Chapter: One

INTRODUCTION

“DEEP SURGERY” is must for the clean-up that would require an “anesthetic” in the form of reorganizing NPA’s on their books.

- Raghuram Rajan, Governor Reserve Bank of India.

This chapter comprises of Background of Study, Concept of Co-operative, World Council of Credit Unions (WOCCU), Rochdale Society of Equitable Pioneers, Granger movement, International Co-operative Alliance (ICA), Cooperative movement of Banking Sector in India, Cooperative movement in Maharashtra, Non-performing Assets (NPA), and Meaning & Norms of NPA, Basel Committee, Basel-I to Basel-IV and Evolutionary path of Indian Cooperative Banks.

Mahatma Gandhi’s preordination has given path by implementation of art and science of mobilizing the entire physical, economical and spiritual resources of the various sectors\(^1\). Father of cooperative movement Robert Owen believed in putting his workers in a good environment with access to education for the society. His Social reform work, socialism and the cooperative movement was influenced over the universal.

Co-operative institutions build a better world in this connection Indian economic system tries to indicate that during the five plans emphasis are given for reasonable income distribution resulting into minimization of monopolies. It clearly explained by IMF that the role of banking sector is considered vital as banking service is backbone of the financial system. Banking system in India have to help the goals of economic policies pronounced in successive five year development plan, particularly concerning equitable income distribution, balanced regional economic growth and the reduction and removal of private sector monopolies in trade and industry. The risks to financial stability continued to remain at elevated levels, with growth witnessing a delicate and multiple pattern of recovery. In the meanwhile, the macro-financial risks shifted from advanced to emerging economies with the latter facing pressures from weakening prospects of growth, falling commodity prices and strengthening of the dollar\(^2\).
The guidelines of RBI indicate that UCBs having volumes business should try to improve their quality of assets through their different operative levels and try to updates them continuously. The Reserve Bank of India committee suggested that multi-state urban cooperative banks with a business size of Rs. 20,000 crore or more shall be changed into 100% commercial bank, if the lender has no special need to remain a cooperative bank.

The asset quality is a prime concern and impacts various performance indicators, i.e., profitability, intermediation costs, liquidity, credibility, income generating capacity and overall functioning of banks. The reduction in quality of asset gets resulted in accumulation of Non-Performing Assets.

In international scenario NPA in banking sector is a prominent issue dominating the soundness, stability, profitability and solvency of the banking institutions. Urban Cooperative Banks play an important role in balanced economic development of nation.

In this regard while determining the lending and accepting monetary policy UCBs has to take precaution, as an urban cooperative bank (UCBs) is to receive deposits and lend money like other bankers. Collecting deposits does not have any risk, because it is the UCB whose duty is to repay the deposit, whenever it is demanded. On the other hand, loaning involves additional risk as there is no certainty of repayment. So, UCBs shall be very careful in lending, because they are not lending money out of their own capital. A maximum amount of money lent is received from people as deposits. All deposits are always repayable on demand. Hence, while lending money, UCBs should follow a very cautious policy. The risk involved in lending business makes it very important as it involves making prominent decisions. Therefore for sanctioning loan/credit facilities, the authority of UCBs should evaluate the project reasonably otherwise it may lead to non-repayment of loans and advances.

Previous studies emphasized that universally the UCBs are presently facing the numerous risks wherein some part of the profit is reserved for protecting the NPA’s. A sound and well-built financial system is a pre-requisite for rapid and balanced development of an economy. In this regard the role of urban cooperative banking sector is considered energetic backbone of the financial system in urban region.
Among various banking segments, the development in UCBs has historical importance. Maharashtra state is innovator and leader in cooperative movement in the India. It also realized remarkable progress in cooperative segment with several types of cooperatives contributing successfully to the growth of the state economy. In general it happens that customers to whom loans given are unable to make repayment of loan in time it leads to increase NPA. But for their survival UCBs are bound to maintain superior asset quality in the competitive market.

This chapter comprises of the broader perspectives of the research on non-performing assets in urban cooperative banks in Thane district of Maharashtra state. It includes a Background of Study, Co-operative concept, Non-performing Assets (NPA), Meaning of NPA and Provisioning Norms, Basel Committee, Basel I, Basel II, Basel III, Basel IV and Evaluation of Indian Urban Cooperative Banks.

1.1 Background of Study

An urban cooperative bank plays an important role in the regional economic growth of urban space. Through its intermediate activities, the banking sector nurtures the production, distribution, exchange and consumption processes in the local urban economic system. It stimulates the flow of funds in the economy and fuels urban economic growth.

Concept of equality, equity and self-help increased the opinions of self-responsibility and self-administration which resulted in introduction of co-operative. The origin on co-operative movement was one such happening rising out of a situation of crisis, exploitation and sufferings.

Co-operative banks are an assembly of financial organizations organized under the provisions of the cooperative society’s act of the states. These banks are basically co-operative credit societies organized by members to meet their short and medium period financial requirements. A co-operative is an autonomous association of persons united voluntarily to meet their common economic, social and cultural needs and ambitions through a jointly owned and constitutionally enterprise. Common co-operation leads to co-operatives.
UCB’s are established on co-operative principles of voluntary association, self-help and mutual aid and one share one vote of members. In India these banks are registered under the Co-operative Societies Act 1904. Also regulated by the Reserve Bank of India (RBI) and governed under the Banking Regulations Act 1949 & Banking Laws (Co-operative Societies) Act, 1965.

The term Urban Co-operative Banks (UCBs), is not formally defined, but it refers to primary cooperative banks located in urban and semi-urban areas. UCB’s were geographically located in traditional localities and on work places of such peoples. They essentially lent to small borrowers and businesses. Today, their scope of operations has increased tremendously. Therefore the increased number of UCB’s all over the India indicates that it as an institution consisting of a number of individuals who join together to pool their surplus savings for the purpose of eliminating the profits of the commercial bankers or money lenders with a view to distributing the same amongst the depositors and borrowers. In general members are assembled on similar characteristics of occupation education, religion, social and cultural basis within the same defined community or geographical area.

1.2 Concept of Co-operative

A co-operative Society is an association of persons came together voluntarily to meet their common economic, social, and cultural needs and aspirations through a jointly created and owned enterprise.

