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Recommendations to Expert Committee on Primary (Urban) CoOp Banks

Date: 1st June, 2021

Presented by:

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1. **Take stock of the regulatory measures taken by the Reserve Bank and other authorities in respect of UCBs and assess their impact over last five years to identify key constraints and enablers, if any, in fulfilment of their socio-economic objective.**

Regulatory Measures and its Impact

i. Over the years, several steps were taken to strengthen the UCB Sector which included signing of Memorandum of Understanding (MOU) with State and Central Govts, Introduction of new instruments for Capital augmentation, Introduction of Inter Bank exposure limits, Parity in maintenance of CRR & SLR with Commercial Banks, Introduction of Expert Directors on Board, Introduction of concept of FSWM, Revised Exposure Limits for Individual and Group entities, Revised target for Priority Sector Lending, Contribution to RIDF against shortfall in attaining PSL target, Reporting of large Exposures to CRILC, Guidelines for introduction of Cyber Security Framework.

ii. In view of the various steps initiated by the RBI and also initiatives taken by several UCBs, the Sector posted satisfactory performance (Source: Trends and Progress in Banking for the year ended 31st March, 2020) as is seen from the following -

a. 84% UCBs had CRAR > 12%
b. 74.5% UCBs attend ratings A, B+ & B.
c. A, B+ & B rated Banks accounted for 75.5% and 76% Deposits and Advances respectively
d. D rated UCBs had only an aggregate Share of 3.8% of Deposits & Advances.
e. Lending by UCB Sector to Priority Sector constituted about 50% of total Lending by UCBs as against 41% by PSBs, 40% by PvtSB.
f. However, due to failure of PMC Bank and Guru Raghavendra Bank the GNPAs at 10.8%, NNPAs at 5.1% and Provision Coverage Ratio at 60.3% stood at reduced levels vis-à-vis the previous year. UCBs could have posted much better results, year after year, had RBI also focussed on Growth and Development of the Sector.

Key Constraints faced by UCBs

i. For want of regulatory comfort, RBI had restricted growth of the existing UCBs for the past several years. The following are the main constraints that are being faced by the UCBs -

a. Opening of new branches
b. Setting up of Offsite ATMs
c. Extending Area of Operations
d. Extending facilities of Internet Banking, Remote Access Viewing to Customers,
e. Access to provide Remittance Facility through NEFT, RTGS, IMPS, etc eventhough, the UCBs are technologically compliant
f. Guidelines requiring UCBs that at least 50% of aggregate Loans and Advances should comprise of loans of not more than Rs 25 Lakhs or 0.20% of Tier 1 Capital whichever is higher. Sanctioning of such small units will result in increased Operational Costs and more Staff. As a consequence of this directive, CD Ratio of many Banks has come down resulting in lower NIMs and lower Profits.

g. Even though, no transactions are entertained involving Foreign Currency permission to open and maintain NRO and NRE Accounts is often denied.
h. Compulsory Membership of 4 Credit Information Companies (CICs) adds to additional work and cost. Membership of 1 CIC should be enough.
i. Detailed Guidelines for Lending under Consortium Arrangement be issued as exposure to single entity and group entity is contemplated to be reduced.
j. Gold loan cap of Rs. 2.00 lakhs for bullet payment option be raised to Rs.10.00 lakhs.
k. All UCBs be empowered to submit Variance Note if there is disagreement with the findings of the Inspecting Officer (IO). RBI should have such Variance Note vetted before finalization of the Inspection Report.
l. Lines of Credit by NHB, NABARD, SIDBI, etc be directly provided to all UCBs with ratings of A, B+ and B. Similarly, all UCBs should be made eligible as Member Lending Institution (MLI) / Channel Partner for sanction and disbursement of all Loans including Mudra Loans.
m. Confer Scheduled Status to eligible UCBs who have applied to the RBI
n. The present Housing Loan limit of Rs 70 Lakhs is grossly inadequate for borrowers from extended suburbs of Metropolitan Cities / State Capitals and to large District Centres. Moreover, repayment period needs to be extended to at least 25 years. So also, all Housing Loans Rs 45 Lakhs be made eligible as Priority Sector Lending.
o. It has been observed that many a times observations in the Inspection Report do not match the Rating accorded to a UCB. This adversely impacts the working of a UCB.

