

# STUDENTS' ECONOMIC FORUM

A monthly publication from South Indian Bank

*To kindle interest in economic affairs...  
To empower the student community...*



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**JANUARY 2020**

Theme 338

**CO-OPERATIVE BANKS;**

**Structure, Functions, Importance and the Recent Amendments**

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**Theme No: 338: Co-operative Banks; Structure, Functions, Importance and the Recent Amendments**

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*“When learning is purposeful, creativity blossoms. When creativity blossoms, thinking emanates. When thinking emanates, knowledge is fully lit. When knowledge is lit, economy flourishes.”*

- DR. A.P.J. ABDUL KALAM

The “SIB Students’ Economic forum” is designed to kindle interest in the minds of younger generation. We highlight one theme in every monthly publication. Topic of discussion for this month is “**Co-operative Banks; Structure, Functions, Importance and the Recent Amendments**”.

Co-operative Banks came into existence with the enactment of the Co-operative Credit Societies Act of 1904. Subsequently in 1912 a new Act was passed which provided for the establishment of Co-operative Central Banks. A Co-operative Bank is member promoted and has to be registered with the state based Registrar of Co-operative Societies. It functions with the rule of ‘one member one vote’ and on ‘no profit, no loss’ basis.

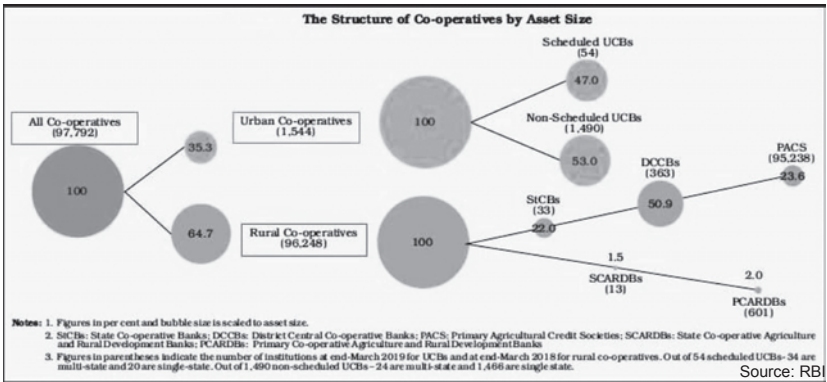
### **Functions**

1. Co-operative credit institutions play a pivotal role in the financial system of the economy in terms of their reach, volume of operations, and the purpose they serve.
2. Co-operative Banks fill in the gap of banking needs of small and medium income groups not adequately met by the public and private sector banks.
3. The Co-operative banking system supplements the efforts of the Commercial Banks in mobilising savings and meeting the credit needs of the local population.

### **Structure**

Broadly, the Co-operative credit sector in India comprises of Rural Co-operative credit institutions and Urban Co-operative Banks.

The Rural Co-operative Credit Institutions comprise of institutions such as State Co-operative Banks, District Central Co-operative Banks, and Primary



Agricultural Credit Societies, which specialise in short-term credit, and institutions such as Co-operative Agriculture and Rural Development Banks (SCARDB & PCARDB), which specialise in long-term credit.

On the other hand, Urban Co-operative Banks (UCBs) are either scheduled or non-scheduled. Scheduled and non-scheduled UCBs are again of two kinds-multi-state and those operating in single state.

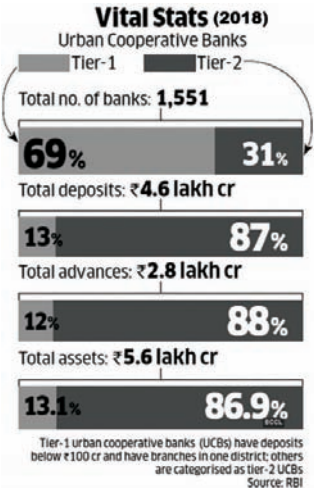
Urban Co-operative Banks are mostly engaged in retail banking. Their exposure to corporate banking is also limited due to factors such as small size of their balance sheet and inadequate expertise.

### Regulation

Co-operative Banks came under the purview of the Banking Regulations Act only in 1966. Urban Co-operative Banks are supervised by the Reserve Bank, while Rural Co-operative Credit Societies are supervised by the NABARD. State Registrars of Co-operative societies also regulate certain functions of both Urban and Rural Co-operative Banks/Societies. The Reserve Bank of India is the regulatory and supervisory authority of UCBs for their banking operations while managerial aspects come under the purview of the State Governments under their respective Co-operative Societies Act.