Co-operatives banks are based on the principles of self-help, self-responsibility, democracy, equality, equity and solidarity. Traditionally founder members of co-operative bank believe in the ethical values of honesty, openness, social responsibility and caring for others.

The principles and rules of co-operative are guidelines for putting the values into practice.

Co-operative banks are voluntary organisations, which are open to all persons who are able to use their services and willing to accept their responsibilities such as membership, without religious discrimination.
Co-operative societies are democratic organisations which are control through their managing committee members, and take decisions. Male and female are elected as managing committee members and are accountable to the members. In primary co-operatives members have equal voting rights and co-operatives at other levels are also organized in a democratic manner.

The benefit of cooperative principles available to all the members, they receive limited compensation, on capital subscribed by them. Balance of surplus is appropriated for statutory reserve as a part to set aside and certain part of it provided to the member as a part of service. The concept of cooperative society provides equality and independence to the society. On the autonomy basis society is able to regulate the activities.

When cooperative societies enter into agreements with other organisations, or governments, or for raising the capital from external sources, it ensures to maintain the democratic control so that co-operative autonomy should not get disturbed.

Every co-operative organization provides education and training to its members, it also organizes for educating its members, elected representatives, managers, and employees so they can contribute effectively to the development of their co-operatives. Cooperative societies inform in general about its nature and benefits to the society.

Co-operative societies provide facilities to their members efficiently by working together at regional, local, national, international structures. It takes into consideration the activity of community for the sustainable development of their communities through cooperative principles.

In general cooperative can define “A cooperative society is a voluntary association of members to meet their common economic, social and cultural needs and aspirations through jointly owned and democratically controlled activities”.

Presently, majority of the world people believe in their living as members of a co-operative. Because of cooperative awareness sustainable growth took place and it increased and opportunity for business diversity. Co-operative societies function as per the needs of its members.
In this concept, Co-operative bank performs all the main banking functions of mobilization and supply of credit and provision of remittance facilities. These belong to the money market as well as capital market. These banks provide limited banking products and are functionally specialists in agriculture related products. Recently, cooperative banks have started providing housing loans to its members. Basically cooperative bank operate in both the regions rural and urban. The Urban cooperative Banks (UCBs) comes out in the supportive environment of national banking sector. Now a day’s some of them are well recognizing on basis of their operative development.

Under the cooperative approach bank give loans and advances to individuals borrowers which may be categorized as standard asset which means a loan which has not defaulted in repayment and if defaulted then it becomes non-performing asset (NPA) based on its (recovery) performance. Most of the UCBs are not developed as well as shut down within a shorter period, and some of them are running with the burdens like Non-performing Assets (NPA). Historically cooperative examples are explained such as Worldwide Cooperative Credit unions, Rockdale Society of Equitable Pioneers etc.

1.2.1 World Council of Credit Unions (WOCCU)

Cooperative movement is series of organized activities that began in the 19th century in Great Britain and later spread to most countries of the world, whereby people organize themselves around a common goal, usually economic. WOCCU is related to the formation of nonprofit economic enterprises for the benefit of those using their services.

Credit societies are financial cooperatives similar to urban cooperative banks. Credit unions are cooperative financial organisations which are owned by its members. Over 96 countries, including the US and the UK, have credit unions. In fact, credit unions are the first microfinance institutions in the world with a history of 150 years. These institutions largely adhere to the Corporate Governance norms laid down by the World Council of Credit Unions (WOCCU).

WOCCU is the leading international trade association and development agency for credit unions worldwide. WOCCU’S headquarters are situated in Madison, Wisconsin, in the United States.
At the end of September 2016, there were around 329 credit unions in England, Scotland and Wales which have provided employment more than 1,500 people and there were 1,274,961 people using credit unions, including 134,206 junior depositors. The total assets of £1.45 billion, total loans of £788 million, total deposits of £1.23 Billion, and annual turnover of £112 million for the year ending September 2016. (Sources: PRA unaudited quarterly figures for September 2016)

The growth of British credit union in the year to September 2015, the sector grew the membership by 4%, assets by 9%, and loans by 6%, deposits by 9% and turnover by 6%. (Source: audited, annual figures for 2015)

During the ten years from 2005 to 2015, this sector doubled its membership and also its loaning capacity. (Source: PRA audited, annual figures and ABCUL)

Credit unions in Britain were relatively small, as there were only 60,500 credit union sectors in 109 countries. More than 223 million credit union members were having assets of almost $1.8 trillion, loans of almost $1.2 trillion, and deposits of almost $1.5 trillion. The growth rate in many developed countries indicates 48% in USA, 44% in Canada, 77% in Ireland, 27% in Australia.

1.2.2 Rochdale Society of Equitable Pioneers

As the mechanization of the Industrial Revolution was forcing more and more skilled workers into poverty, these workers decided to band together to open their own food store selling they could not otherwise afford. With lessons from prior failed attempts at co-operation in mind, they designed the now famous Rochdale Principles, and over a period of four months they tried to earn £1 per person for a total of 28 pounds of capital. On 21 December 1844, the store was opened with very small quantity of butter, sugar, flour, oatmeal and a few candles. After three months, they expanded their selection to include tea and tobacco, as well as unadulterated goods. Ten years down the line, the British co-operative movement had grown to nearly 1,000 co-operatives.3.

The Rochdale Pioneer principles are most famous for cooperative designing and foundation, on which co-ops around the world operate to this day. The model the Rochdale Pioneers used is a focus of study within co-operative economics.
The Rochdale Pioneers first rented store opened in 1867 treated as a museum in 1931. This museum was restructured by the legal name of Rochdale Equitable Pioneers Society in 1989, original its name was Oldham co-operative in 1976.

In 1991, then Norwest Co-operative Society transferred its engagements to United Co-operatives that was run from Rochdale when it in turn transferred to the Manchester-based national hybrid society, The Co-operative Group, in 2007.

