CHAPTER 3
INDIAN BANKING: AN OVERVIEW

In this Chapter, researcher states the origin and evolution of commercial banking in India with special reference to financial sector reforms. This chapter of the study covers the growth of banking industry in India, progress of banking industry, history of banking industry, background of Indian banking industry.

Banking has played a very important role in the economic development of all the nations of the world. Banking is the lifeblood of modern commerce. Modern commerce is dependent upon banking so much that any cessation of banking activity, even for a day or two, would completely paralyze the economic life of a nation. From its original narrow scope and modest purpose of taking care of other people’s money and lending a part of it, banking has developed to such an extent that, in countries like England, France and U.S.A., there is hardly a business deal in which the support of a bank is not required in one form or another.¹

3.1 Bank : The Term Define
Halbury in his ‘Laws of England’ defined banker as an individual, partnership or corporation, whose one and only business is banking, with the aim of the receiving of money on current or deposit account, and the payments of cheques drawn by and the collection of cheques paid in by a customer. Charles J.Woelfel has defined a bank as “any organization engaged in any or all of the various functions of banking i.e., receiving, collecting, transferring, paying, lending, investing, dealing, exchanging and servicing (safe deposits, custodianship, agency, trusteeship) money and claims to money both domestically and internationally”. Dr. H.L.Hart has defined a banker or a bank as “a person or company carrying on the business of receiving money and collecting drafts for customers subject to the obligation of honoring cheques drawn upon them from time to time by the customers to the extent of the amounts available on their current account.
3.1.1 Business of Bank

Banking, according to section 5(b) of the Banking Regulation Act 1949 is:
- Acceptance of deposits from the public and
- Use of deposits in direct lending to borrowers and / or indirect lending through investment in open market securities.

Banking has been defined as YOUR MONEY and MY BRAIN

‘Your money’ refers to the deposits gathered together and ‘my brain’ indicates the standard of productiveness of a banker’s brain in receiving highest return by careful consumption of such deposits which is mobilized. Thus, banks are known as both the repositories of the society savings and purveyor of credits for financial developments. ‘It gathers money from those who have surplus and it lends these money out to those, who require it In order to offer a convenient place to the investors for the investment of the surplus fund and to the investors a source of finance, the banks work as agents or middlemen.

3.2 Evolution of Commercial Banking in India

As per Central Banking Enquiry Committee (1931), money-lending activity in India can be traced to the Vedic period i.e. 2000 to 1400 BC. Banking system was quite varied and was providing the money needs of the trade, commerce, agriculture and individuals in the economy. The huge network of Indian banking houses existed in the country linking the entire towns and cities. They had their own inland bills of exchange or hundis which were the major forms of transactions between Indian bankers and their trans-regional connections. The pre-independence period primarily characterized by the existence of private banks organized as joint Stock companies. The period leading up to independence put down the basics of the Indian Banking System. The western variety of joint stock banking was brought to India by the English Agency houses of Calcutta and Bombay. The first bank of joint stock was Bank of Bombay, established in 1720 in Bombay, followed by Bank of Hindustan in Calcutta, established in 1770 by an agency house that was closed subsequently in 1832. In 1786, the English Agency Houses had established the Bank of Bengal at Calcutta. This was the indication of the beginning of modern banking in India.
As on 2 June 1806, first presidency bank i.e. Bank of Bengal was setup with the capital of rupee fifty lakhs. The Government subscribed twenty percent of its share capital and the bank was given the freedom of appointing directors with voting rights. In 1823, Bank of Bengal was given rights to issue notes. In Year 1840 the second presidency bank, The Bank of Bombay was established with a capital of fifty two Lakh and in July, 1843 with a capital of thirty lakhs, the Bank of Madras, the third presidency bank was established.

3.2.1 From 1860 to 1900

The first formal principles for banks were the introduction of the companies Act in 1850. This act put unlimited liability in favor of banking and insurance companies until 1860. The concept of limited liability was introduced in banking system in 1860, so that, several joint stock banks were floated. List of some of the prominent joint sector banks thus established:

(a) The Allahabad Bank,
(b) The Alliance Bank of Simla,
(c) The Aundh Bank
(d) The Punjab National Bank.

Thus, by the end of 1900 there were three classes of banks in India:

(i) Three Presidency Banks numbering.
(ii) Nine Joint Sector Banks numbering.
(iii)Eight Exchange Banks or Foreign Banks numbering.

3.2.2 From 1900 to 1950

In the early 1900s, The Swadeshi movement started giving motivation to the expansion of indigenous joint stock banks. Some of the banks established during the period were: (i) The Central Bank of India, (ii) The Bank of India, (iii) The Bank of Baroda, and (iv) The Central Bank of India. Three Presidency Banks were merged and created The Imperial Bank of India in the year 1921. In 1947, there were 648 commercial banks including 97 scheduled and 551 non-scheduled banks. The number of offices of the banks stood at 2,987, total deposits at Rs.1,080/- crore and advances at Rs.475/- crore.

Throughout this period, the Indian joint stock banks focused in providing short-term credit for trade in the form of cash credit and overdraft facilities.
Many banks failed between 1900 to 1925. In 1929, The Central Banking Enquiry Committee, which was constituted by the Government of India to study the importance of establishing a central banking authority for India, and stated some important reasons responsible for the failure of banks. They were: (a) insufficient capital, (b) poor liquidity of assets, (c) combination of non-banking activities with banking activities, (d) irrational credit policy, and (e) incompetent and inexperienced directors.

Table No.3.1 Bank failures in India 1913 – 1921

<table>
<thead>
<tr>
<th>Year (Jan – Dec)</th>
<th>Number of Banks failed</th>
<th>Paid-up Capital of Failed Banks (‘000)</th>
<th>Average paid-up capital of failed banks (‘000)</th>
<th>Average paid-up capital of reporting Banks in Category A &amp; B (‘000)</th>
</tr>
</thead>
<tbody>
<tr>
<td>(1)</td>
<td>(2)</td>
<td>(3)</td>
<td>(4)</td>
<td>(5)</td>
</tr>
<tr>
<td>1913</td>
<td>12</td>
<td>3514</td>
<td>293</td>
<td>1152</td>
</tr>
<tr>
<td>1914</td>
<td>42</td>
<td>10902</td>
<td>260</td>
<td>1195</td>
</tr>
<tr>
<td>1915</td>
<td>11</td>
<td>451</td>
<td>41</td>
<td>1190</td>
</tr>
<tr>
<td>1916</td>
<td>13</td>
<td>423</td>
<td>33</td>
<td>1170</td>
</tr>
<tr>
<td>1917</td>
<td>9</td>
<td>2526</td>
<td>281</td>
<td>1315</td>
</tr>
<tr>
<td>1918</td>
<td>7</td>
<td>146</td>
<td>21</td>
<td>1433</td>
</tr>
<tr>
<td>1919</td>
<td>4</td>
<td>403</td>
<td>101</td>
<td>1585</td>
</tr>
<tr>
<td>1920</td>
<td>3</td>
<td>725</td>
<td>242</td>
<td>1675</td>
</tr>
<tr>
<td>1921</td>
<td>7</td>
<td>125</td>
<td>18</td>
<td>1901</td>
</tr>
</tbody>
</table>

Note: Category A: Banks with capital and reserves of ` 5 lakhs and over. Category B: Banks with capital and reserves of over ` 1 lakh and up to ` 5 lakhs.

Reserve Bank of India Act was passed in 1934. As the central banking authority of the country, the Reserve Bank of India (RBI) came into existence in 1935. In 1949 the Banking Regulation Act (BR Act) was approved which give the constitution for the RBI’s guidelines and directions of banks. The Act authorizes RBI to control, administer and develop the banking structure. The power of Banking Regulation Act consists of guidelines for the mergers and
amalgamation of existing banks, establishment of new banks, opening of new branches, closing of existing branches, and shifting of existing branches to new places. The Banking Regulation Act authorized RBI on-site inspection of banks. Throughout the period following 1949, RBI makes an effort to pull together the savings of the public and to adapt a credit system suitable to the rising requirements of the economy.

3.2.3 From 1950 to 1969:

Two important developments took place from the period of 1950 to 1969. First, the All-India Rural Credit Survey Committee suggested the formation of a state partnered/sponsored bank entrusting by the mission of opening branches within the rural areas and scrutinizes the matter of credit accessibility in the rural areas. Accepting the recommendation, the State Bank of India Act, 1955 was passed, under which RBI took control of the Imperial Bank of India and renamed it as State Bank of India (SBI). In 1959, the State Bank of India (Subsidiary Banks) Act was passed allowing SBI to takeover eight state associated banks as its subsidiaries. They were: (1) State Bank of Bikaner, (2) State Bank of Hyderabad, (3) State Bank of Indore, (4) State Bank of Jaipur, (5) State Bank of Mysore, (6) State Bank of Patiala, (7) State Bank of Saurashtra, and (8) State Bank of Travancore. Afterwards out of these eight banks, State Bank of Bikaner and State Bank of Jaipur merged into one bank that is State Bank of Bikaner and Jaipur. The conversion of the Imperial Bank of India into State Bank of India and the formation of the associated banks accelerated the speed to expand banking facilities across the country.

Secondly, in December 1967, the need to bring about wider flow of banking facilities and to change the uneven distributive pattern of bank lending was realized. In December 1967, in the Parliament for relative priorities of progress requirements and for ensuring an equitable and purposeful distribution of credit the scheme of Social Control over Banks was announced. Social Control was planned for attaining a social orientation of banking inside the structure of the existing ownership. The National Credit Council was set up in 1968, to assess the demand for bank credit from different parts of the economy and to make a judgment about their respective priorities in allotment. At the beginning of the First Five Year Plan in 1951, there were 566
commercial banks consisting of 92 scheduled and 474 non-scheduled banks. In 1969, total number of banks declined to 89 out of which 73 were scheduled and 16 were non-scheduled. In the early independence stage, the banking scenario had three distinct features. One, the bank failures had raised the fears regarding the soundness and stability of the banking system. Two, there was large concentration of resources from deposits mobilization in a few hands of business families or groups. Banks raised funds and lent them largely to their controlling entities. Three, agriculture was neglected as far as bank credit was concerned. A major development during this period was the enactment of the Banking Regulation Act empowering the RBI to regulate and supervise the banking sector.

3.2.4 From 1969 to 1990: Era of Nationalization


The Bank Nationalization Act, 1969, states that, the banking system, which touches and should touch the lives of millions, has to be inspired by larger social functions and objectives such as rapid growth in agriculture, small industry and exports, raising employment levels, encouragement of new entrepreneurs, and the development of the backward areas. The Government should take direct responsibility for expansion and diversification of banking services and for the working of substantial part of the banking system. The acquisition of ownership of banks had enabled banks to play, more effectively,
the role of key agent for the economic growth by extending banking facilities to the most deserving classes.