2. Review the current Regulatory/Supervisory approach and recommend suitable measures/changes to strengthen the sector, taking into account recent amendments to the Banking Regulation Act, 1949 (As Applicable to Cooperative Societies).

i. The Amendment to Banking Regulation Act now enables a UCBs to tap Capital Market and raise Capital by issuance of Bonds and

Equity Shares on Private Placement basis or through Public Issue. RBI should issue guidelines at the earliest to enable UCBs to raise Capital.

ii. To quicken the process, the RBI should take lead and constitute a broad-based Committee comprising of Officials from Finance Ministry, Corporate Affairs Ministry, RBI, SEBI, Representatives of Merchant Bankers, Underwriters, etc to formulate and issue guidelines for raising Equity Capital.

iii. However, it would be possible for the RBI to quickly issue guidelines for raising Capital by issue of Bonds on Private Placement basis or Public Issue.

UCBs be permitted to raise Capital by issue of only Secured Perpetual / Irredeemable Bonds so that such Bonds can be classified as Tier I Capital.

iv. Every Urban Cooperative Bank must have more than adequate capital. Diversity and Heterogeneity is the peculiar characteristics of the UCB Sector in India. There are a large number of small sized UCBs like Unit Banks with chequered past, which despite being small in size, have consistently displayed satisfactory performance, year after year. Number of success stories have emerged through such "Small is Beautiful "business model. It is also important to note that many of these UCBs are compliant of various norms and parameters stipulated by the RBI.

v. The adequacy of own funds for growth of aspirant UCBs should not be underestimated. Therefore, a structured and time bound plan to attain sufficient Net Worth through a workable combination of Tier I and Tier II capital instruments to strengthen the capital base of UCBs, is necessary. RBI should proactively mentor such a plan. Simultaneously UCBs aspiring growth should augment its own funds and capital. It is reiterated that all UCBs should at all time remain well capitalised to meet its ever-increasing need for attaining higher Business levels, attaining technological upgradation and hiring management talent.

vi. RBI should stipulate such New Entry Point Norms so that new UCBs can come up not only in areas that have no UCBs, but also across new 17000 approx Urban Centres that are coming up across the Country. Needless to say, new Entry Point Norms will have to realistic and also achievable by the Promoters of the new UCBs.

vii. In developed Countries, a part of Deposits is calculated and construed as Capital e g 20% of Average Deposits of say last 3 years. In a Country like India where Capital is scarce such an innovative instrument for augmenting will go a long way the Net Worth of all Banks, including UCBs. This will also result in reduction of cost for Servicing Capital.

viii. Any Shareholder may remain on the Board continuously for a maximum of two terms i e 5 years X 2.

The recent amendments to the Banking Regulation Act 1949 stipulate that a Shareholder can remain a Director for 8 years. This provision is inconsistent with the existing practice and also the 97th Constitution Amendment which provides a term of 5 years for an Elected Board.

RBI is empowered to waive / amend any provision of the Banking Regulation Act 1949 and hence, RBI should modify and allow a Shareholder to remain a Director continuously for 2 Terms of 5 years each.

ix. Number of Directors from same family or who are classified as "related persons" category should be restricted to maximum 2.

x. RBI may undertake a Review and have the Rating Methodology validated so that the Rating conforms to the observations made in the Inspection Report.

xi. Therefore, detailed guidelines need to be given to the Inspecting Officer and the Team of Senior RBI Officials so that there would not be mismatch / anomaly while giving a Rating.

xii. Post Inspection Meeting with the Office Bearers of the UCB should be utilise for Mentoring and giving Specific Suggestions so that the UCB can improve its working and over a period of time attain better Rating.

3. Suggest effective measures for faster rehabilitation / resolution of UCBs and assess potential for consolidation in the sector.

Rehabilitation / Resolution -

i. In cases where the Board is superseded, the present practice is to appoint an experienced Banker (either from the RBI or a PSU Bank or from State CoOp Bank (StCB) / District Central CoOp Bank (DCCB)). This practice should be stopped forthwith.

Instead, a Financially Strong and Well Managed UCB, preferably, from the same region be appointed as an Administrator this would facilitate weaker revival of the stressed UCB.

