

## The Future of UCBs in India

Urban Co-operative banking Sector is an important constituent of Multi Agency banking system operation in the country. These institutions play an important role in the economic enlistment of lower and middle-income group of persons.

The Reserve Bank of India in its annual report on trends and progress in banking states that urban banks are important purveyors of credit to small borrowers and to weak sections of the society but is not coming out with any supportive policies that will strengthen the role of UCBs. However, in the recent annual statement on Monetary Policy for the year 2008-2009 RBI has decided to form a working group on Umbrella Organization of UCBs and constitution of Revival Fund for UCBs which will facilitate a great deal in strengthening UCBs to put them in right liquidity position. The Working Group has submitted its report on Umbrella Organisation and Constitution of Revival Fund for Urban Co-operative Banks.

**The Summary of Recommendations are as under :**

1. There are a large number of Primary (Urban) Co-operative Banks (UCBs) in the country forming a heterogeneous group in terms of size and spread. Many of these banks are very small in size and reach. They compete with larger participants in the same banking space. Over the years, a number of UCBs have become weak and non-viable, thus posing systemic risk to the UCB sector. They lack avenues for raising capital funds since they can neither go in for public issue of shares, nor can they issue shares to members at a premium. There is a significant part of the UCB sector that lacks professionalism and is unable to keep pace with rapid advancements in IT, modern banking systems and financial products. The sector also has significant number of banks which are weak and need financial support. There have been occasions when due to contagion effect banks have encountered liquidity problems.
2. The organisational structure of UCBs, their small size and limited area of operation add to their vulnerability. Further, in the wake of advances in information and communication technology, payment and settlement systems and services, they need to widen their range of services to run on professional lines and match the services provided by commercial banks.
3. At the same time, there are a number of UCBs in the sector that are financially strong and viable. Some sort of cooperative bonding and mutual support system could make the sector strong and vibrant.

4. Internationally, cooperative banks, popularly called Credit Unions, operate in networks and have an entity which provides a wide range of services to them such as, fund management services, lines of credit, asset management, payment and settlement system gateway, ATM networks, credit card, investment, securitisation, capital raising and other financial services. These entities act as Umbrella Organisations and the networks provide cooperative solidarity. International experience has shown that the presence of such an Umbrella Organization has contributed towards the member Credit Unions being stable, sound and efficient entities. This has also provided regulatory comfort to the regulators. The Working Group had a close look at the Umbrella Organisations of credit unions in certain countries, such as, Australia, Belgium, Canada, Finland, France, Germany, Netherlands, Poland and USA.
5. The Working Group is convinced that there is a strong case for a similar Umbrella Organisation for Urban Cooperative Banks in India, as also for an emergency liquidity support facility for banks confronting liquidity problems. Reserve Bank of India has been instrumental in promoting several institutions and mechanisms in the interest of financial stability. This is yet another area where the central bank can play an important role in strengthening the urban cooperative banking sector as a part of banking sector reforms. Accordingly, the Working Group has made recommendations for constituting an Umbrella Organization for UCBs in India as also for an Emergency Funds Facility.
6. The broad contours of the proposed Umbrella Organization and the Emergency Fund Facility Scheme are summarized hereunder :

**(A) Umbrella Organization (UO)**

- 1) There shall be a professionally managed national level UO which shall provide to the UCBs a range of services on the same lines as is done by UOs for credit unions in several countries. These services are :
  - (i) Offering credit facilities
  - (ii) Providing liquidity to meet short term mismatches
  - (iii) Fund management services
  - (iv) Investment banking services
  - (v) Payment and settlement services/ gateway
  - (vi) IT services

- (vii) ATM Network and services
- (viii) Management consultancy
- (ix) Capacity building services