Another important structural development was the formation of the Regional Rural Banks (RRBs). In 1973, the Government of India had set up a Working Group to study the credit availability in the rural areas. The Working Group recognized various weaknesses of the co-operative credit agencies and commercial banks and came to the conclusion that they may not be able to fulfill the regional and functional needs of the rural credit system. The Study group recommended a new type of institution, which combined the rural touch and experience of cooperatives with the modernized outlook and capacity to mobilize the deposits. Such an institution can carry on banking business within the local limits specified by the Government through notification. The Government of India accepted this recommendation and permitted the establishment of Regional Rural Banks (RRBs). The RRBs are State sponsored, region based, rural oriented commercial banks, set up under the Regional Rural Banks Act 1976. Their ownership vests with the sponsor commercial bank, the Central Government, and the Government of the State in which they are geographically located. Under this approach, 196 RRBs were set up.

3.2.5 1990 onwards Era of Reforms

In 1991, the Government of India launched an extensive economic reform programme. As a part of general reforms, reform measures were introduced in the financial sector. The financial sector reforms were based on the recommendations of the Committee on Financial Sector, 1991 (Narasimham I), and the Committee on the Banking Sector Reform, 1997 (Narasimham II). The main aim of the alteration was to support efficiency of the banking system through competitive services. The policy accepted to raise operational
efficiency of the banking structure and to impart functional autonomy through reduced regulator’s direct interferences in the functioning of the institutions. Reform measures not only imparted greater transparency in dealing and reporting by the entities but also integrated various segments of the financial system such as money market, debt market, foreign exchange market and capital market.

The reform in the banking and financial sector was guided by ‘Pancha Sutra’ or five principles; i) cautious sequencing of reform measures, ii) introduction of norms that were mainly reinforcing, iii) introduction of complementary reforms across sectors, iv) development of financial institutions and v) development and integration of financial markets.

3.2.5.1 Reform Measures for strengthening banks

- Reduction in the pre-emption of funds through lowering the Cash Reserve Ratio (CRR) and Statutory Liquidity Ratio (SLR)
- Redefining and redesigning directed credit programmes
- Dismantling administered interest rates
- Establishment of relevant institutional set up :-
  - Discount and Finance House of India (DFHI) Securities Trading Corporation of India (STCI), Primary Dealers and WDM segment in NSE to strengthen Debt market
  - Introduction of Delivery Versus Payment (DVP) and Negotiated Dealing System (NDS) to improve payment and settlement system in the Government securities market.
- Setting up of a level playing field by redefining the roles of banks and other financial entities
- Promoting competition by permitting new banks in the private sector
- Improving financial health of banks through prescription of risk-weighted capital adequacy ratios, re-capitalization and restructuring of weak banks
- Changes in bank branch licensing policy with a view to helping banks to rationalize their branch network
• Promoting higher standards of accounting and disclosure through prescribing norms for income recognition, asset classification and provisioning for assets on the international lines

• Imparting flexibility in credit delivery system by withdrawing regulatory mandates regarding Maximum Permissible Bank Finance (MPBF).

• Setting up of special Debt Recovery Tribunals (DRTs) for improving recovery of bank loans.

• Introduction of a scheme to disclose information about willful defaulters

• Adoption of reporting standards comparable to the international best practices.

• Strengthening internal monitoring through audit and control systems

• Adoption of modern technology

• Rationalization of manpower permitting banks to introduce voluntary retirement schemes

• Adoption of the principles of Corporate Governance

• Implementation of new Accounting Standards

• Supervision of financial conglomerates

• Application of advanced technology

• Financial Inclusion

The most important stage in the evolution of banking was the stage of financial sector reforms that began in 1991 – 92, which had two sub-phases (1991 – 92 to 1997 – 98; and 1998 – 99 and beyond). First sub-phase (1991 – 92 to 1997 – 98) was the weak health of the banking sector, low profitability weak capital base and lack of adequate competition. To infuse competition in the banking sector, several measures were initiated such as permitting the entry of private banks into the system. A main success of this stage was significant progress in the profitability of the banking sector. However, banks in this phase developed risk aversion because of which credit expansions slowed down in general and to the agriculture sector in particular. In the second sub-phase (1998 – 99 and beyond) the emphasis was on further strengthening of the prudential norms in line with the international best practices, improving credit delivery, strengthening corporate governance practices, promoting financial inclusion, strengthening the urban co-operative
banking sector and improving the customer service. While strengthening the prudential norms, it was necessary to ensure that risk aversion, which had surfaced in the previous sub-phase, did not aggravate. The impact of these measures was encouraging as banks were able to bring down their non-performing assets sharply. This was the most important achievement of this phase. As the asset quality began to improve, banks also started expanding their credit portfolio. Capital position of banks also improved significantly. Competition intensified during this phase as was reflected in the narrowing down of margins. Banks slightly improved their profitability among others, due to increased volumes and improvement in asset quality. Two concerns arose with regard to corporate governance practices followed by banks. These related to concentrated ownership and quality of management that controlled the banks. The corporate governance practices were, therefore, strengthened. In this phase, there was increase in the flow of credit to the agriculture and SME sectors. With a view to bringing a larger segment of excluded population within the banking fold, banks were advised to introduce a facility of ‘no frills’ account. Thirteen million ‘no frills’ accounts were opened in a short span of two years. The confidence in the urban co-operative banking segment was eroded in the early 2000s following a run on a multi-state co-operative bank. In order to restore the confidence and overcome the problem of dual control over urban co-operative banks, a mechanism of the TAFCUBs was put in place, which helped restore the confidence in the urban co-operative banking segment. This phase also observed some important changes in the use of technology by banks. Increased use of technology combined with some other specific initiatives helped improve the customer service by banks.\(^{80}\)

Table 3.2 List of some of the important events, which took place in banking sector from 1973 to 2011:

<table>
<thead>
<tr>
<th>Year</th>
<th>Events</th>
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<tbody>
<tr>
<td>1973–74</td>
<td>• Setting targets for priority sector lending</td>
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<td>1974–75</td>
<td>• Prescription of norms for lending and working capital limits</td>
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<tr>
<td>1982–83</td>
<td>• Prof. S. Chakravarty’s report on Monetary System in India</td>
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<td>• Establishment of the National Bank for Agriculture and Rural Development (NABARD)</td>
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<td>1985–86</td>
<td>• Introduction of MICR Technology</td>
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<td>• Introduction of Health Code System for bank loans</td>
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<td>1987–88</td>
<td>• Permission to banks to float mutual funds</td>
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<td>• Vaghul Working Group on Money Market</td>
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<td>1988–89</td>
<td>• Establishment of the Discount and Finance House of India (DFHI) and the National Housing Bank (NHB)</td>
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<td>• Adoption of Service Area Approach</td>
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<tr>
<td>1989–90</td>
<td>• Enhancement of access to call money market in terms of number of participants</td>
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<td>• Establishment of the Small Industries Development Bank of India (SIDBI)</td>
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<td>1990–91</td>
<td>• Report of the Narasimham Committee on Financial sector Reforms</td>
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<td>• Introduction of new formats for annual accounts of the banks</td>
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<td>1992–93</td>
<td>• Introduction of rupee convertibility on current account</td>
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<td>1993–94</td>
<td>• Announcement of norms for floating new private sector banks</td>
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<td></td>
<td>• Establishment of State Trading Corporation of India (STCI)</td>
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<td></td>
<td>• Introduction of (a) risk – weighted capital adequacy norms (b) prudential norms for asset classifications, income recognition and provisioning for banks</td>
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<td>• Valuation of investment in government securities on the basis of market prices</td>
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<td>• Constitution of Debt Recovery Tribunals,</td>
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<td>• Merger of New Bank of India with Punjab National Bank</td>
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<tr>
<td>Year</td>
<td>Initiatives</td>
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</tbody>
</table>
| 1994 – 95 | • Reduction in the number of prescribed lending rates from six to three  
• Introduction of 365-day Treasury Bills with the market related rates  
• Aligning of rates of interest on dated securities of the Government with market rates  
• Deregulation of interest rates on loans over ` 2 lakh  
• Freedom to banks to decide their Prime lending Rates (PLR) and to link loan rates to their PLR  
• Permission to the Nationalised Banks to raise capital upto 49 per cent of equity from capital market  
• Setting up of the Board for Financial Supervision (BFS)  
• Amendment to the State Bank of India Act to allow the bank to access equity market  
• Budget provision of ` 5,700 crore to re-capitalized banks to enable them to meet new provisioning norms  
• Prescription of prudential norms for Non-Performing Assets  
• Establishment of Debt Recovery Tribunals |
| 1995 – 96 | • Introduction of the Banking Ombudsman Scheme  
• Streamlining of the cash credit system. Abolishment of Minimum Lending Rate on loans above ` 2 lakh |
| 1996 – 97 | • Implementation of measures to strengthen secondary market in government securities  
• The State Bank of India (SBI) issued Global Depository Receipt (GDR) and became the first Indian bank to be listed on stock exchange overseas.  
• Six firms, promoted by banks and financial institutions, were granted license to operate as Primary Dealers (PDs) in the Government Security market |
| 1997 – 98 | • Operationalisation of first shared payment ATM network system  
• Granting of conditional autonomy to the public sector banks.  
• Constitution of the Board for Bank Frauds |
| 1998 – 99 | • Report of the Narasimham Committee on Banking Sector Reforms  
• Revision of capital adequacy norms  
• Deregulation of interest rates on term deposits  
• Amendment to The Reserve Bank of India Act empowering it to supervise Non-Banking Financial Companies |
| 1999 – 2000 | • Issuance of guidelines on asset – liability management  
• Tightening of the provisioning norms for government securities and state Government guaranteed loans and assigning risk weights to this category of investment  
• Introduction of Kisan Credit Card Scheme  
• Permission to banks to operate different PLRs for different maturities of loans  
• Merger of the Times Bank with the HDFC Bank |
| 2000 – 01 | • Introduced a system of off-site surveillance for scheduled UCBs through quarterly returns  
• Given freedom to banks to price loans of Rs. 2 lakh  
• Guidelines issued for compromise settlement of dues of banks and Financial Institutions through Lok Adalat  
• Advised banks to formulate polices for recovery / write off / compromise and negotiated settlements with the approval of Boards for old and unresolved cases under NPA category |
| 2001 – 02 | • Advised to build up Investment Fluctuation Reserve (IFR)  
• Guidelines issued for raising subordinated debt for inclusion in Tier II capital by foreign banks operating in India  
• Guidelines issued on foreign direct investment (FDI) in the banking sector  
• Issued guidelines on market risk management  
• The RBI approved the merger of ICICI Ltd. With ICICI Bank Ltd. The Non-Resident (Non-Repartiable) Rupee Account Scheme and Non-Resident (Special) Rupee Account Scheme discontinued w.e.f. 1.4.2002. |
<table>
<thead>
<tr>
<th>Year</th>
<th>Events</th>
</tr>
</thead>
<tbody>
<tr>
<td>2002 – 03</td>
<td>- The Accounting Standards AS 17, AS 18, AS 21 &amp; AS 22 made applicable to banks w.e.f. 31.03.2003&lt;br&gt;- Advised to take penal measures against willful defaulters&lt;br&gt;- The Benares State Bank Ltd. Merged with Bank of Baroda w.e.f. 20.06.2002&lt;br&gt;- Scheme formulated for setting up offshore banking units (OBUs) in Special Economic Zones by banks&lt;br&gt;- Public sector banks introduced One-time-settlement schemes giving opportunity to the borrowers for settlement of their outstanding dues / NPA accounts below a prescribed value ceiling</td>
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<tr>
<td>2003 – 04</td>
<td>- RBI gave freedom to banks to determine interest rates on loans and advances (i) for purchase of consumer durables, (ii) to individuals against shares and debentures / bonds, and (iii) other non-priority sector personal loans regardless the size of the loans.&lt;br&gt;- Banks were given, freedom to decide all aspects relating to renewal of overdue deposits.&lt;br&gt;- Prudential guidelines on banks’ investment in non-SLR securities were issued to contain risks.&lt;br&gt;- Banks were advised to strictly maintain the confidentiality of information provided by the customer for “Know Your Customer” (KYC) compliance.&lt;br&gt;- Banks were allowed to raise long term bonds with a minimum maturity of five years.&lt;br&gt;- The RTGS was put in live operation from March 26, 2004.</td>
</tr>
<tr>
<td>2004 – 05</td>
<td>- Banks were advised to inform their account holders, at least one month in advance of any change in the prescribed minimum balance and the charges that may be levied if the minimum balance is not maintained.&lt;br&gt;- All SCBs were advised that the subsidy under Swarna Jayanti Shahari Rozgar Yojana (SJSRY) would be back-ended, with a lock-in period of 2 years.&lt;br&gt;- SCBs were advised to strictly maintain the confidentiality of information provided by the customer for “Know Your Customer” (KYC) compliance.</td>
</tr>
</tbody>
</table>
Customer” (KYC) compliance.