RBI may formulate and put in place detailed guidelines for such an **Institutional Administrator**.

ii. In the light of the recent Amendments to the BR Act 1949 for quick recovery of Overdues and NPAs, RBI should come out with a common One Time Settlement Policy / Scheme on the lines of the provisions of Multi-State CoOp Socs Act which allows even Write off of Principal and Reduction / Waiver of Interest, subject to certain conditions/norms.
iii. SARFESI Act is now not only applicable to UCBs registered under Multi-State CoOp Act but is equally applicable to all UCBs which are also registered under respective State CoOp Acts as per the recent judgement of the Supreme Court.
iv. Supreme Court has ruled that Banking being under Central List, SARFESI Act is applicable to all UCBs. Hence, RBI should quickly come out with circular guidelines for all UCBs, both Scheduled and Non-Scheduled.
v. Considering that exposure of UCBs to MSME Sector will now substantially rise, RBI should insist on appointment of Technical Officer/s or avail services from experience and qualified retainers or create a Cell of Technical Officers where a UCBs exposure to the manufacturing sector is in excess of say, Rs 300 crs
vi. UCBs should be permitted to invest in Equity Shares, at par, and or Redeemable Secured Bonds in MSME Units. Such Bonds be for a short period of 3 / 5 years at an interest rate linked to 10 years benchmark G Sec. The UCB should annually create a reserve to mitigate default. This would help revival of potentially viable borrowal accounts while at the same time not impairing the financials of a UCB.
vii. Maximum and overall limits for such investment be prescribed by the RBI.
viii. RBI should issue guidelines to allow UCBs to write off their losses against Capital or any Reserves, including Surplus Statutory

Reserve, Unutilised Funds eg. Building Fund, Dividend Equalisation Fund, Silver / Golden Jubilee Funds, Development Fund, etc.

ix. Needless to say, such permission be granted only if UCB is compliant of fulfilling CRAR, SLR, IRAC Norms.

x. RBI should write to Ministry of Finance and the threshold limit of Rs 1 crore for invoking IBC be reduced to Rs 50 lakhs in case of UCBs.

xi. All UCBs under SAF or AID should necessarily constitute a Rehab Cell at the Bank level for quick and healthy turn around of a stressed UCB.

xii. Linked to improved performance there need to be provision for graded relaxation, to SAF stipulation. This is highly necessary for quick revival of B and C rated UCBs.

xiii. All Members of the Board should compulsorily undergo 20 hours of Continuing Professional Education (CPE) per year. Similarly, all Decision Making Officers and Managers should compulsorily undergo 60 hours of CPE per year. It is suggested that, the above should be reckoned by the Inspecting Officer while according Rating.

Potential for Consolidation –

i. Right to form a CoOperative is now enshrined as a Fundamental Right consequent to passage of 97th Constitution Amendment so also, it is enjoined upon the State i e Central Government and State Government to promote autonomous and professionally managed CoOperatives, including Urban CoOp Banks.

Hence, no Bank should be compulsorily merged or privatised by the RBI.

This extreme option may be considered as a last option, only after all other options have failed, if the Interest of the Depositors are jeopardised.

ii. Often Good and Remunerative Borrowers, as they grow in business, prefer to switch bigger tech savvy Banks for ease of doing business, additional Banking facilities, competitive rates, etc

The above risk has still not been fully appreciated by many UCBs which are primarily constrained by inadequately trained

Management Staff, rather obsolete technological set up and constrained to sanction bigger/comprehensive limits, both fund based and non fund based.

Due to the above limitations, such UCBs tend to be non-competitive and eventually their existence may be at stake.

Such UCBs which do not post robust financials over a period of time, say 2-3 years, should be asked to prepare and put in place a 3 years Plan for Growth and Upgradation.

RBI should monitor such Banks on half yearly basis.

iii. In the event of all D rated UCBs, not achieving a level of at least 50% of the Upgradation Plan, RBI should ask the UCB to shortlist in 6 months, a Bank for its eventual merger, preferably, with a UCB OR should voluntarily convert itself into a CoOp Credit Soc.

iv. If there are no takers for merger, the RBI should allow such UCBs to voluntarily convert itself into a Credit CoOp Soc.

v. To facilitate consolidation in non-disruptive manner, RBI should come out with a Special Policy which will attract financially stronger UCBs to take over such UCBs.