1.2.3 Granger movement:

National Grange of the Patrons of Husbandry an organization founded in 1867 by Oliver H. Kelley and six associates started ‘American agrarian movement’. Its local units were called granges and its member’s grangers. The cooperative movement developed slowly till 1873, but there after increased rapidly by reaching its membership on peak in 1875. Granges were established originally for social and educational purposes; but the local granges converted political forums and increased in number as channels for farmer protest against economic abuses of the day of the concern day.

The granges were trying to correct these abuses through cooperative enterprise. The granges were partially successful by establishing stores, grain elevators, and mills, but they were not successful in their attempt to manufacture farm machinery. With the help of political activity the grangers captured several state legislatures in the Middle West and secured the passage in Illinois, Wisconsin, Minnesota, and Iowa of the so-called Granger laws, setting or authorizing maximum railroad rates and establishing state railroad commissions for administration of the new legislation. This legislation also covers warehouses and elevators. Railroads and other interested parties challenged the constitutionality of these laws in the Granger Cases. But the U.S. Supreme Court, in Munn v. Illinois (1876), established the constitutional judgement of public regulation for private utilities to be devoted to the public.

In nut shell Granger movement revealed the farmer as a political power and forced the older parties to give more attention to his demands. Inadequacy of state regulation, plus the weakening of the Munn v. Illinois ruling by the Wabash Case (1886), led to demands for national legislation. After 1876 the Greenback party, the Farmers' Alliance, and, finally, the Populist Party expressed much of the agrarian protest, and the
granges reverted to their original role, as purely social organizations. Their existence was continued the East, especially in New England, where they were least politically active.

The researchers archive his approach toward cooperative as historical movement which develops the present scenario. In Great Britain the cooperative movement had considerably grown and local cooperatives were federated into national wholesale and retail distributive enterprises and where a large proportion of the population has membership. There were number of examples of cooperative organization are also found in the Scandinavian countries, Israel, the People's Republic of China, Russia, and France. In the United States the cooperative movement was started in the 19th century among workers and farmers. The National Grange, a farmers' cooperative, was established in 1867 and later on it created considerable political influence (see Granger movement)\textsuperscript{6}.

1.2.4 **International Co-operative Alliance\textsuperscript{7} (ICA)**

The International Co-operative Alliance (ICA) is a non-governmental co-operative federation or, more precisely, a co-operative union representing co-operatives and the co-operative movement worldwide. Co-operative movement was founded in 1895 to unite, represent and serve co-operatives worldwide. The Alliance maintains the internationally Recognised definition of a co-operative in the Statement on the Co-operative Identity.[1] The ICA represents 272 co-operative federations and organisations in 94 countries of the world (January 2014).

The Co-operative Alliance provides a global voice and forum for knowledge, expertise and coordinated action for and about co-operatives. The members of the co-operative Alliance are national and international organisations in the field of economy, including agriculture, banking, consumer, fisheries, health, housing, insurance, and workers. The Co-operative Movement Alliance has members from 100 countries, having near about one billion individuals worldwide and near about one hundred million people is working for a co-operative globally. Co-operatives are having values based businesses which are owned by their members. Some of them are their customers, employees or residents, the members get an equal right in the business and a share of the profits.
In 2006 the ICA published the first major index of the world's largest co-operative and mutual enterprises, the ICA Global 300,[2] which demonstrated the scale of the co-operative movement globally.

Researcher observed one of important finding that on the first Saturday of July each year, the ICA coordinates celebrations of International Co-operative Day. The United Nations declared 2012 as the International Year of Cooperatives.

Today the many of cooperatives have increased their international collaboration among the various kinds of cooperative societies for establishment of international cooperative distribution. The co-operative movement is driven by values and not just by profit, the concept of co-operation was agreed internationally to build a better world through co-operation.

1.2.5  Cooperative movement of Banking Sector in India

In comparison with international cooperative financial sector in India it is found in very week manners. The co-operative banks in India are organized groups of people and jointly managed and democratically controlled enterprises. The co-operatives try to serve their members to produce better benefits and services for them. Professionalism in co-operative banks reflects the co-existence of high level of skills and standards in performing, duties involved in an individual. Co-operative bank has to update itself with latest information and technology. It is indeed necessary for co-operative banks to devote adequate attention for maximizing their returns on every unit of resources through effective services.

Co-operative banks have completed 100 years of existence in India. They play a very important role in the financial system. The co-operative banks in India form an integral part of our money market today. Therefore, a brief resume of their development should be taken into account. The history of co-operative banks goes back to the year 1904. In this year the co-operative credit society act was enacted to encourage co-operative movement in India. But the development of co-operative banks from 1904 to 1951 was the most disappointing one. It indicates as compare to international cooperatives India cooperative movement was very minute.
The first phase of co-operative bank development was the formation and regulation of co-operative society. The constitutional reforms which led to the passing of the Government of India Act in 1919 transferred the subject of “Cooperation” from Government of India to the Provincial Governments. Then Mumbai Government has passed the first State Co-operative Societies Act in 1925, “which not only gave the movement, its size and shape but was a pace setter of co-operative activities and stressed the basic concept of, self-help and mutual aid.” This has made the remarkable sign in the history of Co-operative Credit Institutions in India.

In general there was assumption that urban banks have an important role to play in economic structure. This statement was asserted by organizers of committees. 39th Banking Enquiry Committee has observed that urban banks will help the small business and middle class people. According to Mehta-Bhansali Committee 1939 the recommendation made regarding societies which had fulfilled the criteria of financial functioning of banks. The Co-operative Planning Committee 1946 went on record to say that urban banks have been the best agencies for small people in whom Joint stock banks are not generally interested. The Rural Banking Enquiry Committee 1950 impressed by the feature of low cost of establishment and operations recommended the establishment of such banks even in smaller regions than talukas and towns. In reality development of co-operative banks took place after the recommendations of All India Rural Credit Survey Committee, which were made with the view to fasten the growth of co-operative banks.

The UCB’s are expected to perform some duties, namely, extend all types of credit facilities to customers in cash and kind, advance consumer loans, extending of banking facilities in rural areas, mobilize deposits etc. The needs of co-operative bank are different. UCB’s have faced a lot of problems, which resulted in negative development of co-operative banks. Therefore it was necessary to study this concept.