- ‘Yes Bank Limited’ included in the second schedule to the RBI Act, 1934 with effect from August 21, 2004.
- Guidelines issued for implementing the revised Model KCC Scheme of NABARD to take care of the investment credit as also working capital for agriculture and allied activities and a reasonable component for consumption needs.

<table>
<thead>
<tr>
<th>2005 – 06</th>
<th>The Vision Document on Payment and Settlement System 2005 – 06 was released.</th>
</tr>
</thead>
<tbody>
<tr>
<td>2005 – 06</td>
<td>Guidelines on one time settlement scheme for SME accounts issued to public sector banks for recovery of NPAs below ` 10 crore.</td>
</tr>
<tr>
<td>2005 – 06</td>
<td>Bank of Punjab Ltd. was merged with Centurion Bank Ltd. with effect from October 1, 2005.</td>
</tr>
<tr>
<td>2005 – 06</td>
<td>Guidelines on securitization of standard assets issued to all banks.</td>
</tr>
</tbody>
</table>

<p>| 2006 – 07 | Fair Practices Code for Lenders – The Banks were advised to modify the Fair Practices Code and the same should be placed on the bank’s website and also given wide publicity. |
| 2006 – 07 | Primary Dealer Business Operational guidelines for banks undertaking / proposing to undertake Primary Dealer Business was issued. This was done in order to broad base the primary Dealership system. Banks, undertaking Primary Dealer business, were advised to comply with the instructions / guidelines issued on 9th August, 2006. |
| 2006 – 07 | The United Western Bank Ltd. (UWB) amalgamated with IDBI |</p>
<table>
<thead>
<tr>
<th>Year</th>
<th>Events</th>
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<tbody>
<tr>
<td>2006</td>
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</tbody>
</table>
|       | - Sangli Bank Ltd. Amalgamated with ICICI Bank Ltd. With effect from 18<sup>th</sup> April, 2007.  
|       | - The transfer of undertaking of the Bharat Overseas Bank Ltd. With the Indian Overseas Bank tool place with effect from 31<sup>st</sup> March, 2007.  
|       | - To improve the credit delivery mechanism revised guidelines on lending to the priority sector were issued.  
|       | - Guidelines on ‘When Issued’ (WI) trading in ‘Central Government Dated Securities’ were prescribed in May, 2006 and this segment commenced from August, 2006 |
| 2007  |  
| 08    | - The final guidelines on the revised capital adequacy framework (Basel II) were issued to banks in India on 27<sup>th</sup> April, 2007.  
|       | - Revised guidelines on derivatives were issued on 20<sup>th</sup> April, 2007.  
|       | - Two new sections were introduced for the implementation of the ‘fit and proper’ criteria for elected directors on the boards of banks.  
|       | - Guidelines on KYC/AML/CFT were issued to banks on 13<sup>th</sup> April 2007. |
| 2008  |  
| 09    | - The Reserve Bank transferred its entire share holding in the State Bank of India to the Government of India.  
|       | - Guidelines on KYC Norms/AML Standards/combating of Financing of Terrorism (CFT) – Wire Transfer issued to SCBs. Similar guidelines were issued to StCBs and DCCBs on May 18, 2007 to UCBs on May 25 2007 and to NBFCs on April 23, 2008.  
|       | - Revised guidelines on lending to priority sector issued to SCBs (excluding RRBs).  
|       | - Final guidelines on prudential norms for off-balance sheet exposure of banks were issued to all SCBs.  
|       | - The Guidelines on Asset – Liability Management system was |
amended and all commercial banks advised accordingly.
- The Finance Minister in his Budget Speech (2008 – 09) had announced the Debt Waiver and Debt Relief Scheme for farmers. A detailed scheme in this regard was notified for implementation by all scheduled commercial banks, besides RRBs and co-operative credit institutions. Banks were advised that the implementation of the Debt Waiver and Debt Relief Scheme should be completed by June 30, 2008.

| 2009 – 10 |  
| --- | --- |
| State Bank of Saurashtra merged with State Bank of India with effect from August 13, 2008. |  
| South Indian Co-operative Bank Ltd merged with Saraswat Co-operative Bank Ltd. With effect from September 1, 2008. |  
| American Express Banking Corporation was included in the second schedule of the Reserve Bank of India Act 1934 with effect from December 19, 2008. |  
| There were 91 Regional Rural Banks as at end March 2008. However, due to amalgamation, number of such banks came down to 86 as on March 31, 2009 and further down to 84 as on July 20, 2009. |  
| IDBI Bank Ltd has been included in Nationalized Banks. |  

| 2010 – 11 |  
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| All scheduled commercial banks were directed to switch over to the new system of base rate in place of the existing benchmark prime lending rate (BPLR) system from July 1, 2010. |  
| 1st Financial Stability Report was released on March 25, 2010. |  
| Guidelines on “Note Authentication and Fitness Sorting Parameters” which prescribe the standards/parameters to be followed by banks while processing bank notes were issued. |  
| General permission granted to domestic scheduled commercial banks other than regional rural banks (RRBs) to start mobile branches in Tier 3 to Tier 6 centers (with population up to 49,999 as per Census 2001) and in rural, semi-urban and urban centres in the North-Eastern States and Sikkim. |  
| All banks advised that they open no-frills accounts or other |
accounts for students from minority communities or other disadvantaged groups, who wish to avail of the scholarships being awarded by the Ministry through the state governments. However, ‘know your customer’ (KYC) norms as appropriate should be followed.

- UCBs which maintain CRAR of 12 per cent or above on a continuous basis, have been exempted from the extant mandatory share linking norms with effective from November 15, 2010.
- All scheduled commercial banks (SCBs) directed to pay interest on savings bank accounts on a daily product basis from April 1, 2010.
- The coverage of the interest subvention scheme of 2 per cent on rupee export credit for the period April 1, 2010 to March 31, 2011 extended to certain additional sectors. Viz (i) handicrafts; (ii) carpets; (iii) handlooms; (iv) small and medium enterprises; (v) leather and leather manufactures; (vi) jute manufacturing including floor covering; (vii) engineering goods; and (viii) textiles.
- RRBs permitted to lay down policies with their Board’s approval for sanction of gold loan with bullet repayment option, subject to conditions.
- The date of providing banking services through a banking outlet in every village having a population of over 2000 revised to March 2012. March 2011 could, however, be considered as an intermediate target.
- SCBs including RRBs and local area banks (LABs) permitted to engage companies registered under the Indian Companies Act, 1956, excluding NBFCs, as business correspondents in addition to individuals / entities permitted earlier.
- UCBs which maintain CRAR of 12 per cent or above on a continuous basis, exempted from the mandatory share linking norms from November 15, 2010.
- Bank of Rajasthan Ltd. Merged with ICICI Bank Ltd. With effect
from August 13, 2010.

- State Bank of Indore merged with State Bank of India with effect from August 27, 2010.

- First Rand Bank was included in the second schedule of the Reserve Bank of India Act 1934 from 12th June, 2009.

- Commonwealth Bank of Australia was included in the second schedule of the Reserve Bank of India Act 1934 from 19th March, 2010.

- Japan Bank for International Cooperation was included in the second schedule of the Reserve Bank of India Act 1934 from 16th April, 2010.

- There were 86 Regional Rural Banks (RRBs) as at the end of March 2009. However due to amalgamation, number of such banks came down to 82 as at end-March 2010.
3.3 Co-Operative Banking In India

This chapter of the study explains the theoretical framework of Urban Co-operative Banks. It explains the co-operative credit structure, origin and growth of UCBs both in India. This chapter discusses meaning, definition, concept, need, objectives and functions of Urban Co-operative Banks.

3.3.1 Origin of co-operative movement

In 1889 under the guidance of Vithal Laxman also known as Bhausaheb Kavthekar, the first known mutual aid society in India was the ‘Anyonya Sahakari Mandal’ organized in the erstwhile princely State of Baroda. In their formative phase, urban co-operative credit societies were organizing on a community basis to meet the consumption oriented credit needs of their members. Salary earners societies inculcating habits of saving and self-help played a significant role in popularizing the movement, especially amongst the middle class. From its origins to today, the thrust of UCBs, historically, has been to mobilize savings from the middle and low income urban groups and purvey credit to their members – many of which belonged to weaker sections. The Cooperative Credit Societies Act, 1904, however, gave the real force to the movement. The first urban cooperative credit society was registered in Canjeevaram (Kanjivaram) in the erstwhile Madras province in October, 1904. Amongst the prominent credit societies were the Pioneer Urban in Bombay (November 11, 1905), the No.1 Military Accounts Mutual Help Co-operative Credit Society in Poona (January 9, 1906). Cosmos in Poona (January 18, 1906), Gokak Urban (February 15, 1906) and Belgaum Pioneer (February 23, 1906) in the Belgaum district, the Kanakavli-Math Co-operative Credit Society and the Varavade Weavers’ Urban Credit Society (March 13, 1906) in the South Ratnagiri (now Sindhudurg) district. On January 23, 1906, the most well known between the early credit societies was the Bombay Urban Co-operative Credit Society, sponsored by Vithaldas Thackersey and Lallubhai Samaldas was established.

In 1912, The Cooperative Credit Societies Act, 1904 was with a view to broad basing it to enable organization of non-credit societies. To review their performance and suggest measures for strengthening them, The Maclagan Committee of 1915 was appointed. The committee found that such institutions
were extremely suited to supply to the needs of the lower and middle-income group of society and would inculcate the principles of banking amongst the middle classes. The committee also believed that the urban cooperative credit movement was more feasible than agricultural credit societies. During the banking crisis of 1913 – 14 when 57 joint stock banks collapsed; there was a flight of deposits from joint stock banks to co-operative urban banks.  