- 2) Membership of the UO shall be voluntary. The regulatory may consider issuing appropriate instructions to UCBs for subscribing to the share capital of the UO.
- 3) UO will be a non-deposit taking Non Banking Financial Company to start with. The conversion of the UO to a banking company may be considered in due course in the light of experience gained.
- 4) Its authorized capital will be Rs. 200 crore and startup paid-up capital Rs. 100 crore. The paid-up capital could be called up in two or more instalments depending on the need and response.
- 5) The capital will be contributed by the UCBs voluntarily @ 10 paise per Rs. 100/- of assets or such rate as may be necessary.
- 6) The Governments may consider providing suitable fiscal incentives to UCBs for contributing to the share capital of the UO.
- 7) There shall be a onetime uniform membership fee of Rs. One lakh per member UCB which shall reside in a Reserve Fund.
- 8) Being a non-deposit taking NBFC, it would have access to the following sources for its working capital :
  - (i) Borrowings from banks/ financial institutions
  - (ii) Deposits : term deposits from UCBs
  - (iii) Debt instruments : bonds/debentures
  - (iv) Refinance : against financial assets (loans and advances) including securities
  - (v) Other miscellaneous sources
- 9) Considering that the proposed UO would be a national level organisation intended to strengthen the UCB sector and consequently promote financial stability, the Reserve Bank of India which has played a pioneering role in promoting several financial and developmental institutions in the country may consider grant of certain reliefs and regulatory dispensations, which would help in making the UO sustainable, such as :
  - (i) Deposits kept by the UCBs with UO qualifying as CRR/SLR

- (ii) Permitting the UO membership of the Payment & Settlement systems
- (iii) Any other support that may be required in future, such as setting up of ATM networks, etc.

- 10) The UO will be a professionally managed organisation having adequate number of independent directors. The CEO will be a person of repute, possessing wide experience and acumen in finance and banking. In the formative years, the Reserve Bank of India may closely guide and oversee the affairs of the UO through a nominee director. Subsequently, they may consider placing an observer on the Board.
- 11) The Reserve Bank of India may consider constituting a Steering Committee under the chairmanship of a senior official to work out the modalities for setting up of the UO. The Committee will have as its members the Central Registrar of Cooperative Societies (CRCS), Registrar of Cooperative Societies, Maharashtra (the state with maximum number of UCBs), representative each of the NAFCUB and four major UCBs.

#### **(B) Emergency Fund Facility Scheme**

- 1) In each state, emergency liquidity support to UCBs in distress on account of sudden pressures on liquidity could be provided through "Emergency Fund Facility Scheme" under a tripartite Industry Support Agreement (ISA) Under the Agreement, all the UCBs registered under a particular State Co-operative Societies Act should contribute a certain sum (say 0.05% of their assets) to the Emergency Fund as deposits at a specified rate of interest (say at the prevailing interest rate for deposits for six months), which would be available to the participating UCBs as a soft loan (liquidity support) carrying interest, say at 8% [cost of funds(6%) +2% markup] for a period of not more than six months/one year. The quantum of liquidity support at a sort rate (First Tranche) may be capped at 50% of net worth of the UCB concerned.
- 2) Under the ISA, a participating UCB should also commit to provide a line of credit to the Emergency Fund when called upon to do so (say additional 0.05% of its assets) at a specified rate of interest(say, the prevailing interest rate for one year deposit). The amount that could be raised through the line of credit may be used for providing liquidity support under Second and Third Tranches to UCBs, at rates higher than the loan under First Tranche say at 10% [cost(8%) +2% mark up] and 12% [cost(10%) + 2% mark up] respectively. The Second and Third Tranches

may also be to the extent of 75% and 100% of the net worth of the UCB concerned, respectively.

- 3) In states where the presence of UCBs is small and it is not viable to set up such a facility, UCB could affiliate themselves with another state that offers such a facility.
- 4) In the concerned states an UCB Emergency Fund Facility Trust should be established. The Board of Trustees will comprise representatives of State Government, participating UCBs and State Federation.
- 5) Financial assistance to distressed UCBs from the trust funds may be made on the recommendations of TAFUCB. The modalities and terms and conditions for such support may be worked out by the Board of Trustees in consultation with TAFUCB.
- 6) UCBs registered under the Multi State Cooperative Societies Act having presence in more than one States may seek affiliation to the trust fund of the State where their registered Head Office is located, or they may choose to have their separate trust fund.
- 7) TAFUCBs may be entrusted with the responsibility of working as the Steering Committee for setting up of trust fund.