### Importance

1. There are 1,540 Co-operative Banks with a depositor base of 8.60 crore having total savings of about Rs 5 lakh crore.



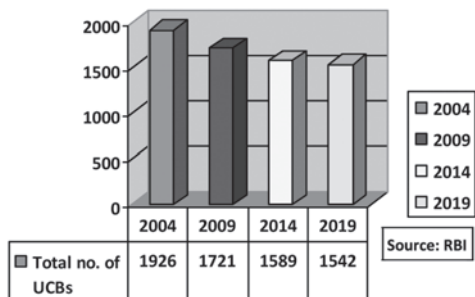
2. The UCBs are required to extend 40% of their total advances to priority sector, of which 10% needs to be deployed to the weaker section.
3. Co-operative Banks are an integral source of credit to agriculture.
4. They serve as an important instrument in small scale operations.
5. They have extensive branch network.
6. Traditional importance.

### Is there an Issue?

Urban Co-operative Banks (UCBs) have reported nearly 1,000 cases of frauds worth more than Rs 220 crore in the last five fiscals, according to Reserve Bank of India (RBI). The cases of frauds assume significance as the Punjab and Maharashtra Co-operative (PMC) Bank came into the news recently. PMC Bank is a Co-operative Bank with 137 branches and spread over seven states including Delhi and Punjab and has deposits of about Rs. 11,617 crore. It is among the country's top five Urban Co-operative Banks. It has been brought under RBI's restrictions under section 35 A of the Banking Regulation Act for a period of 6 months since September 23, 2019.

The Central Bank had found financial irregularities, including huge under-reporting of loans and non-performing assets to a real estate developer to the tune of Rs 6,500 crore, against its entire assets of Rs 8,880 crore, using hundreds of dummy accounts. A single borrower had around 73% of the total Bank's advances and all of this was not being serviced. The bank also allegedly created fictitious accounts of companies which borrowed small sums of money, and created fake reports to hide from regulatory supervision. The Bank has been barred from granting, renewing loans, making investments or accepting fresh deposits etc. without the prior written approval from the RBI.

Urban Co-operative Banks' failures occurred with alarming frequency and regularity. The number of banks fell from 1926 in 2004 to 1542 in 2019 according to RBI data. As on March 2019, 46 UCBs had negative net worth and 26 were under directions of RBI. Around 40% of PACs are loss-making. Deposit insurance claims are much higher for Co-operative Banks than for Commercial Banks. Nearly 24% of SCARDB's loans and 33% of the PCARDB's loans as on March 2017 were NPAs.



### **Why things go wrong for the Co-operative Banks?**

- a) They have a small capital base. For example, Urban Co-operative Banks can start with a capital base of Rs. 25 lakhs compared to Rs. 100 crore for Small Finance Banks.
- b) These Banks may be hijacked with vested political interests.
- c) RBI's Supervision of Co-operative Banks is generally not as stringent as that of Commercial Banks. Typically, the State Government audits the Co-operative Banks while RBI inspects their books just once a year.

### **What is the recent governance initiated by the Central Government?**

The Union Cabinet has approved amendments to the Banking Regulation Act to empower the Reserve Bank of India to regulate Co-operative Banks. The government is looking to tighten scrutiny around Co-operative Banks after the collapse of Punjab and Maharashtra Co-operative (PMC) Bank. The proposed law seeks to enforce banking regulation guidelines of the RBI in Co-operative Banks, while administrative issues will still be guided by Registrar of Co-operatives.

### **Major highlights of the new amendments**

- a) Oversight of Cooperative Banks would be brought under the Reserve Bank of India.
- b) Co-operative Banks would be audited according to RBI rules.
- c) Appointment of CEOs would require prior approval from the Central Bank.
- d) The RBI will also have the right to supersede the management of a Cooperative Bank in consultation with the State Government, in case of governance failure.
- e) The administrative role will continue to be done by the Registrar of Co-operative Societies.
- f) Better professionalism and Corporate Governance will be ensured.
- g) Interest of depositors will be protected.

This has been a demand of the depositors and the financial sector for many years in order to bring financial stability. The new regulations would be phased in gradually. The move is expected to ensure greater accountability and transparency in the functioning of Co-operative Banks.



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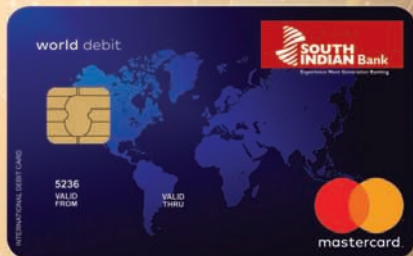
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