3.3.2 Structure of Co-operative Institutions in India

The co-operative banking structure in India comprises urban co-operative banks and rural co-operative credit institutions. Urban co-operative financial institutions consist of a single tier viz., primary co-operative banks, referred to as Urban Co-operative Banks (UCBs).

Rural Co-operative Credit Institutions played an important role in providing institutional credit to the agricultural and the rural sectors. These credit institutions are further divided into two distinct structures, as the Short-Term Co-operative Credit Structure (STCCS) and the Long-Term Co-operative Credit Structure (LTCCS). The STCCS have a three-tier structure comprising State Co-operative Banks (StCBs) at the apex level, District Central Co-operative Banks (DCCBs) at the intermediate level, and the Primary Agricultural Credit Societies (PACS) at the base level. The LTCCS have generally, a two-tier structure consisting of State Co-operative Agriculture and Rural Development Banks (SCARDBs) at the State level and Primary Co-operative Agriculture and Rural Development Banks (PCARDBs) at the district or block level. LTCCS have a unitary organization in some States with State level banks operating through their own branches, while in other States, they have a mixed structure with the existence of both unitary and two-tier systems. The States which do not have LTCCS are served by StCBs.

“The short term co-operative credit structure provides mainly loan for crop production, marketing of crops, purchase and distribution of inputs etc. and the period of these loans is one year. The medium term loans are granted for agriculture and allied purposes including animal, husbandry or such other purposes connected with agriculture operations for periods not less than 15

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months and not exceeding 5 years. The long term credit structure is federal in 12 states and unitary in 8 states and the loans are provided for investment purpose with a loan maturity varying from 5 to 15 years. In the non agriculture structure, Urban Cooperative Banks among the primary credit societies, occupy an important place. They have got unitary structure and are affiliated to the central co-operative banks in the upper hierarchy and advance short term, medium term and long term loans to small traders, artisans, salary earners’ in the urban areas on security as well as against gold and silver.”

3.3.3 Theoretical Framework

3.3.3.1 Urban : The Term Defined

“According to the Urban Land (Ceiling & Regulation) Act 1976, an urban agglomeration is made up of main town together with the adjoining area of urban growth and is treated as one urban spread. The population covered by such spreads is categorized as urban. The urban centers and the area of their agglomeration are specified in scheduled 1 of the above Act. The Act also provides that the state governments may notify other areas having populations of more than 1 lakhs as urban agglomeration. In such cases, as the peripheral area shall be 1 K.M”

3.3.3.2 Definition of Co-operation:

The word ‘Co-operation’ is a derivative of the Latin term ‘Co-operari’ where ‘Co’ means ‘with’ and ‘operari’ means ‘to work’. Co-operation is a form of organization for the promotion of economic interests of themselves, where persons voluntarily connect together as human beings on a basis of equality. Co-operation performs three functions like firstly the warp i.e. holding together; second is the cement, the brick function i.e., supporting each other, and third is the eyes and leg function i.e. working together.

Co-operation is a voluntary and independent association of human beings based on equality (of control and opportunity) and equity (of distribution) and mutuality for the promotion of their common interest as producers or

consumers. Solidarity, democratic control, mutuality or self-help through mutual help, voluntarism, equality and service motive are its characteristic features."84

3.3.3.3 Principles of the Co-operative:

A co-operative is an independent association of persons combined voluntarily to meet their social and cultural needs, common economic, and aspirations through a jointly owned and democratically controlled enterprise. The co-operative Principles are guidelines through which co-operatives set their values into practice.

- Voluntary and Open Membership
- Democratic Member Control.
- Member Economic Participation.
- Autonomy and Independence.
- Education, Training and Information.
- Co-operation among Co-operatives.

3.3.3.4 Concept of Co-operative Banks

A co-operative bank is one which performs the banking business on a co-operative basis.

N. Barouin define a co-operative bank as “a bank formed by co-operative and labor organization for the purpose of accumulating their collective funds and saving of their individual members; it manages their financial interest, grants credit to co-operative and labor enterprises, and help to satisfy the need for personal credit of their individual members; the banks’ surpluses are distributed between shareholders, depositors, and borrowers or placed to reserves”

Devine in his book “people’s co-operative banks” defined a co-operative bank as ‘a mutual society formed, composed and governed by working people themselves, for encouraging regular savings and granting small loans on easy terms of interest and repayment.

According to Henry Wolff, co-operative banking is an agency which is in a position to deal with a small man on his own terms accepting the security he has and without drawing on the protection of the rich. That agency must not be a channel for pouring charity or subsidizing the small man out of the public funds; instead the material help must be backed by moral improvement and strengthening the fiber.  

3.3.4 Urban Co-operative Banks: Definition and History

Definition

Urban Co-operative Banks have been defined as PRIMARY CO-OPERATIVE BANKS in the banking regulation Act 1949 (As applicable to Co-operative Societies). In term of Section 5 of the said Act: A ‘primary co-operative bank’ means a co-operative society, other than a primary agricultural credit society,

1. The primary object or principal business of which is the transaction of banking business;
2. The paid-up share capital & reserves of which are not less than one lakhs of rupees; and
3. The bye-laws of which do not permit admission of any other co-operative society as a member provided that this sub-clause shall not apply to the admission of a co-operative bank as a member by reason of such co-operative bank subscribing to the share capital of such co-operative society out of funds provided by the state government for the purpose.

It, therefore, means that the bye-laws of a primary co-operative bank will not debar admission of a co-operative bank as its member when such co-operative banks will contribute to the share capital of the primary co-operative bank with the help of the funds provided by the state.  

3.3.5 History of UCBs

“The term Urban Co-operative Banks (UCBs), though not formally defined, refers to primary co-operative banks located in urban and semi-urban areas. These banks were traditionally centered around communities, localities work place groups. They essentially lend to small borrowers and businesses. Today, their scope of operations has widened considerably.

The origins of the urban co-operative banking movement in India can be traced to the close of nineteenth century when, inspired by the success of the experiments related to the co-operative movement in Britain and the co-operative credit movement in Germany such societies were set up in India. Co-operative societies are based on the principles of co-operation, mutual help, democratic decision making and open membership. Co-operatives represented a new and alternative approach to organization as against proprietary firms, partnership firms and joint stock companies which represent the dominant form of commercial organization.

There was the general realization that urban banks have an important role to play in economic construction. This was asserted by a host of committees. The Indian Central Banking Enquiry Committee (1931) felt that urban banks have a duty to help the small business and middle class people. The Mehta-Bhansali Committee (1939) recommended that those societies which had fulfilled the criteria of banking should be allowed to work as banks and recommended an Association for these 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 low cost of establishment and operations recommended the establishment of such banks even in places smaller than taluka towns.

The first study of Urban Co-operative Banks was taken up by RBI in the year 1958-59. The Report published in 1961 acknowledged the widespread and financially sound framework of urban co-operative banks; emphasized the need to establish primary urban co-operative banks in new centers and suggested that State Governments lend active support to their development. In 1963, Varde Committee recommended that such banks should be organized at all Urban Centers with a population of 1 lakh or more and not by any single
community or caste. The committee introduced the concept of minimum capital requirement and the criteria of population for defining the urban centre where UCBs were incorporated. The urban cooperative banking sector comprises a number of institutions which vary in terms of their size, nature of business and geographic spread while concentrating on credit delivery in urban areas.

Since 2005 an effort is being made to address the problem of dual control of UCBs by signing of Memorandum of Understanding (MOUs) between the Reserve Bank and the respective state governments. The process of signing MoUs, which was started in June 2005, was completed in February 2010, thus bringing all the UCBs in the country under the cover of MoUs. With the comfort of coordinated supervision, financially sound and well managed UCBs were permitted to expand their business by allowing them to open currency chests, sell units of mutual funds and insurance products, provide foreign exchange services, open new ATMs and convert extension counters into branches. Furthermore, UCBs were also considered for grant of license to open new branches. The Reserve Bank issued guidelines on merger/amalgamation for UCBs in February 2005. Pursuant to the issue of guidelines on merger of UCBs, the Reserve Bank received 143 proposals for mergers in respect of 124 banks. The Reserve Bank has issued no objection certificate (NOC) in 103 cases. Of these, 83 mergers became effective upon the issue of statutory orders by the Central Registrar of Co-operative Societies (CRCS) / Registrar of Co-operative Societies (RCS) concerned. Twenty-five proposals for merger were rejected by the Reserve Bank, 6 proposals were withdrawn by the banks and the remaining 9 are under consideration. Out of the 83 banks for which orders of merger have been received from the RCS/CRCS, 52 had negative net worth.\(^{87}\)

At the end of March 2009, there were 1721 UCBs including 79 salary earners’ banks, 108 Mahila banks and 6 SC/ST banks as against 2084 UCBs, including 90 salary earners’ societies and 117 Mahila banks as on March 2001.

The Reserve Bank adopted a multi-layered regulatory and supervisory strategy aimed at the merger/amalgamation of viable UCBs and the exit of unviable

\(^{87}\)K Ramkrishnan,, 2010,CEO Indian Banks Association “Indian Banking Year Book, 2010”. Indian Banks Association, pp 81-82.
ones for the revival of this sector. This initiative led to a gradual reduction in the number of UCBs. Thus at the end of March 2012, there were 1606 UCBs having 46 multi-state operations.

### 3.3.6 Operations of UCBs
UCBs are also classified into scheduled and non-scheduled as well as into Tier I and Tier II categories. In terms of number of banks, the sector was dominated by non-scheduled Tier I banks, however, in terms of size of the banking business the sector was dominated by scheduled tier II banks. The banking business per UCB was the highest in scheduled Tier II banks followed by non-scheduled Tier II and non-scheduled Tier I. Thus, tier II banks, both scheduled and non-scheduled together, accounted for around 80 per cent of the total banking business of the sector as at end-March 2010. There was an improvement in the asset quality of the entire UCB sector both in absolute and percentage terms as at end-March 2010 over the previous year. However, both gross as well as net non-performing loans of the UCB sector continued to be on the higher side. Balance sheets of UCBs expanded at a higher rate at end-March 2010 over the previous year, which can be attributed to deposits on the liability side, and investments and disbursement of loans and advances on the asset side. The investment profile of UCBs shows that majority of investments of UCBs were in SLR instruments, constituting more than 80 per cent of the total investments of UCBs as at end-March 2010. Investments in Central Government securities constituted around half of the total SLR investments as at end-March 2010.\(^{88}\)

### 3.3.7 Regulatory Initiatives
During the year, lots of initiatives were taken to improve the functioning of UCBs. Licensed UCBs Tier I and Tier II classified as Grade I by the Reserve Bank are allowed to extend their area of operation to the whole of the district of registration and to its adjoining districts within their State of registration, without prior permission from the Reserve Bank. UCBs are allowed closure of

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un-remunerative branches / Extension Counters (ECs) without prior permission of RBI subject to the certain stipulations.

The proposals of UCBs for extension of Area of Operation, opening of branches, extension counters etc. shifting of offices, splitting of branches, etc. should be sent only with the prior approval of the bank’s Board of Directors and appropriate resolutions in this behalf should be passed. The relevant resolutions should be submitted to the Regional Offices. The relevant records may also be preserved and made available to the Reserve Bank’s inspection team for scrutiny during the course of inspection.