The first review study of Urban Co-operative Banks was taken up by RBI in the year 1958-59. The Report published in 1961 indicated enlarged and financially sound framework of urban co-operative banks. It emphasized the need to establish primary urban co-operative banks in new centers and suggested that State Governments to give
active support for their development. During 1963, Verde Committee recommended that UCB’S should be organized at Urban Centers with a population of 1 lakh or more and not by any single community or caste. The committee also suggested that the equation of minimum capital requirement and the criteria of population for defining the urban center, where UCBs were incorporated.

Table 1.1: Table consist of explanation regarding Deposits, Advances and Assets of top ten UCBs and bottom ten PCBs in India.

<table>
<thead>
<tr>
<th>Banks</th>
<th>Deposits</th>
<th>Advances</th>
<th>Total Assets</th>
</tr>
</thead>
<tbody>
<tr>
<td>Saraswat Co-operative Bank Ltd.,</td>
<td>271.71</td>
<td>177.98</td>
<td>348.28</td>
</tr>
<tr>
<td>Cosmos Co-operative Urban Bank Ltd.</td>
<td>158.35</td>
<td>111.6</td>
<td>190.89</td>
</tr>
<tr>
<td>Shamrao Vithal Co-operative Bank Ltd.</td>
<td>124.68</td>
<td>79.54</td>
<td>144.74</td>
</tr>
<tr>
<td>Abhyudaya Co-operative Bank Ltd., Mumbai</td>
<td>97.61</td>
<td>57.46</td>
<td>117.57</td>
</tr>
<tr>
<td>Bharat Co-operative Bank Ltd., Mumbai</td>
<td>77.58</td>
<td>52.53</td>
<td>89.35</td>
</tr>
<tr>
<td>TJSB Sahakari Bank</td>
<td>71.8</td>
<td>44.08</td>
<td>88.01</td>
</tr>
<tr>
<td>Punjab &amp; Maharashtra Co-operative Bank Ltd.</td>
<td>68.7</td>
<td>48.79</td>
<td>79.86</td>
</tr>
<tr>
<td>Janata Sahakari Bank Ltd., Pune.</td>
<td>70.7</td>
<td>47.51</td>
<td>79.69</td>
</tr>
<tr>
<td>Kalupur Commercial Coop.Bank Ltd.</td>
<td>47.56</td>
<td>27.29</td>
<td>62.92</td>
</tr>
<tr>
<td>NKGSB Co-operative Bank Ltd.,</td>
<td>53.35</td>
<td>36.37</td>
<td>61.82</td>
</tr>
</tbody>
</table>

Source: RBI Report of the High Powered Committee on Urban Co-operative Banks (UCBs) 2015.

During the year 2011-12 the financial capabilities of the urban co-operative sector has shown a considerable improvement indicating an increased return on assets and a decrease in Non-Performing Assets (NPAs). As per the CAMELS rating, 61 per cent of the UCBs, account for near about 78 per cent of the total banking business of the UCB sector. They have ratings of 'A' and 'B', indicating the good financial health of this sector. Continuing failures in Cooperative Banks by Sucheta Dalal in 2016 asking quest on ‘when will the cycle of political interference and failed supervision by Reserve Bank end?’

Cooperative banks fail with scandalous regularity and end up duping depositors who often get just 10% to 15% of their money after a decade-long liquidation process. Often, they only get Rs1 lakh each through the Deposit Insurance Guarantee Corporation (DIGC). According to Rajendra Phanse, director of a cooperative bank 165 UCBs have
been shut down in Maharashtra in the past 30 years. It is a negative effect generated by NPAs of UCBs.


The total deposits and advances of the UCB sector which together constitutes its business size grew from Rs.1398.71 billion and Rs. 904.44 billion as on March 2008 to Rs. 3155.03 billion and Rs. 1996.51 billion as on March 2014 registering a growth of 125.6% and 120.7% respectively. However, this growth was not common among all the UCB sector as some of them UCBs grew exponentially during the concern period. As such, some UCBs have shown such unprecedented growth in their balance sheet size over the years, that they have acquired the size of commercial banks.

While the number of UCBs has declined since 1770 to 2014, there was consistent growth in deposits and advances; it recorded a CAGR of 14.52% and 14.11% respectively which is surprising. List of large UCBs by business/assets size:

Table 1.1 indicate that Indian top ten UCBs and Deposits, Advances and Assets. It clearly states that top ten UCBs will in a position to take over the business of bottom ten private sector banks. Considering social values in general, these UCBs are of great importance in compare to bottom ten private bankers though in future UCBs may prosper their path can become like nationalized banks. Under this situation RBI and government of India shall give due importance for UCBs development.

1.2.6 Cooperative movement in Maharashtra

India is a union of States. Co-operation is a State subject, which falls within the scope of State legislation. Each State has its Co-operative Societies’ Act, as Maharashtra State Co-operative Societies Act, 1961, which regulates the working of the co-operative movement in Maharashtra. Co-operative credit structure has vital institutional arrangement for the development of agriculture and allied sectors. In Maharashtra State economy, especially in rural area, Co-operative credit structure is of three tier nature. Co-operative credit is divided in three type’s i. e. short term, medium term and long term credit. The nature of finance in UCB’s Consists of three levels, at - at the apex level there
is State co-operative bank, at the district level Central co-operative bank, and at the village or grass root level there is Primary Agricultural Credit Societies. The Short Term loan is made available for a period of 12 to 15 months for meeting the cost of expenditure during the agricultural season. Medium Term loan is given for a period of up to five years for the purchase of agricultural equipment. Thus the agricultural credit reached accurate to set their needs through the Primary Agricultural Credit Societies (PACS). Maharashtra State Co-operative Agriculture and Rural Development Bank (MASCARD) provides at the apex level, its branches at district level and sub branches at taluka level. Such loans granted by central Co-operative Land Mortgage Banks at the State level and their affiliated Primary Land Mortgage Banks at lower levels. The Long Term Loans are usually granted for period exceeding five years mainly for sinking of wells, permanent fencing, purchase of land, purchase of heavy agricultural machinery like tractors etc. as well as for lift irrigation schemes.

