Urban Cooperative Banks

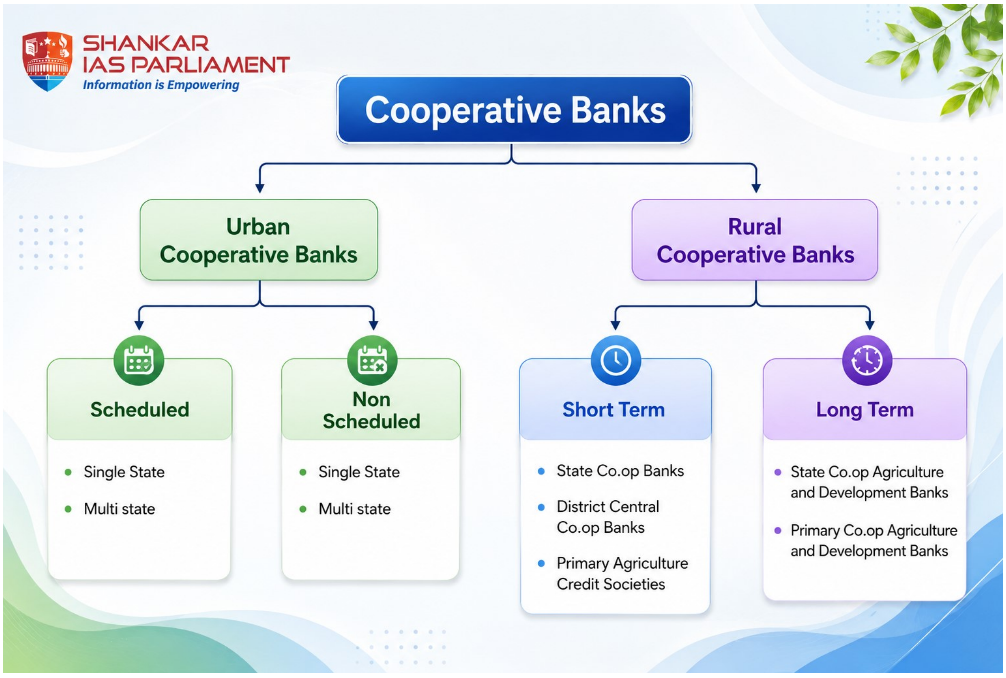
Mains: *GS III – Economy*

Why in News?

Recently RBI has decided to resume the Licensing of the Urban cooperative Banks (UCBs).

What are Urban Co-operative Banks (UCBs) in India?

- **UCBs** – They are primary co-operative financial institutions operating mainly in **urban and semi-urban regions**.
- **Historical evolution** - The movement received legal backing from the **Cooperative Credit Societies Act, 1904**.
- The first urban cooperative credit society was registered at **Kanjivaram, Madras Province, in October 1904**.
- UCBs expanded rapidly, reaching **2,104 banks by March 2003**, including 56 scheduled UCBs.
- Subsequently, the number declined to around **1,500** because of cancellations, mergers, conversions and liquidations.
- **Norm** – They function on the principles of mutual assistance, democratic participation and member ownership.
- **Target groups** – Their major clientele includes small borrowers, local traders, small businesses and salaried middle-income groups.
- **Structure and Governance** – UCBs are owned and managed by their members, who elect the Board of Directors.
- The co-operative principle of “one member, one vote” ensures equal voting rights irrespective of the amount of share capital held.



- **Registration** – UCBs operating within a single state are registered under the respective State Co-operative Societies Act.
- Those operating across multiple states are registered under the Multi-State Co-operative Societies Act, 2002.
- **Regulation and Control** – UCBs are subject to a dual regulatory framework, involving both banking regulators and co-operative authorities.
- **Reserve Bank of India (RBI)** – The RBI oversees their banking operations, including licensing, capital adequacy, interest-rate related matters, prudential regulations and overall banking supervision under the Banking Regulation Act, 1949.
- **Registrar of Co-operative Societies (RCS)** – The RCS deals primarily with non-banking and administrative aspects, such as registration, management, audit, elections and liquidation of co-operative societies under the relevant state or central legislation.

***UCBs** combine the **democratic and member-oriented character** of co-operatives with the regulatory framework applicable to banking institutions.*

What is the significance of UCBs?