The area of operations of UCBs, is to withdraw the existing restrictions on granting multi-state status and extension of area of operation beyond the state of registration for such UCBs having a minimum net worth of Rs.50 crore; to allow such UCBs which have acquired weak banks in other state(s) to extend the area of operation to the entire state of registration of the target bank provided they have minimum net worth of Rs. 50 crore; and to allow Tier II UCBs registered or deemed to be registered under the Multi-State Co-operative Societies Act, 2002 to extend area of operation to the entire state of original registration.

For financial inclusion purpose, well managed and financially sound UCBs are permitted to engage business correspondents (BCs) / business facilitators (BFs) using information and communication technology (ICT) solutions.

The UCBs can provide housing, real estate and commercial real estate loans up to 15 per cent of their deposit resources as on March 31 of the previous year. It has now been decided to link housing, real estate and commercial real estate loans of UCBs to their total assets instead of deposits. Accordingly it is proposed to replace the existing limit of 15 per cent of deposits for housing, real estate and commercial real estate loans by a limit of 10 per cent of total assets and an additional limit of 5 per cent of total assets will be available for housing loans granted to individuals by the UCBs for purchase/construction of dwelling units up to Rs.10 lakh. RBI permitted all licensed UCBs, other than those under all inclusive directions issued under Section 35 A of the Banking Regulation Act, 1949, to open Current Account and Subsidiary General Ledger (SGL) Account with the RBI. Such UCBs are also allowed to take up membership of the RTGS. However, for RTGS membership, the UCBs apart
from being financially sound and well managed are required to have a minimum net-worth of `25 crore. It is mandatory for borrowers of UCBs to subscribe to the shares of the bank to the extent of 2.5% to 5.0% of their borrowings. In order to provide flexibility to UCBs, which are already well capitalized to extend loans without adding to capital, RBI exempted UCBs, which maintain a minimum CRAR of 12 per cent on a continuous basis from the mandatory share linking norms.

### 3.3.8 Information Technology Support to UCBs:

The Reserve Bank undertook important steps covering IT infrastructure and implementation of new applications. A High Level Committee was constituted under the Chairmanship of the Deputy Governor (Dr. K.C. Chakrabarty) and members from IIT, IIM, Banks, and the Reserve Bank to prepare the IT Vision for the Reserve Bank for the period 2011 – 2017, inter alia, to review the functions of Department of Information Technology and suggest measures for way forward.\(^{89}\)

### 3.3.9 Need of Urban Co-operative Banks

“Need for provision of credit facilities to town-dweller was as much urgent as it was in village in order to combat usury. The disintegration of rural economy under the impact of centralized administration under the British rule has had the effect of attracting to towns the salary earning middle classes, the artisans, petty traders, shopkeepers and other man engaged in various crafts and trades. Many of this people stood as much in urgent need of credit for plying their trade, craft or professions as their counterpart in rural areas.

Joint stock banks are not interested in providing credit to this people because the cost of advancing and recovering them is very high. Further, as joint stock banks are not likely to have under ordinary circumstances full and intimate knowledge of the standing and resources of persons of moderate means, they will not advance loans on personal security. Under these circumstances, the men with limited means in urban areas resort to money lenders for small loans and obtain them at very high rate of interest. This was aptly summarized by

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\(^{89}\)K Ramkrishnan., 2010,CEO Indian Banks Association “Indian Banking Year Book, 2010”, Indian Banks Association, pp 83-84.
W.K.H. Campbell: ‘A very little investigation of the conditions of the salary-earning class is frequently enough to reveal that, when sudden emergencies arise which make an unexpected demand on their fixed salaries, they have to borrow, that they do so on most unfavorable terms and that, as a class, they are heavily, and in most cases, hopelessly indebted.’ Such type of credit obtained from money lenders ‘supports the people as the hangman’s rope supports the hanged. Hence the problem was to evolve an agency which will replace the private credit even in the towns and provide credits to the townsman on easy terms of interest and repayment and also inculcate the habit of thrift in them. Co-operation came to their rescue. Solution to the above problem was found in the Co-operative Urban Bank.”

3.3.10 Objectives of Urban Co-operative Banks

“Urban Co-operative Banks are people’s banks, promoted by the people for the benefit of the people.”

Following are the objectives of UCBs.

1. To mobilize savings in urban and semi-urban areas by way of deposits from members and non-members;
2. To grant loans on reasonable terms to members mainly for productive and, to some extent, also for consumption purpose;
3. To encourage thrifts, self-help, and co-operation among the urban middle class;
4. To offer various banking services such as collection of bills, cheques, drafts etc. accepted or endorsed by members or approved constituents, remittance of funds, discounting of cheques, and bills of approved members subject to rules and bye-laws in this behalf, financing hire purchase schemes to help its members in acquiring domestic and other requirement etc;

5. To arrange for the safe custody of valuables and documents of members and constituents; and to provide all other banking facilities normally provided by commercial banks.  

3.3.11 Features of Urban Co-operative Banks

3.3.11.1 Organizational Structure

Most of the primary urban co-operative banks are small in size and unitary (i.e. single-tier) structure and not a federal structure like the agricultural banks. They are affiliated to the concerned district central co-operative banks (DCCBs) and also expected to avail finance from them in case of need. But in actual practice most of the urban banks are self-sufficient and even more financially sound, and, therefore, do not require any substantial funds from the district central co-operative banks.

3.3.11.2 Registration

The authority for registering a primary (Urban) co-operative banks vests with the Registrar of Co-operative Societies of the state in which the bank is established. Its organization and functioning are, therefore, governed by the Co-operative Societies Act applicable to that states and the rules formed there under. Its constitutions, objects and functions, procedures and methods of working, sources of funds and the manner of their utilization, earnings and their disposal etc. are all laid down in its bye-laws which have to be framed at the time of its registration and approved by the Registrar of Co-operative Societies. In doing so, its promoters usually adopt the model bye-laws formulated by the Registrar for the purpose, with such modifications as they find necessary to meet their own special requirements. Any amendment to the bye-laws, which may be proposed from time to time, have to be passed by its general body and approved by the Registrar of Co-operative Societies.

3.3.11.3 Licensing

The Reserve Bank of India is entrusted with the authority to grant a license to primary (Urban) co-operative banks under section 22 of the B.R.Act 1949

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(AACS) in order to commence/carry on banking business. Before granting such a license, the Reserve Bank weighs the application of the new bank from the point of its attaining viable status within a reasonable period keeping in view other relevant considerations including the public interest that would be served by the establishment of a new bank in the area concerned and the capacity of proposed bank’s management to manage the affairs of the bank to safeguard the interest of the depositors.

3.3.11.4 Co-operative Character
As urban bank being primarily a co-operative society has to satisfy certain basic cooperative principles. It should conform to the principles of the community interest, motto of mutual service rather than maximization of profit, democratic management as signified by the supremacy of the general body in all matters and ‘one man, one vote’ as its meetings as well as those of the board of directors, committees etc., and to promotion of thrift and savings which is one of the fundamental objectives of a cooperative credit institutions.

3.3.11.5 Target-Group
Urban banks mainly cater to the needs of borrowers comprising small scale industries, retail traders, professionals and salaried classes housed at metropolitan, urban and semi-urban areas. Their main focus of finance is thus targeted towards priority sector to which not less than 60% of their total advances are purveyed, of which 25% again is directed towards the poorer and weaker sections of the society. The main thrust of such finance is for non-agricultural productive purposes.

3.3.11.6 Functional Jurisdiction
Urban co-operative banks registered in metropolitan city/town shall have an area of operation contiguous with the limit of metropolitan area/town limits including the urban agglomeration thereof and the defined peripheral areas appertaining thereto. Urban banks registered in urban/ semi-urban centers may be allowed to operate throughout the district of registration and such banks may be permitted to finance non-agricultural/allied agricultural credit
requirements in the peripheral rural areas which are within a distance of 10 kms from the boundary of the concerned urban/ semi-urban centre.

3.3.11.7 Management Structure

The success or failure of an urban co-operative bank is closely linked with the character and the ability of its management. The term ‘management’ here is used in its wider sense and includes (i) the general body, (ii) the elected board of directors and (iii) the paid professional employees i.e. the chief executive and the other managerial Personnel. Some banks have constituted sub-committees sanctioning loans and for other special purposes. The general body which is, under statutory obligation, convened once in a year is a final and supreme authority in any bank. The relative functions and powers of the various bodies, the frequency of their meetings, the procedure to be adopted by them and other relevant matters are laid down in the bye-laws. The general management of an urban bank is vested in a board of directors elected at the general body meeting and the day-to-day management of the banks with the managerial staff headed by a professionally competent person known as chief executive officer. In view of the nature, volume and responsibility of business conducted, the bank is divided into departments and departments sub-divided into sections each being placed under the responsibility. The powers delegated to the chief executive in the Head Office and the managers in the branches is specified in the board resolutions adopted for the purpose and rules framed accordingly for the guidance of the officers.

3.3.11.8 Sources of Funds

The source of funds for urban co-operative banks consists of their owned funds as well as borrowed funds. Owned funds represent the paid-up share capital and the accumulated reserves created out of profits apportioned. Borrowed funds consist mainly of the different types of deposits received from both members and nonmembers, and includes borrowings from central co-operative financial agencies and apex institutions in case of need.
3.3.11.9 Uses of Funds

Urban co-operative bank grant fixed loans or cash loans to their members against the mortgage of unencumbered immoveable property, mercantile or industrial goods, insurance policies, fixed deposits receipts or on the surety of one or more persons who are also member of the bank. Salaried persons are entitled to personal loans up to a stipulated multiple of their monthly salary while, in case of others, the limit is very often expressed as a multiple of their contribution to the share capital. The purpose for which urban bank lend money include trade and commerce, extensions and repairs to dwelling houses, purchase of domestic appliances, vehicles etc; educational and Medical expenses, religious and ceremonial expenses, discharge of prior debt, consumption purposes, starting of small business, working capital/block capital of small scale and cottage industries and allied agricultural purposes and a number of other emergencies.

3.3.11.10 Investments

The investment policy of a bank depends mainly on the nature of its resources, the period for which they are available and the objectives for which it has been organized. As regards urban co-operative banks, their deposits are mainly short-term and medium-term. Consequently, their investments have also to be short term and medium term. Besides utilizing the available resources for granting various types of advances to members, and maintaining minimum CRR and SLR at 3% and 25% of total time and demand liabilities on a day-to-day basis as per sections 18 and 24 respectively of the Banking Regulation Act 1949, urban banks may also invest a reasonable portion of their liabilities in Government and other trustee securities and fixed deposits with other banks.

3.3.11.11 Distribution of Profits

The Urban Co-operative Banks earn their incomes from various sources viz. (a) interest on loans and advances, (b) interest on government and other securities, (c) commission from agency services, bill collection etc; (d) entrance fees, (f) interest on deposit with other banks, (g) discounts/commission on bills and cheques, and (h) profits from trading activities. The net profit arrived at after meeting all the expenses are
distributed in accordance with the rules and bye-laws. A certain percentage is transferred to the Statutory Reserve Funds. A certain percentage is carried to the Dividend Equalization Fund to enable the bank to declare dividend uniformly to the shareholders. A certain portion is transferred to the Common Good Fund which is utilized for charitable, educational and cultural purposes as decided by the Board from time to time. Some amount is set apart for giving bonus to the employees. A certain percentage is deposited into the Building Fund and the balance may be transferred to the General Reserve Fund.