1.3 Non-performing Assets (NPA)

According to RBI explanations NPA is an asset, including a leased asset, becomes non-performing when it ceases to generate income for the bank. A ‘non-performing asset’ (NPA) was defined as a financing facility which results in overdue of interest and/or installment of principal for certain period. The specified period was reduced from four quarters to two quarters since 1995. There are various reforms and Acts that has been implemented to overcome this intense problem. Upgradation of restructured substandard accounts which were in respect of principal installment or interest amount, by whatever modality, would be eligible to be upgraded to the standard category only after the certain period i.e., a period of one year after the date when first payment of interest or of principal, whichever is earlier, falls due, subject to satisfactory performance during the period. The amount provided for earlier for the sacrifice shall also be reversed after the one year period. During this one year period, the sub-standard asset will not get deteriorate in its classification, if satisfactory performance of the account is shown. In case, the satisfactory performance during the one year period is not evidenced, the classification of the restructured account would be governed as per the applicable prudential norms with reference to the pre-restructuring payment schedule.
According to RBI, NPAs may go up to 5.4% by September 2016. The gross non-performing assets (NPAs) ratio of bad loans as a percentage of total loans of the Indian banking system could reach 5.4% by September 2016, the Reserve Bank of India's (RBI) financial stability report (FSR) said on December 24, 2015. In September 2015 the gross NPA was 5.1%.

According to the FSR report, the bad loan ratio could subsequently improve to 5.2% by March 2017. Meanwhile, RBI governor Raghuram Rajan had recently said that the central bank wants banks to clean up their balance sheets by March 2017.

Researcher personally observed during his thesis writing that SBI declared its financial report for the year ended March, 2017 in which it stated that present NPA of the bank is 6.5% which is reduced from 6.9% of previous quarters. Similar parameter need to be applied for UCBs also.

But according RBI governor NPAs movement is ongoing mechanism which depends on functioning of the UCBs. He further quoted that “This is an ongoing process and my hope is as the banks recognise more of what needs to recognise and they deal with the stressed assets,” it means fresh policy measures with respect to some of the stressed sectors are expected to help ease the pressure to some extent, the results may take time to manifest themselves fully.

It is considered that among the bank-groups, public sector banks (PSBs) might continue to register the highest NPA ratio. “Their GNPA ratio may go up to 6.3% by September 2016 from 6.2% as of September 2015 and may improve thereafter to 5.8% in March 2017,” the report said, adding that under a severe stress scenario, it may go up to 8.0% by March 2017.
Several prudential, payments, integrating and provisioning norms have been introduced to improve efficiency and trimming down the NPAs” to improve the financial health of the banking sector. In this sense present study observing the small part of NPAs which comes under the UCBs of Thane district.

Basically there are four types of assets are observing in the UCBs, those are i) Standard assets: it is generating regular income to the bank. ii) Sub-standard assets: it is overdue for a period of more than 90 days but less than 12 months. iii) Doubtful assets: it is overdue for a period of more than 12 months and iv) Loss assets: these are doubtful and considered as non-recoverable by bank, internal or external auditor or central bank inspectors.

NPA generally found observed three assets; in Sub-standard assets, Doubtful assets and Loss assets due to;

i) Default: “One of the main reasons behind NPA is default by borrowers,”

ii) Economic conditions: “In Economic sense if region is affected by natural calamities it may cause regional NPA”,

Figure 1.1: Relationship of NPA Characteristics

Source: Researcher developed on the basis of secondary data observation
iii) No more proper risk management: Rumor is one of the major reasons behind default. Sometimes banks provide loans to borrowers with bad credit history. Such cases result in maximization of defaults.

iv) Miss-management: Often ill-minded borrowers bribe bank officials to get loans with an intention of default.

v) Diversion of funds: Many times borrowers use the funds for the purposes other than mentioned in loan documents. It is very difficult to recover loan from these kinds of borrowers.

“DEEP SURGERY” is must for the clean-up that would require an “anesthetic” in the form of reorganizing NPA’s on their books. Raghuram Rajan, Ex. Governor Reserve Bank of India.

The UCBs are part of banking sector. It traces mainly an importance in the regional economic growth by serving the goals of economic policies enunciated in successive five-year development plan. The efficiency of UCBs is helping in the determination step of development in regional economy. In academic view the post-independence period, the Banking sector has played important and commendable role in supporting the government to achieve its social and economic objectives through deposit mobilization, mass branch networking, and priority sector lending, employment generation etc.

The asset quality is a prime concern and influences various performance indicators, i.e., profitability, intermediation costs, liquidity, credibility, income generating capacity and overall functioning of UCBs. The reduction in asset quality results in accumulation of Non-Performing Assets (NPAs).

In connectivity of present study, on the growth of NPA in the public and private sector banks in India, analysed sector wise non-performing assets of the commercial banks by academicians.

The present study focuses on the current scenario of urban co-operative banking system with special reference to Non-performing Assets (NPA) in Thane district, Maharashtra state of India, by mentioning its need, brief history, current structure, improvement in financial position of UCBs, contribution of UCBs towards economic
development of the country. This study also highlights the challenges faced under the NPA and its future effect on urban cooperative Banks.

1.3.1 Meaning & Norms of NPA

NPA is defined as a loan asset, which has stopped to generate any income for a bank whether in the form of interest or principal repayment. As per the prudential norms suggested by the Reserve Bank of India (RBI), a bank cannot book interest on an NPA on accrual basis. In other words, such interests can be booked only when it has been truly conservative. Therefore, an NPA account not only reduces profitability of banks by provisioning in the profit and loss account, but their carrying cost is also increased which results in excess & avoidable management attention. Apart from this, a high level of NPA also puts strain on a bank’s net worth because banks are under pressure to maintain a desired level of performance; it tries to look towards the internal financial strength to fulfill the norms thereby slowly eroding the net worth10.

Practical banking practice calls for efficient asset/liability management. A good banker is one who manages interest yielding assets by acquiring an optimum blend between risk-assets (Loan and Advances) and non-risk assets (treasury bills and government bonds) so as to cover his interest cost to depositors, overhead costs and a net return to shareholders. There is absolutely no logic for any banker to increase the proportion of risk assets to total interest yielding assets to a level where loan losses incurred continue to damage capital.