- **Support to small borrowers** – UCBs primarily serve small businesses, local traders, MSMEs and salaried groups, especially within their local communities.
- **Easy access to credit** – They provide an alternative source of formal credit for urban poor and informal-sector workers, reducing dependence on informal moneylenders.
- Community-based banking **– Their local presence promotes trust,** thrift, mutual assistance and personal accountability among members.
- **Democratic governance** – UCBs follow the cooperative principle of "one member, one vote", allowing members to elect their representatives.
- **Inclusive growth** – Their surplus is generally used to strengthen reserves and support members/community welfare, rather than primarily benefiting external shareholders.
- **Priority Sector Lending** – UCBs channel credit towards priority sectors, particularly

MSMEs and other underserved segments, supporting employment and inclusive economic development.

UCBs = Financial Inclusion + Local Credit + Democratic Governance + Community Development + MSME Support

UCBs** act as a bridge between formal banking and underserved urban communities, promoting both **economic inclusion and cooperative participation.

What are the challenges faced by UCBs?

- **Political interference** – Political influence over bank boards can result in biased, directed or irregular lending decisions.
- **Conflict of interest** – Directors or influential members may obtain preferential loans, increasing the chances of malpractice and fraud.
- Fraudulent accounting and regulatory violations contributed to major bank failures.
- **Weak professionalism** – Lending and management decisions may be influenced by personal, community or political considerations rather than sound banking principles.
- **Dual regulatory framework** – The division of responsibilities between the **RBI and State authorities** has historically created coordination and regulatory difficulties, although recent reforms have strengthened RBI's supervisory powers.
- The **"one member, one vote"** structure sometimes discouraged additional capital infusion.
- **Limited capital mobilization** – Unlike commercial banks, UCBs have limited avenues to raise additional capital, particularly through capital markets, restricting their ability to expand and absorb financial shocks.
- **High NPAs** – Rising non-performing assets (NPAs) reduce profitability, weaken balance sheets and constrain lending capacity.
- **Technology gap** – Smaller UCBs often lack modern digital infrastructure and strong cybersecurity systems, making it difficult to compete with technologically advanced commercial banks and fintech platforms.
- **Major Examples of Failure –** Cases such as **Madhavpura Mercantile Cooperative Bank (MMCB)** and **Punjab and Maharashtra Cooperative Bank (PMC Bank)** highlighted problems of excessive exposure, poor governance, concealed stressed assets and inadequate risk management.

What measures could be taken to strengthen UCBs?

- **Professional expertise** – Ensure that a significant share of directors possess expertise in banking, finance, law or accountancy.
- **Balanced tenure** – Provide directors with stable but time-bound tenures, ensuring continuity while preventing excessive concentration of power.

- **Early supervision** – Strengthen monitoring mechanisms such as Prompt Corrective Action (PCA) to identify and address financial weaknesses at an early stage.
- **Shared technology support** – Use institutions such as NUCFDC to provide UCBs with common IT infrastructure, cybersecurity support and technical expertise.
- **Digital adoption** – Reduce the cost and entry barriers for smaller UCBs to adopt platforms such as Aadhaar Enabled Payment System (AePS).
- **Modern banking services** – Expand digital banking products, mobile-based services and doorstep banking to improve customer convenience.
- **Branch expansion** – Allow financially sound UCBs to open additional branches within prescribed limits with greater regulatory flexibility.
- **Diversified lending** – Increase permissible limits for housing and selected gold loans, enabling UCBs to diversify their loan portfolios.
- **Faster recovery** – Provide greater flexibility for loan recovery and one-time settlement (OTS) mechanisms, broadly aligning them with commercial banking practices.

Why RBI is Reigniting UCBs?

• RBI has decided to resume licensing of UCBs after more than two decades.
• The objective is not to increase their number indiscriminately, but to create a smaller group of strong, professionally managed and well-capitalised UCBs.
• This is important because MSMEs continue to face credit gaps, while large commercial banks primarily serve the formal economy.
• **New Regulatory Approach** – RBI's strengthened framework focuses on:
- Higher entry requirements
- Stronger capital base
- Better governance and risk management
- Technology readiness and cybersecurity
- Greater supervisory oversight
- A four-tier regulatory structure introduced in 2022

• For new licences, the proposed framework includes:
- **Minimum capital** – Rs.**300 crore**
- **Capital Adequacy Ratio** – At least **12%**
- **Net NPA** – Not more than **3%**
- Ideally **10 years** of operational experience
- At least **5 years** of sound financial performance

What lies ahead?

- UCBs can become an important “third pillar” of Indian banking, alongside commercial banks and small finance banks, if they Strengthen governance, Improve capitalization, Adopt technology, Enhance cybersecurity, Reduce NPAs , Professionalise management.

References

1. RBI| UCBs
2. The Hindu| Issues with UCBs

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