3.3.11.12 Dual Control

The Reserve Bank has no statutory powers in regards to registration, administration, amalgamations, reconstruction, liquidation, of urban co-operative banks which on the contrary vest with the Registrar of Co-operative Societies under the provisions of the Co-operative Societies of the State concerned. The Reserve Bank is only entrusted with control and supervision over the banking business of such bank under the provisions of the Banking Regulation Act 1949.92

3.3.12 Grade wise Classification of Urban Co-operative Banks

“UCBs are grouped into different categories based on the reviews carried out by Reserve Bank of the statutory returns and/or other statements submitted by banks, statutory inspections or scrutiny of books of accounts of UCBs conducted by the Reserve bank of India. Thus, the Urban Cooperative Banks are classified into four Grades viz. I, II, III, IV, instead of ‘weak’ and ‘sick’ as indicated below:

i) Grade -I: They are sound banks, i.e., banks having satisfactory financial position not having any liquidity problems and not involved in any other serious irregularities. The norms for classifying banks under Grade I would be as under:

i. Compliance with CRAR norms for the year just ended, &

ii. Net NPAs is less than 10% of the net loans and advances as on 31st March or as identified by the RBI subsequently, &

iii. Net profit (after making adequate provisions against NPAs and other assets losses as per the latest inspection report or statements/returns submitted by the bank) for the financial year just ended, &

iv. No default in maintenance of Cash Reserve Ratio (CRR) /Statutory Liquidity Ratio(SLR) in the previous year (unless the default was inadvertent or for any other acceptable reason).

ii) Grade – II :
Where a bank meets the conditions (ii) to (iv), but the shortfall in CRAR is less than 1%. Such banks are classified under Grade II. Thus, Banks are classified under grade D if they meet anyone of the following norms.

(i) CRAR is 1% below the prescribed norms, or

(ii) Net NAPs is 10 % or more but below 15% of the net loans and advances as on 31st March, or as identified by the Reserve Bank subsequently, or

(iii) Incurred net losses (after making adequate provisions for impairment of all assets) for the financial year just ended, or

(iv) Defaulted in maintenance of CRR/SLR in the previous year (unless the default was inadvertent or for any other acceptable reason) and/or there is more or less continuous default in maintenance of CRR/SLR during the current year.

iii) Grade – III :
The banks are placed under this category if they meet any 2 of the following 3 norms.

i. if CRAR is below 75% of the minimum prescribed level, the 50% or above,

ii. Net NAPs is 10 % or more but below 15% of the net loans and advances as on 31st March, or as identified by the Reserve Bank subsequently.

iii. Incurred net losses for 2 years out of the last 3 consecutive financial year after making adequate provision for assets losses as indicated by the statutory auditor/RCS and /or RBI

99
(iv) Grade-IV:
UCBS are placed under this category.
(i) If their CRAR falls below 50% of the minimum prescribed level &
(ii) If net NAP is 15% or more of net loans and advances as on 31March or as
identified by the RBI subsequently. or
(iii) If they show net losses (as per balance sheet) for the last 3 consecutive
financial years.”

Along with profitability, the general health of the UCB sector has also
improved. This can be seen from the increasing number of banks in Grade I
and II especially after the process of signing of MoUs with the Central and
State Governments and continuous reduction in the gross and net NPAs of the
sector. As on March 31, 2004, the share of Grade I and Grade II banks out of
total UCBs was at 61.6 per cent, which increased significantly to 81.8 per cent
as on March 31, 2011. Similar improvement is observed in the quality of
assets of the UCBs along with their compliance with the prescribed regulatory
capital requirement (CRAR).  

3.3.12.1 Growth of Urban Co-Operative Banks In India

“In 1966 when the Banking Regulation Act was made applicable to UCBs,
there were about 1100 UCBs with deposits and advances of Rs.167 crores and
Rs.153 crores respectively. As at the end of 1996, the number of UCBs
increased to 1501 and their deposits and advances rose significantly to
Rs.24,161crores and Rs. 17,927 crores. The UCBs continued to grow at a fast
pace till 2003, when their number increased to 1941 and their deposits and
advances to Rs. 1,01,546crores and Rs.64,880 crores respectively.” After
that, the number of UCBs declined in 2006 to 1853 with total deposits of
Rs.1,12,236crores and loans & advances of Rs.70,378 crores. Further, it can
also be stated that in the very next year, i.e. 2007, the number of UCBs again
dropped at 1813 with total deposits of Rs. 1,20,984crores and loans &
advance of Rs. 1,486 crores. “The Reserve Bank adopted a multi-layered
regulatory and supervisory strategy aimed at the merger/amalgamation of

viable UCBs and the exit of unviable ones for the revival of this sector. This initiative led to a gradual reduction in the number of UCBs. As a Result, the total number of UCBs at end-March 2013 stood at 1606 as against 1618 at end-March 2012.”

Table 3.3
Tier-Wise Distribution of Urban Co-operative Banks
AS at end-March 2013
Amount in Rs. Billion

<table>
<thead>
<tr>
<th>Tier Type</th>
<th>No. of Banks</th>
<th>Deposits</th>
<th>Advances</th>
<th>Assets</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Number</td>
<td>% to Total</td>
<td>Number</td>
<td>% to Total</td>
</tr>
<tr>
<td>Tier I UCBS</td>
<td>1194</td>
<td>74.3</td>
<td>434</td>
<td>15.7</td>
</tr>
<tr>
<td>Tier II UCBs</td>
<td>412</td>
<td>25.7</td>
<td>2335</td>
<td>84.3</td>
</tr>
<tr>
<td>All UCBs</td>
<td>1606</td>
<td>100</td>
<td>2769</td>
<td>100</td>
</tr>
</tbody>
</table>

(Trend and Progress of Banking in India, www.rbi.org.in)

The Reserve Bank discontinued the erstwhile classification of UCBs into different grades for regulatory and supervisory purposes with the introduction of CAMELS rating model to gauge the financial soundness of UCBs. Under the new CAMELS rating model, a composite rating of A/B/C/D (in decreasing order of performance) is given to a bank, based on the weighted average rating of individual components of CAMELS.

Table 3.4
Rating-Wise Distribution of UCBs
As at end-March 2013
Amount in Rs. Billion

<table>
<thead>
<tr>
<th>Rating</th>
<th>No. of</th>
<th>% share in</th>
<th>Deposits</th>
<th>% share in</th>
<th>Advances</th>
<th>% share in</th>
</tr>
</thead>
<tbody>
<tr>
<td>A</td>
<td>214</td>
<td>13.3</td>
<td>1169</td>
<td>42.2</td>
<td>787</td>
<td>43.5</td>
</tr>
<tr>
<td>B</td>
<td>861</td>
<td>53.6</td>
<td>1175</td>
<td>42.4</td>
<td>761</td>
<td>42.1</td>
</tr>
<tr>
<td>C</td>
<td>432</td>
<td>26.9</td>
<td>365</td>
<td>13.2</td>
<td>228</td>
<td>12.6</td>
</tr>
<tr>
<td>D</td>
<td>99</td>
<td>6.2</td>
<td>60</td>
<td>2.2</td>
<td>33</td>
<td>1.8</td>
</tr>
<tr>
<td>Total</td>
<td>1606</td>
<td>100</td>
<td>2769</td>
<td>100</td>
<td>1810</td>
<td>100</td>
</tr>
</tbody>
</table>

(Trend and Progress of Banking in India, www.rbi.org.in)
According to the new classification, at end-March 2013 around 67 percent of the UCBs had composite ratings of A and B, accounting for about 85 percent of the total banking business (deposits plus advances) of the UCBs. There was a perceptible improvement in the financial strength of UCBs during the year. Around 27 percent of the UCBs had a composite rating of C accounting for 13 percent of the banking business of the UCB sector. The lowest rating of D representing the weakest financial health was assigned to about 6 percent of the UCBs.\footnote{K.A.abdul Kaddus, 2014, “Theory, Law and practice of co-operative banking”, third edition, Limra Publication, Chennai,2014,pp 231.}

<table>
<thead>
<tr>
<th>CRAR in %</th>
<th>Scheduled UCBS</th>
<th>Non-Scheduled UCBS</th>
<th>All UCBs</th>
</tr>
</thead>
<tbody>
<tr>
<td>CRAR &lt; 3</td>
<td>5</td>
<td>155</td>
<td>160</td>
</tr>
<tr>
<td>3 &lt; CRAR &lt; 6</td>
<td>1</td>
<td>7</td>
<td>8</td>
</tr>
<tr>
<td>6 &lt; CRAR &lt; 9</td>
<td>0</td>
<td>23</td>
<td>23</td>
</tr>
<tr>
<td>9 &lt; CRAR &lt; 12</td>
<td>9</td>
<td>216</td>
<td>225</td>
</tr>
<tr>
<td>12 &lt; CRAR</td>
<td>36</td>
<td>1154</td>
<td>1190</td>
</tr>
<tr>
<td>Total</td>
<td>51</td>
<td>1555</td>
<td>1606</td>
</tr>
</tbody>
</table>

Source: www.rbi.org.in

About 88 percent of UCBs reported CRAR above the statutory minimum in 2012-13. The Capital to Risk-Weighted Assets Ratio (CRAR) was above the statutory minimum of 9 percent at end-March 2013 with respect to 1,415 UCBs. 191 UCBs both scheduled and non-scheduled, reported CRAR below the statutory minimum as at end-March 2013. Among scheduled UCBs, four had a negative CRAR.
Table 3.6
Indicators of Profitability of UCBs

(Amount in billions)

<table>
<thead>
<tr>
<th>Indicator</th>
<th>Scheduled UCBs</th>
<th>Non-scheduled UCBs</th>
<th>All UCBs</th>
</tr>
</thead>
<tbody>
<tr>
<td>Return on Assets</td>
<td>1.12</td>
<td>0.9</td>
<td>1.14</td>
</tr>
<tr>
<td>Return on Equity</td>
<td>10.51</td>
<td>8.65</td>
<td>9.17</td>
</tr>
<tr>
<td>Net Interest Margin</td>
<td>2.98</td>
<td>2.89</td>
<td>3.59</td>
</tr>
</tbody>
</table>

Note: Data for 2012-13 are Provisional

Source: www.rbi.org.in

Profitability indicators of UCBs remained stable in 2012-13. UCBs’ net profits witnessed moderation during 2012-13. There was a sharp increase in both their interest and non-interest income. The share of non-interest income remained nearly stable both for SCBs and UCBs. However, UCBs’ total expenditure also rose during the year primarily due to a pick-up in the interest component of expenditure. Major indicators of profitability of UCBs remained stable in 2012-13. Both the return on assets (ROA), defined as net profits as percent of average assets, as well as return on equity (ROE), defined as net profits as percent of average equity, remained almost the same as that of the preceding year. A disaggregated level analysis suggests that two scheduled UCBs reported negative ROA in 2012-13.