#### (C) Revival Fund

- 1) A large number of weak and sick UCBs (about 399; 23% of the total) need solvency support.
- 2) If UCBs with negative net worth were to be brought to positive net worth, an enormous sum of about Rs. 2,500 crore may be required. While RBI may pursue a menu of options, including mergers, with or without DICGC support, and financial restructuring for turn around of these banks, possibly, an amount of Rs. 2000 crore may still be necessary. However, such a fund could only be raised out of contribution from the net profits of UCBs. The total net profit of the sector being about Rs. 1,000 crore, mobilization of this magnitude of resources from the sector may not be feasible. Further, contribution from the profits to the Revival Fund would be resisted by UCBs. The Working Group also felt that the State and Central Government may not come forward to contribute to the Revival Fund for UCBs. Therefore, creation of separate Revival Fund for UCBs is not recommended.
- 3) UCBs not complying with CRAR may be supported from the Emergency Funds.

The Working Group, inter alia, recommends setting up of an Umbrella Organisation at the National level and Emergency Fund Facility Trusts at the State level.

We, as the Maharashtra Urban Co-operative Banks Federation, Mumbai are hopeful that the recommendations made by the Working Group would facilitate emergence of a mutual support system and strengthen the UCB sector.

Presently the global economy is going through turbulent times. Some banks in Western Countries are being closed, many industrialists are become bankrupts share markets have crashed and many investors have become high and dry due to this gloomy financial atmosphere. The rupee has touched to its lowest mark against the dollar, In spite of this dark scenario; the Indian economy is going strong. Though there were some initial shaky reactions to global gloom, Shri P. Chidambaram, Ex-Finance Minister has stated that Indian economy is strong and there is no need to worry. Our Prime Minster Shri Manmohan Singh has also backed him adding that the Indian Banking system is on its sound footing UCBs in India are playing major role in servicing rural economy and there is no need to worry as evident from following data regarding UCBs in India.

Total Number of Banks in India	1770
Total Deposits	Rs.1,12,000 crs
Total Advances	Rs. 78,000 crs.
Total No. of scheduled banks in India	53
Total No.of Mahila Banks	139
Total No. of Mahila Banks in Mah.	27
Total No.of 1 Unit Banks	900
Salary Earner Banks	24
Total deposits of scheduled banks	Rs. 51,173 crs (42% of total deposits of UCBs)
Total advances scheduled banks	Rs. 32, 884 crs.
Total Number of Banks in Maharashtra	619
Total deposits	Rs. 44,706 crs.
Total advances	Rs. 28,524 crs.
Own Funds	Rs. 7612 crs.
Total NPA of UCBs	17%
Tota CD Ratio	67%
Gradation of Banks all India level	
Grade-I Banks	690
Grade-II	430

Grade-III	390
Grade-IV	260
Gradation of Banks in Maharashtra	
Grade-I	195
Grade-II	133
Grade-III	170
Grade-VI	121

With the onset of liberalization, Co-operative banks in India are under pressure to change the ways in which they do business. They now face an increasingly competitive environment not only from banks but also from non-bank financial institutions. Explosive growth in IT has changed the way individuals interact with banks and the way banks respond. In the changed scenario, success will depend on the ability of banks to leverage the human potential and capabilities, Marketing of Banking products, G-sec Market, Customer value added services, competitive pricing of deposits and advances, good corporate governance, information & Technology.