The past realities toward the UCB was cleared by the “plan to cite the moral hazard created by the National Democratic Alliance (NDA) immediately after the government came to power, when it ordered infusion of a massive Rs 2,375 crore to revive 23 unlicensed district cooperative banks across India. Mr Phanse alleges that these 23 were the worst among 313 banks whose finances were so grim that they must to have been shut down under RBI’s own licensing rules, but were saved by amending the rules. It’s an increasing interest the study on UCBs and particularly concerning the NPAs.

In the post-independence period, the Banking sector has plays important and commendable role in supporting the government to achieve its social and economic objectives through deposit mobilization, mass branch networking, and priority sector
lending, employment generation etc. The Urban Cooperative bank (UCB) also a part of it. It traces mainly an important in the regional economic growth by serve the goals of economic policies enunciated in successive five-year development plan. The efficiency of UCBs is helping in the determination step of development in regional economy.

NPA characterizes by its asset quality. It influences various performance indicators, i.e., profitability, costs, liquidity, credibility, income generating capacity and overall functioning of UCBs. The reduction in asset quality results in accumulation of Non-Performing Assets (NPAs). The reforming process is the main function of an every UCB. Since it involves counterpart risk characteristic.

The loans or advances are an important source of income for the UCBs. The strength and soundness of the UCBs primarily depend on the quality and performance of the loan selection, i.e. the serenity of responsibilities by borrowers promptly.

1.4 Basel Committee

The Basel Committee on Banking Supervision has its origins in the financial market turmoil that followed the breakdown of the Bretton Woods system of managed exchange rates in 1973. After the collapse of Bretton Woods, many banks suffered from losses. On 26 June 1974, West Germany's Federal Banking Supervisory Office withdrew Bankhaus Herstatt's banking license after finding that the bank's foreign exchange exposures amounted to three times of its capital. Banks outside Germany registered heavy losses on their unsettled business accounts with Herstatt. In October the same year, the Franklin National Bank of New York also closed its doors after incurring large foreign exchange losses.11

Presently committee members come from Argentina, Australia, Belgium, Brazil, Canada, China, France, Germany, Hong Kong SAR, India, Indonesia, Italy, Japan, Korea, Luxembourg, Mexico, the Netherlands, Russia, Saudi Arabia, Singapore, South Africa, Spain, Sweden, Switzerland, Turkey, the United Kingdom and the United States. The Committee's headquarters are located at the Bank for International Settlements (BIS) in Basel, Switzerland. However, the BIS and the Basel Committee remain two distinct entities. First are specific task forces to work on specific issues i) The Standards Implementation Group (SIG) and ii) The Policy Development Group (PDG).
Luxembourg formed a standing committee in 1974 under the control of the Bank for International Settlements (BIS), called the Basel Committee on Banking Supervision. Since BIS is headquartered in Basel, this committee got its name from there. The committee comprises representatives from central banks and regulatory authorities. In 1988, the Basel Committee on Banking Supervision (BCBS) in Basel, Switzerland, published a set of minimum capital requirements for banks. These norms were known as Basel I which focused on credit risk i.e. default risk - the risk of counter party failure. It defined capital requirement and structure of risk weights for banks. Basel II was introduced in 2004, laid down guidelines for capital adequacy, risk management and disclosure requirements. Basel III norms were proposed in 2010. The guidelines of Basel III aim to promote a more efficient banking system by focusing on four vital banking parameters viz. capital, leverage, funding and liquidity.

The Committee encourages full, timely and consistent implementation of its standards by members and, in 2012, began monitoring implementation to improve the resilience of the global banking system, promote public confidence in prudential ratios and encourage a regulatory level playing field for internationally active banks.

In 1996, a Joint Forum was established under the sponsorship of the Basel Committee on Banking Supervision (BCBS), the International Organization of Securities Commissions (IOSCO) and the International Association of Insurance Supervisors (IAIS) to deal with issues common to the banking, securities and insurance sectors, including the regulation of financial mismanagements. It consists of similar number of senior bank, insurance and securities supervisors representing each supervisory constituency. This Forum discontinued its operations in 2015, after it was superseded by bilateral and other arrangements for cooperation. The secretariat for the Joint Forum was provided by the Basel Committee.

1.4.1 Basel- I

It is the foundations for supervision of internationally active banks laid, capital adequacy soon became the main focus of the Committee's activities. In 1980s the Latin American debt crisis threatened the Committee's concerns that the capital ratios of the main international banks were deteriorating at a time of growing international risks.
Committee members decided to restructure the capital standards their banking systems and to work towards ease in the measurement of capital adequacy. This resulted in a broad consensus on a weighted approach to the measurement of risk.

There was strong recognition within the Committee of the superseding need for a multinational accord to strengthen the stability of the international banking system and to remove a source of competitive inequality arising from differences in national capital requirements. Following comments on a consultative paper published in December 1987, a capital measurement system commonly referred to as the Basel Capital Accord (1988 Accord) was approved by the G10 Governors and released to banks in July 1988.

The 1988 Accord has made a provision of minimum capital ratio of capital to risk-weighted assets of 8% since 1992. This framework was introduced all over the world with active international banks. In September 1993, the Committee issued a statement confirming that G10 countries' banks with material international banking business were meeting the minimum requirements set out in the Accord.

The Accord was always intended to have over time, which was amended in November 1991. According to the 1991 amendment gave greater precision to the definition of general provisions or general loan-loss reserves that could be included in the capital adequacy calculation. In April 1995, the Committee issued an amendment, to take effect at end-1995, to recognize the effects of bilateral netting of banks' credit exposures in derivative products and to expand the matrix of add-on factors. In April 1996, additional documents were issued explaining how Committee members intended to recognize the effects of multilateral netting.

The Committee also focused on credit, which was the focus of the 1988 Accord. In January 1996, following two consultative processes, the Committee issued the so-called Market Risk Amendment to the Capital Accord, to take effect at the end of 1997. This was designed to incorporate within the Accord a capital requirement for the market risks arising from banks' exposures to foreign exchange, traded debt securities, equities, commodities and options. An important aspect of the Market Risk Amendment was that banks were allowed to use internal models as a basis for measuring their market risk capital requirements, subject to strict quantitative and qualitative standards. Much of the
preparatory work for the market risk package was undertaken jointly with securities regulators.