3.3.13 Structure of Urban Co-operative Banks in India.

“In the economic development of the nation, banks occupy an important place. Banking institution forms an important part of the money market and is indispensable in a modern developing society. Indian money market comprises both organized as well as unorganized sector. The unorganized sector includes money lender and indigenous, bankers and largely caters to the need of persons living in villages and small towns. It is estimated that about one third of the total credit requirements of the country are met by the unorganized sector. Financial institution in the organized sector has grown significantly in the last three decades. Amongst the institutions in the organized sector of the Indian money market commercial banks and cooperative banks have been in existence for a pretty long time. An important development in the organized
sector was the formation of Regional Rural banks (RRBs) in the seventies to cater to the financial need of rural areas. Commercial banks have also expanded their activities in multifarious ways, i.e., geographically expansion, amount of credit, type of credit facilities and different new types of customers. Thus, quantitatively as well as qualitatively this banking institution have increased their services tremendously in recent years.  

“The structure of the co-operative banking sector in India is complex. Credit needs of diverse sections of the population, both in terms of location and tenor, are addressed by different segments of the cooperative banking sector. While the urban areas are served by the urban co-operative banks with a single tier structure, the rural areas are largely served by two distinct sets of institutions extending short-term and long-term credit. The short term co-operative credit institutions have a three-tier structure comprising State co-operative banks (StCBs) at the apex level, district central co-operative banks (DCCBs) at the intermediate level and primary agricultural credit societies (PACS) at the base level. The long-term co-operative credit institutions have, generally, a two-tier structure comprising the State co-operative agriculture and rural development banks (SCARDBs) at the state level and the primary co-operative agriculture and rural development banks (PCARDBs) at the district or block level. Long-term co-operative credit institutions have a unitary structure in some States with State level banks operating through their own branches, while in other States; they have a mixed structure with the existence of both unitary and two-tier systems. The States which do not have long-term co-operative credit entities are served by State co-operative banks.”

In Terms of geographical spread, UCBs are distributed unevenly across the states. As on March 31, 2012, from total 1618 UCBs, 1398 UCBs were spread in five States viz. Maharashtra, Gujarat, Karnataka, Andhra Pradesh, and Tamil Nadu. Further, the UCBs in these states account for approximately 88% of the deposits and advances of the sector.

<table>
<thead>
<tr>
<th>Name of the States</th>
<th>No. of banks in % share in total</th>
<th>Deposits % share in total</th>
<th>No. of branches % share in total</th>
</tr>
</thead>
<tbody>
<tr>
<td>Maharashtra</td>
<td>33.90 32.32</td>
<td>61.4 62.7</td>
<td>55.50 55.1</td>
</tr>
<tr>
<td>Gujarat</td>
<td>15.10 14.65</td>
<td>16.10 10.50</td>
<td>11.50 10.1</td>
</tr>
<tr>
<td>Karnataka</td>
<td>15.90 16.44</td>
<td>6.50 7.60</td>
<td>10.80 9.8</td>
</tr>
<tr>
<td>Tamil Nadu</td>
<td>7.50 7.97</td>
<td>2.30 2.50</td>
<td>4.00 3.6</td>
</tr>
<tr>
<td>Other States</td>
<td>21.00 22.2</td>
<td>11.40 13.50</td>
<td>15.10 18.00</td>
</tr>
<tr>
<td>Total</td>
<td>100 100</td>
<td>100 100</td>
<td>100 100</td>
</tr>
</tbody>
</table>

Source: www.rbi.org.in

The non-performing assets of the 1091 banks stood at Rs.2901.70 crore constituting 10.30% of their aggregate advances as on 31st March 1998 as compared with 11.30% in respect of 756 banks as at the end of March 1997. The details of NPA at the end of March 2007 to March 2013 are given below:
Table No. 3.8

NPA Position of Urban Cooperative Banks
(Rupees in crore)

<table>
<thead>
<tr>
<th>As at end March</th>
<th>Gross NPA</th>
<th>Gross NPA as % of GrossAdvances</th>
<th>Net NPA</th>
<th>Net NPA as % of Net Advances</th>
</tr>
</thead>
<tbody>
<tr>
<td>2007</td>
<td>14,541</td>
<td>18.3</td>
<td>6,235</td>
<td>8.8</td>
</tr>
<tr>
<td>2008</td>
<td>14,037</td>
<td>15.5</td>
<td>6,083</td>
<td>7.7</td>
</tr>
<tr>
<td>2009</td>
<td>12,862</td>
<td>13.1</td>
<td>5,161</td>
<td>5.9</td>
</tr>
<tr>
<td>2010</td>
<td>11,399</td>
<td>10.1</td>
<td>3,821</td>
<td>3.9</td>
</tr>
<tr>
<td>2011</td>
<td>11,500</td>
<td>8.4</td>
<td>2,700</td>
<td>2.1</td>
</tr>
<tr>
<td>2012</td>
<td>11,000</td>
<td>7.0</td>
<td>2,800</td>
<td>1.9</td>
</tr>
<tr>
<td>2013P</td>
<td>10,900</td>
<td>6.0</td>
<td>2,500</td>
<td>1.4</td>
</tr>
</tbody>
</table>

P : Provisional. (Source : Report on trends and progress of banking in India, RBI)

3.3.13.1 Cooperative Court

The Maharashtra Cooperative Societies Act provides for setting up of cooperative courts to hear and give award on recovery cases of cooperative banks in the time bound manner. It also has provisions for filing summary suits for recovery of small loans, which are not secured by tangible assets. Since the cooperative departments in most of the States do not have officers exclusively to hear the cases of UCBs, the RBI could help the urban banks by suggesting to the State Governments to implement the system followed by Maharashtra to urban banks. NAFCUB was also taking up the issue with State Governments.

3.3.13.2 Declaration of dividend by UCBs

The UCBs can declare the dividend without prior permission of RBI subject to compliance with the following conditions:

- Compliance with CRAR norms as prescribed by RBI
- Net NPA or less than 5% after making all necessary provisions (including provisions required as per assessment made by RBI in the last inspection report)
- There is no default in CRR/SLR during the year for which dividend is proposed
- All required provisions have been made for NPAs, investments and other assets as per prudential norms
- Dividend is paid out of the net profit and after making all statutory and other provisions and adjustment for accumulated losses in full.

UCBs complying with all the above parameters except net NPA, and desirous of declaring divided my approach the respective regional office of the RBI for permission for declaring dividend provided the Net NPA is less than 10%.

Scheduled UCBs

In 1988, the notification regarding scheduling of UCBs with deposits of Rs.50 crore and above was issued. Due to the progress made in terms of profit, deposits, working capital, advances and recovery, some of the UCBs they are honoured with the status of Scheduled Banks.

There were 53 scheduled UCBs consisting of 25 Multi-State UCBs and 1668 non-scheduled UCBs consisting of 15 Multi-State UCBs functioning in the country at the end of March 2009. Scheduled UCBs like Saraswat Cooperative Bank, Mumbai, Bombay Mercantile Cooperative Bank, Mumbai, Mahesh Cooperative Urban Bank, Andhra Pradesh, Ahmedabad Mercantile Cooperative Bank, Gujarat, Amanath Cooperative Bank, Karnataka, Mahila Cooperative Bank, etc., are some of the Scheduled UCBs functioning in India.

At the end of March 2013, there were 1606 UCBs consisting of 51 scheduled (3.2%) and 1555 (96.8%) non scheduled banks. There were 46 UCBs functioning as multi-state institution in India. The positions of assets, loans and deposits of scheduled and non-scheduled UCBs at the end of March 2013 accounted for Rs.1524 and Rs.1849, Rs.839 and Rs.970 and Rs.1263 and Rs.1506 respectively. This shows that 3.2%' of scheduled banks have the business (deposits plus loans) of 45.92% of total UCBs in India. (Source: Report of trends and progress of banking in India, RBI)

RBI recently insists UCBs with deposits not less than Rs.750 crore on a continuous basis for one year, a minimum capital adequacy ratio of 12%, and

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97UBD.BPD.(PCB).Cir.No.4/12.05.001/2012-13 dated 5th July 2012.
continuous net profit for the previous three years to apply for scheduled bank status. Such banks should have gross non-performing assets (NPAs) of 5% or less and need to be in compliance with the mandatory cash reserve requirements stipulated by RBI. Besides, such lenders should not have any major regulatory and supervisory issues.

3.3.13.3 Maintenance of CRR

In terms of section 42(1) of the RBI Act, 1934, every Scheduled UCBs, the CRR prescribed by the Reserve Bank is 4% of a bank’s total of demand and time liabilities. All non Scheduled UCBs are required to maintain 3% as CRR.

3.3.13.4 Maintenance of SLR

In term of section 24 (2A) of the BR Act, 1949 (AACS), every co-operative bank in addition to the Cash Reserve required to be maintained under section 18 (1), shall maintain in India, liquid assets, the value which shall not be less than such percentage as may be specified by Reserve Bank in the Official Gazette from time to time and not exceeding 40% of its DTL in India as on the last Friday of the second preceding fortnight. Presently the Scheduled UCBs are required to maintain a uniform SLR of 23% on their total DTL and non Scheduled UCBs are required to maintain the same at 25%.

3.3.13.5 Maintenance of CRAR

The Capital Risk Adequacy Ratio (CRAR) serves as a buffer, which can absorb the unforeseen losses a UCB may incur in the future.

In order to strengthen the capital base of banks and in keeping with the recommendations made by the Basel committee on Banking Regulations and Supervisory Practices, the RBI has introduced Capital to Risk Assets Ratio (CRAR) system for commercial banks (including foreign banks) in India as a capital adequacy measure way back in 1993. The prudential norm relating to capital adequacy was not made applicable simultaneously to urban cooperative banks due to certain statutory constraints faced by them. The High Power Committee (Madhavrao Committee), has observed that UCBs perform the same banking functions as commercial banks and are exposed to similar risks and therefore non-application of capital adequacy norms to them undermines
the stability of the whole banking system. It therefore recommended the application of capital adequacy norms to UCBs. Pursuant to the recommendations of the High Power Committee UCBs were brought under the CRAR discipline with effect from March 31, 2002, in a phased manner. Presently, the CRAR, is fixed invariably for all UCBs at 9%.98 The details of CRAR of UCBs for the year 2008-09 and 2012-13 is given below:

Table No. 3.9 CRAR Wise Distribution of UCBs

<table>
<thead>
<tr>
<th>Range of CRAR</th>
<th>Less than 3%</th>
<th>3% and less than 6%</th>
<th>6% and less than 9%</th>
<th>9% and above</th>
</tr>
</thead>
<tbody>
<tr>
<td>Scheduled UCBs</td>
<td>8</td>
<td>5</td>
<td>1</td>
<td>1</td>
</tr>
<tr>
<td>Non-Scheduled UCBs</td>
<td>136</td>
<td>155</td>
<td>24</td>
<td>7</td>
</tr>
<tr>
<td>Total</td>
<td>144</td>
<td>160</td>
<td>25</td>
<td>8</td>
</tr>
<tr>
<td>% of Share</td>
<td>8.37</td>
<td>9.96</td>
<td>1.45</td>
<td>0.5</td>
</tr>
</tbody>
</table>

(Source: Report on Trend and Progress of Banking in India, RBI)

3.3.13.6 Branch Licensing

The Reserve Bank has taken steps to liberalize and rationalize the branch licensing norms for UCBs to provide incentive to financially sound UCBs to expand their branch network. It was indicated in the Annual Policy Statement 2004-05 that fresh issuance of licenses to UCBs would be considered only after a comprehensive policy on UCBs, including an appropriate legal and regulatory framework for the sector, was put in place and a policy for improving the financial health of the UCB sector was formulated. Subsequently, in the Annual Policy for 2007-08, it was decided to allow the opening of new branches/ extension counters to banks that were registered under the Cooperative Societies Act of the States that has signed MOUs with Reserve Bank or under the Multi-State Cooperative Societies Act, 2002 subject to certain parameters.