There are many small and weak UCBs across the Country and bigger FSWM UCBs will have to be incentivised by extending their Area of Operation to States (which are not necessarily be adjacent to their existing Area of Operations). Need base liquidity support from DICGC, non compulsion to absorb all Employees and Shareholders, Guidelines for only takeover of Realisable Assets and Deposits, etc.

vi. We propose a new structure of Networked/Federated of smaller UCBs with financially stronger UCB/s which will provide handholding support and over a period of time small UCBs would merge, in stages, with the stronger and bigger UCB/s.

Under such new arrangement, it would be possible to share technology platform, ensure compliance to Cyber Security Norms provide support for appraisal of Credit and Investment Proposals, extend facilities for Capacity Building/Training, help formulate various policies regarding HR, Recovery, etc.

4. Consider the need for differential regulations and examine prospects to allow more leeway in permissible activities for UCBs with a view to enhance their resilience.

I. There is need for differential regulation considering the Net Worth, Size of a UCB based on Deposits or Assets (Advances and Investments) Level of Technology Absorption and preparedness for Cyber Security.

II. A Matrix of good combination of such relevant attributes need to be evolved for Growth and Development of UCB Sector.

III. Continuing with the prevalent Deposit-based model, the revision in the threshold limits is proposed hereunder-

Class I:

IV. All Unit Banks - Prevailing RBI guidelines, prescriptions, etc. to continue

Class II

Tier I: All UCBs with Deposits < or = Rs. 500 crs.

Tier II: All UCBs with Deposits more than Rs. 500 crs but < or = Rs. 5000 crs.

Tier III: UCBs with Deposits more than Rs. 5000 crs but < or = Rs.10000 crs.

Tier IV: UCBs with Deposits more than Rs. 10000 crs.

iv. While continuing with the permissible activities, RBI in tune with the above proposed Classifications, should proactively revise the norms to allow more leeway for permissible activities for UCBs with a view to enhance their resilience. An illustrative list of the activities which need the immediate review and revision is as under-

- Enlarging Area of Operation
- Shifting/ Relocating Branch/es
- Installation of Off Site ATMs
- Direct membership of NPCI, NDS, CCIL, etc
- MSF facility

- Net Banking, RTGS, NEFT, IMPS, etc (wherever the UCBs is compliant of RBI norms relating to technology and Cyber Security.)
- Opening and maintaining NRO and NRE Accounts
- Credit- Relaxation of norms for Loans to Nominal members, Gold loan under Bullet payment Scheme, Housing loans up to Rs. 45 Lakhs under PSL. Exposure limits for Individual and Group, percentage and proportion of specified small size loans, Benchmarks for PSL, etc
- Factoring Provisioning Coverage Ratio while selling NPAs to ARCs
- Permeability for merging small/weak banks
- Supervisory Rating/Grading Models to progressively include compliance of different risk parameters with reference to BASEL I, II & III.
- Need for differentiated percentage/proportion of Professional Directors as per category of UCBs proposed above
- Guidelines relating to education and experience in respect of specially designated executives

v. The scope of “Auto Mode” for different types of permissions needs to be enhanced.

5. Draw up a vision document for a vibrant and resilient urban co-operative banking sector having regards to the Principles of Cooperation as well as depositors’ interest and systemic issues.

i. Vision Document should outline a National Policy for Growth and Development of the UCB Sector should be framed which encourages setting up of UCBs across the Country.

ii. Consistent with the Vision Document, a Roadmap with Milestones be formulated for guiding and implementing the UCBs to adopt and implement prescriptions of the RBI that may be regarding –

A. Minimum Net Worth,
B. Fit and Proper Norms for Chairmen, Directors, CEOs and also for Sr Mmgt Team.
C. Putting in place robust IT Infra (eg Hardware, Software, Disaster Recovery Site, Cyber Security Framework, etc)
D. Constitution and functioning of Committees of the Executives

iii. No new UCB has been licensed in the last twenty years. There are several applications pending with the RBI. The same be processed and licensing of new UCBs be initiated immediately. Applications for starting new UCBs should now be processed under On Tap basis.