1.4.2 Basel - II

It is observed that reforming in capital framework is introduced in Basel II during 1999; the Committee issued a proposal for a new capital adequacy framework to replace the 1988 Accord. This led to the release of the Revised Capital Framework in June 2004. Generally known as "Basel II", the revised framework comprised three pillars, namely: a) Minimum capital requirements, which sought to develop and expand the standardized rules set out in the 1988 Accord; b) supervisory review of an institution's capital adequacy and internal assessment process; and c) effective use of disclosure as a lever to strengthen market discipline and encourage sound banking practices.

The new framework was designed to improve the capital requirements which reflect underlying risks and to address the financial innovation that occurred in recent years. The changes aimed at rewarding and encouraging continued improvements in risk measurement and control.

The framework's publication in June 2004 followed almost six years of intensive preparation. During this period, the Basel Committee consulted various agencies, representatives, supervisory agencies, central banks and outside observers in an attempt for development of risk-sensitive capital requirements.

Following the June 2004 release, which focused primarily on the banking book, the Committee turned its attention to the trading book. In close cooperation with the International Organization of Securities Commissions (IOSCO), the international body of securities regulators, the Committee published in July 2005 a consensus document governing the treatment of banks' trading books under the new framework. For ease of reference, this new text was integrated with the June 2004 text in a comprehensive document released in June 2006: Basel II: International Convergence of Capital Measurement and Capital Standards: A Revised Framework - Comprehensive Version.

All the countries including member and non-member countries agreed to adopt the new rules. Thereafter, consistent implementation of the new framework across
borders became a more challenging task for the Committee. The entire supervisors faced problem worldwide under Basel II was the need to approve the use of certain approaches to risk measurement in multiple jurisdictions. This concept was not new for the supervisory community – there was involvement of market risk. A similar requirement - Basel II extended the scope of such approvals and demanded an even greater degree of cooperation between home and host supervisors. To overcome this issue, the Committee issued guidance on information-sharing in 2006. In the subsequent year, advice on supervisory cooperation and allocation mechanisms were also took place.

1.4.3 Basel - III

To overcome the financial crisis like Lehman Brothers mishap the need for a fundamental establishment was become necessary. The banking sector suffered huge financial crisis with too much influence and insufficient liquidity buff. This was due to poor governance and risk management, as well as unsuitable incentive structures. The dangerous combination of these factors was demonstrated by the mispricing of credit and liquidity risk, and excess credit growth.

Responding to these risk factors, the Basel Committee issued principles for sound liquidity risk management and supervision in the same month that Lehman Brothers failed. In July 2009, the Committee issued revised guidelines of documents to strengthen the Basel II capital framework, preferably with regard to the treatment of certain complex securitization positions, off-balance sheet vehicles and trading book exposures. These enhancements were part of broader guidelines to strengthen the regulation and supervision of internationally active banks, in the light of weaknesses revealed by the financial market crisis.

In September 2010, global minimum capital standards for commercial banks were announced. This followed an agreement prepared in July regarding reforming the capital and liquidity reform package, now referred to as "Basel III". In November 2010, the new capital and liquidity standards were declared at the G20 Leaders’ Summit in Seoul and subsequently agreed at the December 2010 Basel Committee meeting.

The proposed standards were issued by the Committee in mid-December 2010 (and have been subsequently revised). The December 2010 versions were set out in Basel
III: International framework for liquidity risk measurement, standards and monitoring
and Basel III: A global regulatory framework for more resilient banks and banking
systems. The enhanced Basel framework revised and strengthened the three pillars
established by Basel II. It also extended the framework with several innovations, namely:

a) An additional layer of common equity - the capital conservation buffer - that, when breached, restricts payouts of earnings to help protect the minimum common equity requirement;

b) A countercyclical capital buffer, which regulates restrictions on participation by banks in system-wide credit booms with the aim of reducing their losses in credit busts;

c) A leverage ratio - a minimum amount of loss-absorbing capital relative to all of a bank's assets and off-balance sheet exposures regardless of risk weighting (defined as the "capital measure" (the numerator) divided by the "exposure measure" (the denominator) expressed as a percentage);

d) Liquidity requirements - a minimum liquidity ratio, the liquidity coverage ratio (LCR), intended to provide enough cash to cover funding needs over a 30-day period of stress; and a longer-term ratio, the net stable funding ratio (NSFR), intended to address maturity mismatches over the entire balance sheet; and

e) Additional proposals for systemically important banks, including requirements for supplementary capital, augmented contingent capital and strengthened arrangements for cross-border supervision and resolution.

In January 2012, the GHOS endorsed a detailed process which was proposed by the Committee to monitor members' implementation of Basel III. The Regulatory Consistency Assessment Programme (RCAP) consists of two distinct but complementary work streams to monitor the timely adoption of Basel III standards, and to assess the consistency and completeness of the adopted standards including the significance of any deviations in the regulatory framework.

The Basel Committee has worked in close collaboration with the Financial Stability Board (FSB) given the FSB's role in coordinating the monitoring of
implementation of regulatory reforms. The Committee designed its programme to be consistent with the FSB's Coordination framework for monitoring the implementation of financial reforms (CFIM) as agreed by the G20.

These revised definitions of capital, significantly higher minimum ratios and the introduction of a macro-prudential display the fundamental overhaul for banking regulation. Therefore in totality, the Basel Committee, its governing body and the G20 Leaders have emphasized that the reforms will be introduced recovery as per requirement of the real economy.

Further, time is needed to translate the new international norms into national legislation. To overcome these problems, a set of transitional arrangements for the new standards was announced in September 2010. National authorities were also given freedom to impose higher standards and shorten transition periods where appropriate.

This strengthened definition of capital will phase in over five years its requirements were introduced in 2013 and will be fully implemented by the end of 2017. Capital instruments that no longer qualify as common equity Tier 1 capital or Tier 2 capital will be phased out over a 10-year period, beginning 1 January 2013.