### **Co-operative banking – The challenges ahead**

In recent years, there has been a considerable widening and deepening of the Indian financial system, of which banking is a significant component. With greater liberalization, the financial system has come to play a much larger role in the allocation of resources than in the past and its role in future can be expected to be much larger than at present. The growing role of the financial sector in the allocation of resources has significant potential advantages for the efficiency with which our economy functions. Consequently, the adverse consequences of malfunction of the financial system are likely to be more severe than they used to be in the past. Hence, all our efforts today are focused at ensuring greater financial stability. Given the significance of the co-operative banking system, one cannot afford to underplay the importance of a strong and resilient co-operative banking system.

You all are very well aware that Urban Co-operative banking Sector is an important constituent of Multi Agency banking system operation in the country. These institutions play an important role in the economic upliftment of lower and middle-income group of persons. In recent years, the functioning of UCBs has come into sharp focus of the Govt. of India and the regulatory and supervisory authorities viz. Reserve Bank of India. The weakness which have crept into the urban co-operative banking system, over the years, leading to failure of some of them have posed systemic threat and shaken the confidence of the general public in the system. The problems faced by the co-operative banks are mismanagement,

financial impropriety and poor credit appraisal and wrong investment decisions. The Reserve Bank of India is concerned with the deteriorating health of the system and is now focusing its supervisory attention more closely for consolidation of the system. The urban banking sector is presently going through a bad patch. It is making sincere efforts to improve its financials and creditability. In the present day highly competitive banking sector, Urban Co-operative Banks (UCBs) are facing competition not only from Commercial Banks, Foreign Banks and Private Sector Banks but also from other Urban Co-operative Banks. To make it competitive, it is in the process of technology up gradation introducing core-banking solutions, requires considerable amount of investment.

The Reserve Bank of India has subjected the co-operative banks to very stringent prudential norms, particularly with respect to net NPA percentage and capital adequacy percentage. The Co-op. Banks are doing their best to cope up with these norms. All this is being done to safeguard the interest of the depositors whose savings are pivotal to capital formation. But looking at the limitations available to UCBs for augmenting share capital; UCBs require certain relaxations in order to fulfill the prudential norms.

The Urban Co-operative Banks are gearing themselves up fast to meet the challenge of competition and to build efficiency. They are continuously holding meetings, conferences and training their staff at all levels to enhance their knowledge and skills levels and to ready them for excellent marketing and customer service. This establishes the UCBs will and determination not only to survive but also to prevail.

UCBs have always played a pivotal role in the development and progress of the Nation. It is the timely assistance offered by UCBs to small and medium enterprises that has propelled the growth-graph of our Nation and the States, in particular.

It is true that the MMCB episode was a bad accident but the DOMINO effect thereafter has derailed the country's UCB sector as a whole. It is not that commercial banks/ private sector banks are exempt from this phenomenon, but they are 'Too big to default', in various laid down ratios, besides, they have various avenues to garner sufficient capital and deposits, domestic as well as overseas.

It is evident to analyze as what has gone wrong with the UCBs, but in order to avoid similar situations and strengthen the UCBs sector,

a collective effort by all the UCBs by representing continuously and on an ongoing basis to the regulators as well as to the ruling government would change the scenario. Every forum should reverberate and be dominated by the debate concerning the problems faced by UCBs.

The future of UCBs is bright but not dark. It is only challenging. The future is a capacity building exercise, characterized by conversation, consolidation, competition, cost consciousness and customer orientation. The future calls for strong evidence of transparency and disclosure good corporate governance, productivity and efficiency, profession oriented knowledgeable competent and contributing directors and last but not least constant feed back review and learning. The UCBs should bear in mind that they should firstly survive and then grow in their era of fundamental and seismic changes. It is not difficult being democratically managed, success would depend upon the capability of the Directors to understand what is happening around them.: "In short, the 21st century is an era of competition and seismic changes. If co-op. Banks to succeed in this challenge, the movement has to change its face. Attract, nourish and develop are the keywords for success, what is needed is a creative re-construction of the co-operatives which will bread new opportunities.

(Arvind G. Deshpande)

Chief Executive & Secretary

The Maharashtra Urban Co-operative

Banks Federation Ltd; Mumbai