i. Malegam Committee had recommended in the Interest of Depositors that Large CoOp Credit Socs complying with entry Regulatory Prescriptions be allowed to convert themselves into a UCB. RBI should encourage such voluntary conversion in the Interest of the Depositors.

ii. With a view to reduce constrains arising out of dual control, the present Model Bye Laws were adopted about 8 years back by the UCBs. In the light of Amendments to the Banking Regulation Act, 1949, it is now necessary to modify the present Bye Laws for smooth functioning of the UCBs.

iii. Calendar of Review to be considered at the monthly Board Meeting of the UCBs needs to be updated in the light of the change Scenario.

iv. Issue guidelines for putting in place Business Continuity Plan,

v. Banking Regulation Act, 1949 now empowers the UCBs to raise Capital by Public Issue and through Private Placement basis. Guidelines in this regard may please be issued at the earliest.

vi. Broad guidelines for One Time Settlement, Write Offs/Remission of Interest may please be issued at the earliest to facilitate recovery of Overdues/NPAs, particularly on the background of COVID 19 Pandemic.
In the absence universal guidelines, UCBs adopt practices which vary from State to State. RBI is now empowered to issue such guidelines post Amendments to the Banking Regulation Act, 1949.

vii. We once again request you to revisit the RBI Guidelines relating to the constitution of the Board of Management (BoM), particularly as full regulatory powers have now been conferred on RBI.

viii. RBI should formulate Norms for Declaring of Dividend. The Statutory Auditor should certify compliance of RBI Norms and only thereafter, Resolution may be moved for declaration of Dividend. This will obviate the need to seek permission from RBI which many a times is both time consuming and painful.

ix. Depending upon the Net Worth and the Bank being under FSWM category norms be formulated for opening Branches and Extension Counters be formulated for attaining sustained growth. Norms to be certified by the Statutory Auditor.

x. Depending upon the Net Worth and the Bank being under FSWM category norms for setting up of Offsite ATMs be formulated for extending reach of the Bank where it doesn't have a branch.

However, a UCB need not be a FSWM categorised UCB for installation of Onsite ATM with E Lobby attached to a branch, as it results in reduction of Operational Cost and the Bank is able to provide services on 24 X 7 basis.

xi. Housing Loans

a. Personal Housing Loan should NOT be classified under CRE
b. The present Housing Loan limit of Rs 70 Lakhs also needs to be revised upwards and it should also be raised to 0.75% of Tier 1 Capital or Rs 1.50 crs for Metropolitan Cities and State Capitals of all Large States and Rs 1 Crore for all other Centres, whichever is higher.
c. Maximum Limit of Housing Loans by a UCB be stipulated as a percentage of Net Worth plus 30% of Average Deposits of last 3 years.

xii. DICGC should be given a distinct role in situations when it infuses funds for resolution purposes. It should be empowered to Nominate its Representative/s on the Board and relevant Committees. In challenging situations, it should be empowered to Veto any decision of the Bank which is detrimental to the interests of the Depositors.

xiii. New instruments eg Non Voting Shares and New Formats/Institutions – SPVs, wholly owned Subsidiary, etc - need to be introduced so that UCBs may innovatively raise Capital and help UCBs to keep pace with the emerging Technology driven Banking.

xiv. The present TAFCUB arrangement is almost dysfunctional and is proving to be redundant. Hence, the present format has to be revamped to make it meaningful by ensuring effective dialogue and participation.

xv. We welcome the permission given by the RBI for setting up Umbrella Organisation for the UCB Sector. To make it fully operational, RBI will need to infuse Capital and also extend handholding support by deputing its Officials, at least for first 5 years.

The Umbrella Organisation should repay the Capital infuse by the RBI in a phased manner. So also, RBI Officials may be repatriated, once the operations of the Umbrella Organisation stabilises and is able to attract both Capital and Talent.

xvi. The Standing Advisory Committee for UCBs also needs to be broad based and should meet at least twice a year say in late July (by which time post Audit and Finalisation of Accounts, Returns are received by RBI) and in early November when the exercise for Annual Budget commences in Ministry of Finance.

The present practice to invite on rotation basis Representatives only of large UCBs and some Office Bearers of State Federations alongwith NAFCUB needs to be modified to include Representatives from different Tiers of UCBs, CoOperators and Bankers.