Diverting to the minimum capital requirements, Tier 1 capital were phased in from 2013, and will become effective at the beginning of 2015. The schedule is as follows:

a) The minimum common equity and Tier 1 requirements increased from 2% and 4% to 3.5% and 4.5%, respectively, at the beginning of 2013.

b) The minimum common equity and Tier 1 requirements rose to 4% and 5.5%, respectively, at the beginning of 2014.

c) The final requirements for common equity and Tier 1 capital will be 4.5% and 6%, respectively, beginning in 2015.

d) The 2.5% capital conservation buffer, which will comprise common equity and is in addition to the 4.5% minimum requirement, will be phased progressively starting on 1 January 2016, and will become fully effective by 1 January 2019. In beginning with all the bankers are asked to clean their balance-sheet by 31 March 2017. Researcher noted
that tremendous fluctuation in functioning and management of the selected UCBs of the present study.

The leverage is improving gradually. Began in 2013 and will run until 2019, with a view to migrating to a Pillar 1 treatment on 1 January 2018 based on review and appropriate calibration. The evaluative measure of the leverage ratios were finalized in January 2014.

The liquidity coverage ratio (LCR) was phased in from 1 January 2015 and bankers will be require to hold a buffer of good liquid assets sufficient to deal with the cash outflows encountered in an acute short-term stress scenario as specified by supervisors. To ensure that banks can implement the LCR without disruption to their financing activities, the minimum LCR requirement will begin at 60% in 2015, rising in equal annual steps of 10 percentage points to reach 100% on 1 January 2019.

The other minimum liquidity standard criteria’s were introduced by Basel III was net stable funding ratio. Which will take effect as a minimum standard by 1 January 2018, and will promote longer term funding and provide incentives for banks to use stable funding sources? So it will resulting in minimizes the NPA of studied UCBs

1.4.4 Basel - IV

According to Basel-IV it is expected to follow the third Basel accords (Basel III), and would require more stringent capital requirements and greater financial disclosure.

Patricia Jackson\textsuperscript{13}, presented in her paper that looks at the changes that have been announced, as well as those still under consideration, and the implications for banks. The areas of change cover three broad themes which are as follows;

1. Unfinished business has led to a significant volume of change. For example, the swift changes to the market risk requirements and securitization treatments immediately post-crisis were seen as stopgap measures, and a fundamental review of the FRTB was launched. It was focused in particular on the treatment of the relative liquidity or illiquidity of different instruments (and the banking book/trading book boundary), as well as a more consistent approach to modeling tail risks within market risk portfolios. Another area of unfinished business was the bank wise leverage ratio.
2. Suitable standard approaches were observed as necessity for credit risk, counterparty risk, operational risk, and in the FRTB, market risk. These were possible for a bank to move from a modeled to a standardized approach for the regular capital calculations if there were concerns over the quality of its internal models. Improved approaches were also standardized and were more risk-sensitive. Under the FRTB, it has been stated explicitly that the standardized will be a floor against the modeled-position risk requirements.

3. Continuous capital requirements for banks were raised as an important issue, in consideration with use of internal ratings-based (IRB) models for credit risk. This will result into taking out of the IRB scope and the introduction of floors on certain parameters in the models.

It is clear that the changes announced to date and the path of future changes will drive capital requirements for banks yet higher.

All the banks at various level i.e. regional to international will be affected, both large international banks and those more locally focused. Even though for some low-risk bankers may manage the standardized approaches, such as mortgage banks with very low loan-to-value (LTV) mortgages, there could be reductions in the capital required as the non-modeled approaches become more risk-sensitive, other standardized approach banks will see increases.

1.5 Evolutionary path of Indian Cooperative Banks

In India co-operative institutions was emerged during 19th century, when the first mutual aid society was formed in Gujarat at Baroda on February 05, 1889. According to Mr. R. Gandhi, Dy. Governor, RBI, the Banking Regulation Act, 1949 was extended to co-operative societies on March 01, 1966 when there were about 1100 UCBs in existence. In 1996 there were 1501 UCBs, this number has gone up to 1926 UCBs in 2004. On the basis of weakness and sickness 38% of total UCBs were categorized in Grade III or IV. Which has forced the Reserve Bank to look at the sector differently and new regulations had to be prescribed.
It was also observed that nearly one third of the newly created UCBs became financially unsound within a short span of time. In this view it was announced in the monetary policy statement for 2004-05 that no fresh proposals for setting up of new Urban Co-operative Bank (UCB) or for conversion of Co-operative Credit Societies into UCBs will be considered till a comprehensive policy on UCBs, including an appropriate legal and regulatory framework for the urban co-operative banking sector is put in place and a policy for improving the financial health of the urban co-operative banking sector is formulated. Further, controlling was also made on issuance of new branch licenses for the UCBs.

A vision document for the UCB sector was drawn up by RBI in 2005 which imagined that state specific strategy would be adopted to deal with the UCBs. Then business growth of the UCB sector emerged financially stronger ever since RBI conceived the document for the sector in 2005. The Document envisaged a multi-layered regulatory and supervisory approach, revival of potentially viable UCBs and non-disruptive exit of non-viable ones. This sector witnessed a process of rehabilitation and consolidation. The number of UCBs has reduced from 1872 as at the end of March 2005 to 1579 as at the end of March 2015 because of mergers of UCB’s. The sector accounted for 3.9% of the deposits of the banking sector and 3.3% of the advances by the banking sector as on March 31, 2015.

RBI observed that asset quality of the UCB sector was improved as reflected by the continuous decline in the gross NPAs ratio from 21% as on March 2003 to 6.02% as on March 2015. The gross NPAs are still very high as compared with commercial banks which have Gross NPAs at 4.62% as on March 31, 2015.

The profitability of the UCB sector has also shown remarkable improvement as net profit increased to 34.89 billion during the financial year 2014-15. Return on Assets (RoA) had increased to 0.84% in 2015 and Return on Equity (RoE) had increased to 9.85% in 2015. In respects of capital capability, it was observed that 1503 UCBs i.e. 95.18% of the total UCBs have reported a CRAR of 9 per cent or more as on March 2015. The UCB sector, still, continues to be upset with the existence of 48 UCBs which
are having negative net worth. Overall situations increased the interest of researcher for district level NPA study of UCBs.
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