Pursuant to the announcement in the Annual Policy Statement for 2008-09, branch licensing norms were liberalized for well-managed and financially sound UCBs operational in the MOU States and those registered under the Multi-State Cooperative Societies Act.

3.3.13.7 Currency Chest

In pursuance of the announcement made in the midterm review of the Annual Policy Statement for the year 2005-06, the currency chest facility was extended to Scheduled UCBs registered under the respective States’ Acts where the State Governments have assured regulatory coordination by entering into MOU with RBI. The main conditions of the eligibility norms were that the banks should have: a) minimum net worth of Rs.200 crore, b) CRAR of 12%, c) Net NPA at less than 10%, d) made profit in the preceding 3 years, net of accumulated losses, e) complied with CRR and SLR requirements and f) elected board of management with at least 2 professionals. (Ref.: RBI - Trends and Progress of Banking in India, 2005-06)

3.3.13.8 Insurance Business

According to the Annual Policy Statement for the year 2007-08, UCBs registered in States that had entered into with the RBI or those registered under Multi-State Cooperative Societies Act, 2002, were allowed to undertake insurance agency business as corporate agents without risk participation, subject to the condition the minimum net worth of Rs.10 crore to be maintained. All banks entering into insurance business will be required to obtain prior approval of the Reserve Bank. The Reserve Bank will give permission to banks on case to case basis keeping in view all relevant factors including the position in regard to the level of non-performing assets of the applicant bank so as to ensure that nonperforming assets do not pose any future threat to the bank in its present or the proposed line of activity, viz., insurance business. However, there is no objection to banks offering referral services to their customers for financial products subject to the following conditions:
a) The bank/third party issuers of the financial products should strictly adhere to the KYC/AML guidelines in respect of the customers

b) The bank should make it explicitly clear upfront to the customer that it is purely a referral service and strictly on a non-risk participation basis.

3.3.13.9 Inspection

As per Section 35 of the B.R. Act (as applicable to cooperative societies), 1949, UCBs are inspected by Urban Bank Division (UBD) of RBI. Currently the frequency of onsite inspection cycle for scheduled UCBs and weak UCBs is once in a year, while well-managed non-scheduled UCBs are inspected once in 3 years. All other urban banks are inspected once in 2 years.

3.3.13.10 Supervision of UCBs

The Reserve Bank development prudential supervisory reporting system in the form of Off-Site Surveillance (OSS) for the UCBs to obtain relevant information on areas of prudential interest as well as to address the management information needs and to strengthen the MIS capabilities within the UCBs. OSS returns are called for the purposes of “prudential supervision”, i.e. for overseeing financial soundness and safety of banks. OSS returns are also designed to address the management information needs and strengthen the MIS capabilities within the reporting institutions. The OSS reporting system was first introduced in April 2001 for the Scheduled UCBs comprising ten OSS returns.

OSS returns are statutory returns that are called in exercise of powers vested in REI under Section 27(2) of Banking Regulation Act which reads as follows “The Reserve Bank of India may at any time direct a co-operative bank to furnish it within such time as may be specified by the Reserve Bank, with such Returns and information relating to the business or affairs of the banking company (including any business or affairs with which such banking company is concerned) as the Reserve Bank may consider necessary or expedient to obtain for the purposes of this Act”. Non-submission of or wrong reporting in these returns attracts penalties as specified in Section 46 of the Act.
3.3.13.11 Internal Control System and Audit

Some of the urban banks have internal control and audit system. This is not adopted in many of the weak banks. This system has become a must because of multiplicity of various factors like expansion of branches, growth of volume of operations and diversification of business. RBI has appointed a Committee under the Chairmanship of Shri. Uday M. Chitale, a prominent Chartered Accountant for reviewing the audit system in UCBs and suggesting appropriate model. The Committee has strongly recommended for induction of professionals to carry out the audit of UCBs as the later are distinctly different from other cooperative institutions. The Committee among other suggested for commissioning Chartered Accountants to carry out statutory audit of large size urban banks with deposits over Rs.25 crore. RBI has accepted the Committee’s recommendation and advised the State Governments for expeditious implementation of the recommendation.

3.3.13.12 Rating Model for UCBs

The UCBs had to be rated on the basis of the CAMELS components, viz., Capital, Asset Quality, Management, Earnings, Liquidity, and Systems & Control on a scale of 1 to 100, based on the weighted average of the ratings of the components, UCBs had to be assigned rating of ‘A+’ to ‘D’ whose details are given below:

- Capital Adequacy: Marks are given for the level of CRAR, ability to plough back profit to reserves over and above statutory limit, growth in capital fund vis-a-versa in Risk Weighted Assets and Net Worth, etc.
- Asset Quality: Marks are given for percentage of net NPA, Quality of advance portfolio, etc.
- Management: Marks are given to quality and composition of Board, functions of various committees, etc.
- Earnings: Marks are given for Return on Assets, Return on owned funds, Net Interest Margin, operating profit to total assets, etc.
- Liquidity: Marks are given for ratio related to customer deposits, compliance with CRR/SLR, etc.
• Systems and Control: Marks are given for effectiveness of audit committee, degree of compliance, vigilance, etc.

In order to bring about supervisory convergence between UCBs and commercial banks, the rating models were revised from the inspection cycle beginning March 31, 2009. With the introduction of revised rating model, the gradation system of UCBs was dispensed with. The revised CAMELS rating model was made applicable to UCBs with deposits of Rs.100 crore and above, and a revised simplified version of the same was made applicable to UCBs with deposits of less than Rs.100 crore. The details of rating of UCBs during 2012 - 13 are given below.

<table>
<thead>
<tr>
<th>Rating</th>
<th>No. of Banks</th>
<th>% share in total</th>
<th>Deposits</th>
<th>% share in total</th>
<th>Advances</th>
<th>% share in total</th>
</tr>
</thead>
<tbody>
<tr>
<td>A</td>
<td>214</td>
<td>13.3</td>
<td>1169</td>
<td>42.2</td>
<td>787</td>
<td>43.5</td>
</tr>
<tr>
<td>B</td>
<td>861</td>
<td>53.6</td>
<td>1175</td>
<td>42.4</td>
<td>761</td>
<td>42.1</td>
</tr>
<tr>
<td>C</td>
<td>432</td>
<td>26.9</td>
<td>365</td>
<td>13.2</td>
<td>228</td>
<td>12.6</td>
</tr>
<tr>
<td>D</td>
<td>99</td>
<td>6.2</td>
<td>60</td>
<td>2.2</td>
<td>33</td>
<td>1.8</td>
</tr>
<tr>
<td></td>
<td>1606</td>
<td>100</td>
<td>2769</td>
<td>100</td>
<td>1809</td>
<td>100</td>
</tr>
</tbody>
</table>

(Source : Trends and progress of banking, RBI) (Source: Report on trends and progress of banking in India, RBI, 2012-13)

As per the new CAMELS rating model, 67% of the UCBs, accounting for about 85% of the total banking business of the UCB sector, had ratings of ‘A’ and ‘B’, indicating the good financial health of this sector. Further, around 27% of the UCBs had a composite rating of C; these UCBs accounted for about 13 per cent of the banking business of the UCB sector. Only about 6% of the UCBs had the lowest rating of D, representing the weakest financial health.

3.3.14 Welfare Schemes

Similar to agriculture credit cooperatives, UCBs also render many social welfare measures. For instance, the Kalupur Commercial Cooperative Bank Ltd., the largest Multi-State Urban Cooperative Bank in Gujarat, celebrated its 44th foundation day on 5th December 2013 by appealing to its customers to
donate unused/discarded items like old clothes, toys, electric/electronic
gadgets, utensils, etc., which in turn would be distributed among the needy
people.
Ambarnath Jai Hind Cooperative Bank Ltd., Maharashtra has started
AADHAR linked saving bank a/c facility to the customers as a part of
financial inclusion programme. Customers can avail facility of Direct Benefit
Transfer of gas subsidy, student’s scholarship, pension and other government
benefits from November 2013 onwards.
In Sir M. Visvesvaraya Cooperative Bank Ltd., a non-refundable medical aid
maximum of Rs. 10,000 will be paid to the members for specified diseases. In
order to encourage the children of the members in their education/sports/literature, the rank holders and distinction holders of the
State, will be honored. A death relief fund up to Rs. 6000 will be given for
helping the bereaved families to carry out the last rites of the deceased. The
bank is focusing the light on quality consciousness in the formal way by
implementing the quality system through systematic feedback and its scientific
measurements and follow up.99

3.3.15 Financial position Urban Co-operative banks in Pune as on 31/3/2014
Total urban co-operative banks in India as on 31/3/2014 are 1596, from those
525 urban co-operative banks in Maharashtra, since those 53 urban co-
operative banks are in Pune. As on 31st March 2015, 10% UCBs as compared
to Maharashtra are in Pune.
Total share capital Rs. 865.94 crores, total number of shareholders are 8,
73,235. Share capital increased by Rs.30.13 crores (3.61%) and number of
share capital increased by 40205 (4.28%) as compared to last years. In Pune
City, CRAR for 48 UCBs are 12% and for remaining 5 UCBs in Pune are in
between 9% to 12%. Deposits as on 31st March 2014 are Rs.35844.78 crores,
which was increased by 4703.22 crores (15.10%) as compared to last year.
Ratio of total deposits to working capital is 86.89%, so that it will reduce the
profitability of UCBs. Current deposits are Rs.1888.44 crores(5.26%), saving

deposits are 6147.35 crores (17.15%) and other term deposits are Rs. 27808.99 crores (77.59%).

53 Urban co-operative banks in Pune are having 67,54,340 number of depositors and on an average per depositor deposit is Rs.53100. Total profit of 53 UCBs in Pune is Rs.328.83 crores. Ratio of total profit to capital is 0.79% and average return on investments is 0.85%. As on 31st March 2014 investments in government securities and other banks are Rs. 13,404/- crores, which is increased by Rs.1765.76 crores (15.17%) as compared to last year. Urban co-operative banks financed for 383060 members, average loan to each member is around Rs.6,20,840 and Credit Deposit ratio is 66.34% , Gross NPA is 4.45% and Net NPA is 1.95%. Net NPA of thirty two UCBs in Pune are 0% and Net NPA of eighteen UCBs in Pune are 5% . Gross NPA of 30 UCBs in Pune is less than 5%, and gross NPA of seventeen UCBs is in between 5% to 10%. As on 31st March 2015, Fifty three UCBs in Pune have 645 branches and 268 ATM to provide services to the customers. Per employee business of UCBs are 6.62 crores.