by individuals who share common needs and come together to fulfill mutual economic objectives.
- **Purpose:** It aims to empower its members, particularly focusing on uplifting economically weaker sections through principles of self-reliance and mutual support.
- **Resource Utilization:** Members contribute and combine their resources to maximize collective benefits.
- **Cooperative Movement:** The growth of cooperatives worldwide has been significantly influenced by the efforts of the **International Cooperative Alliance (ICA)**.
 - Established in 1895 by **E.V. Neale** and **Edward Owen Greening**, the ICA is a prominent international NGO dedicated to promoting worker cooperatives.
 - **India hosted the ICA's Global Cooperative Conference for the first time in November 2024.**

Cooperatives in India

- **Origin:** The cooperative movement in India began with the enactment of the **Cooperative Credit Societies Act in 1904**.
- **Present Scenario:** India accounts for **27% of the world's cooperatives**, with **20% of the Indian population** engaged in them (compared to the global average of 12%).
- **Major Sectors:** The three dominant cooperative sectors in the country are **Housing, Dairy, and Primary Agricultural Credit Societies (PACS)**.

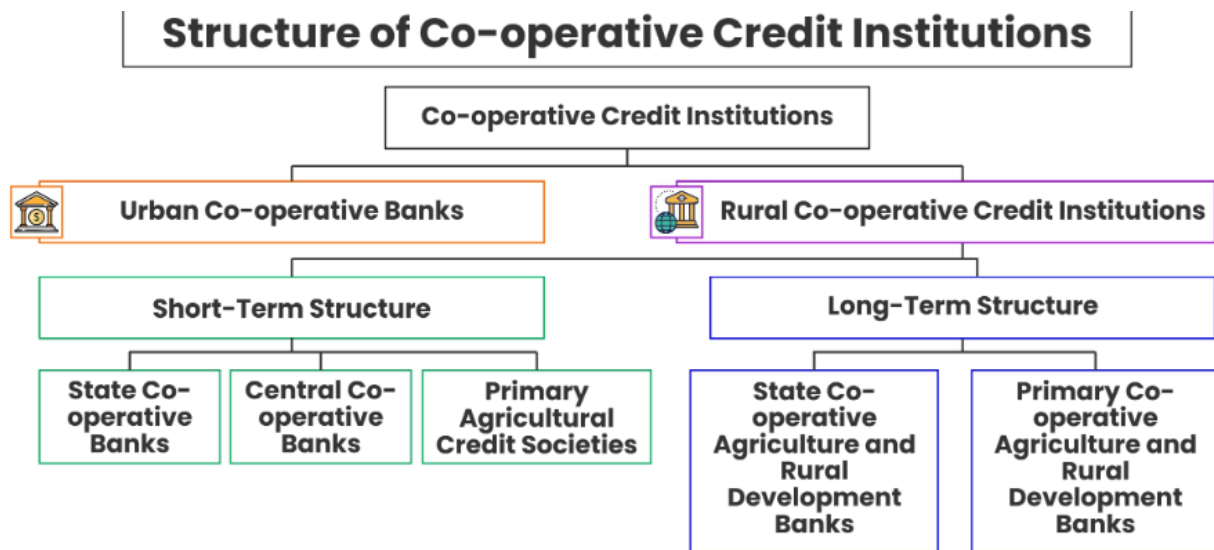
- **Key States:** Around **57% of all Indian cooperatives** are concentrated in **Maharashtra** (which alone has 25%), **Gujarat, Telangana, Madhya Pradesh, and Karnataka.**
- **Constitutional Recognition:**
The **97th Constitutional Amendment (2011)** provided cooperatives with constitutional backing, including:
 - **Fundamental Right:** Inclusion of "cooperative societies" under **Article 19(1)(c)**, recognizing the right to form cooperatives.
 - **Directive Principle:** Addition of **Article 43B**, encouraging the promotion of cooperative organizations.
 - **New Part IXB:** Incorporation of **Articles 243ZH to 243ZT**, laying out the framework for cooperative governance.
- **Administrative Framework:**
 - **Multi-State Cooperatives:** Regulated under **Entry 44 of the Union List**, governed by the **Multi-State Cooperative Societies Act, 2002.**
 - **State Cooperatives:** Regulated under **Entry 32 of the State List**, governed by individual **State Cooperative Societies Acts.**



What are Cooperative Banks?

- **Definition:** Cooperative banks are financial institutions established on cooperative principles and are owned and operated by their members.
- **Legal Status:** These banks are registered under the **respective State Cooperative Societies Acts.**

- **Regulatory Framework:** They are regulated by the **Reserve Bank of India (RBI)** under two key legislations:
 - **The Banking Regulation Act, 1949**
 - **The Banking Laws (Cooperative Societies) Act, 1955**
- **Capital Raising:** With prior approval from the RBI, cooperative banks can issue **equity shares, preference shares, or special shares.**
- **Current Presence:** India has approximately **1,400 urban cooperative banks**, with nearly **50% located in Gujarat and Maharashtra.**



About Urban Cooperative Banks (UCBs)

Urban Cooperative Banks are a category of cooperative banks in India that mainly operate in **urban and semi-urban areas.**

Historical Background:

- The legal base for UCBs was laid by the **Cooperative Credit Societies Act of 1904**, during **Lord Curzon's** tenure, and further strengthened by the **1912 amendment.**
- The **first urban cooperative credit society** was founded in **1889 in Baroda**—named **Anyonya Sahakari Mandali.**

Registration:

- UCBs are registered as cooperative societies under the **State Cooperative Societies Acts** (for single-state operations) or under the **Multi-State Cooperative Societies Act, 2002** (for multi-state operations).







Regulatory Oversight:

UCBs operate under a **dual regulatory system**:

1. **RBI Regulation** (under the **Banking Regulation Act, 1949**)—Since 1966, the RBI oversees their licensing, capital adequacy, lending policies, and financial soundness.
 - The **Banking Regulation (Amendment) Act, 2020** expanded RBI's authority to intervene in UCBs' governance and management.
2. **Registrar of Cooperative Societies (RCS)**—The **State or Central government** handles administrative control through the RCS.

Comparison with Commercial Banks

Key Differences Between UCBs and Commercial Banks

 Feature	Urban Cooperative Banks (UCBs)	Commercial Banks
 Ownership	Owned and controlled by members (cooperative structure)	Owned by shareholders (public or private entities)
 Regulation	Dual control by RBI and Registrar of Cooperative Societies.	Regulated solely by RBI
 Profit Motive	Not focussed on profit maximization.	Profit-driven institutions
 Lending Focus	Small businesses, self-employed, weaker sections.	Large corporate loans, retail banking, government projects.
 Voting Rights	One-member-one-vote system.	Shareholders' voting rights based on shares held

Importance of UCBs

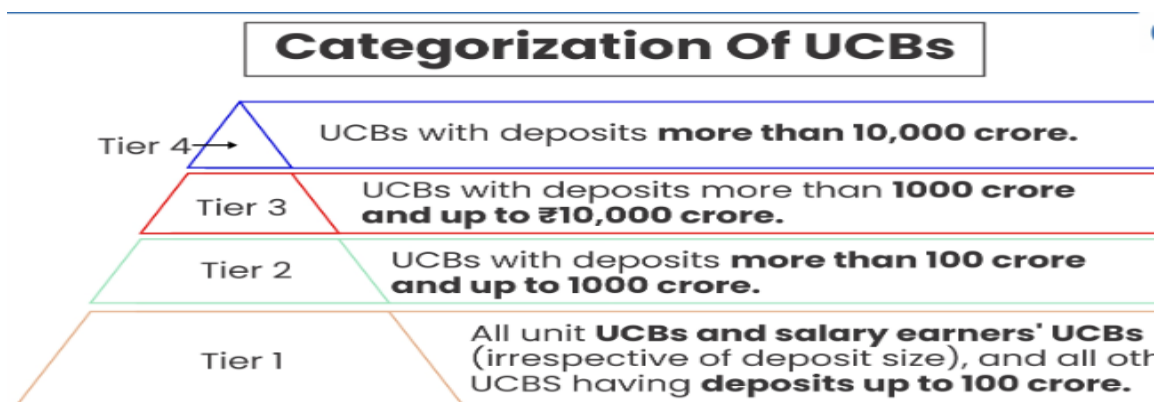
- **Financial Inclusion:** They cater to **small borrowers, micro-entrepreneurs**, and **low-income groups** in urban and semi-urban localities.
- **Community-Based Services:** Their localized approach helps meet the **specific financial needs** of communities.
- **Priority Sector Lending (PSL):** UCBs are required to allocate **65% of their loans to priority sectors** in FY 2024–25, increasing to **75% by March 2026**.
- **Support for Non-Agricultural Needs:** UCBs serve non-agricultural sectors, focusing on **urban borrowers**, a shift from earlier limitations (until 1996) that restricted lending only for non-agricultural purposes.

Challenges Faced by UCBs

- **Poor Governance & Fraud Risk:** Issues like political influence, nepotism, and financial irregularities weaken UCBs.
 - In 2023–24, 24 UCB licenses were revoked.
- **Stiff Competition:** Their share in the banking sector **fell to 2.5% in March 2024**, down from **3.8% in 2017**, due to competition from **commercial banks and fintech companies**.
- **Rising NPAs:** UCBs had **Gross NPAs of 8.8%** as of March 2024, hurting profitability and stability.
- **Capital Constraints:** Limited access to capital markets restricts their ability to meet regulatory capital norms.
- **Compliance Issues:** The dual regulatory system complicates compliance and creates inefficiencies.
- **Lag in Technology:** Many UCBs are yet to adopt **modern digital banking tools**, affecting customer experience and operational efficiency.

Recent Initiatives to Strengthen UCBs

- **Banking Regulation (Amendment) Act, 2020:** Gave the RBI more authority to manage and reform troubled UCBs.
- **PCA Framework Extension (2024):** RBI extended the **Prompt Corrective Action (PCA)** framework to UCBs, setting benchmarks for capital, asset quality, and profits to enable early intervention.
- **Umbrella Organization (UO):** The **National Urban Co-operative Finance and Development Corporation** was set up to offer **liquidity support** to UCBs.
- **Four-Tiered Regulatory Structure:** RBI introduced a **tier-based system** based on deposit size to customize regulations.



Other Measures:

- UCBs can now open up to **10% new branches (maximum 5)** annually without RBI's prior approval.
- They are permitted to provide **doorstep banking services**.
- Like commercial banks, UCBs can now **settle outstanding loans through one-time settlements**.

Way Forward

- **Improve Governance:** Make it mandatory for at least **50% of board members** to have expertise in **banking, finance, or law**.
- **Promote Mergers:** Encourage **voluntary consolidation** of weaker UCBs with stronger ones to create stable entities.
- **Regular Independent Audits:** Ensure financial discipline through **frequent audits by independent agencies**.
- **Embrace Technology:** Push UCBs to **modernize their operations** with digital solutions.
- **Social Audits:** Conduct **community-led audits** to review policies, practices, and fund usage.