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# **A CRITICAL ANALYSIS OF** **REGULATORY FRAMEWORK OF THE** **CO-OPERATIVE BANKS IN INDIA**

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## **Abstract**

This research work mainly emphasizes on the banking structure and system follows in entire India. This project clearly states the relationship shared by RBI and other banks (either private or public). Whole banking structure is regulated by RBI, RBI determines the financial position of bank. RBI plays important role in boosting banking sector by slashing or increasing Repo rate, Reverse repo rate etc., according to the demand of the situation. There are several functions of banks and powers of RBI discussed further in this research. In short, every decision taken by RBI affects in a way or another banks of India.

## Introduction

Co-operative banks are an important financial institution that belongs to its associates, who are both owner and consumers of their bank. A cooperative bank is always made by individuals join the same locality who shares a general interest. It generally offers their people with a broad variety of banking services such as loan, deposits, saving and current accounts and ATM facility<sup>1</sup>. A cooperative bank varies from the action bank by their firm, their goals, their importance and their domination. In many nations, it is controlled by banking authority and should obey prudential banking rules, which situate them on an equivalent footing with a shareholder bank. A co-operative bank is much more significant in India than any place else in the globe. The distinguishing nature of it is service at a lesser rate and services without misuse. This bank has achieved its vitality by the position assigned to them, the expectation they are supposed to accomplish and the number of branches they function. Its role in rural finance pursues to be vital gradually, and their dealing in the cities also has risen extraordinarily in recent time chiefly because of the quick raise in the number of prime Co-operative banks. In rural locality, to the extent that the farming and associated activities are considered, the delivery of credits were insufficient, and money lenders would use the poor public in rural locality giving them loans at higher interest rate. Hence, these banks mobilize deposit and rural credits with a broad outreach and give institutional credits to the farmer. Co-operative banks<sup>2</sup> have also been a significant tool for many growth schemes, mainly subsidy-based programme for poor.<sup>3</sup>

### History of Cooperative Banking in India:

Cooperative movement in India was started primarily for dealing with the problem of rural credit. The history of Indian cooperative banking started with the passing of Cooperative Societies Act in 1904. The objective of this Act was to establish cooperative credit societies “to encourage thrift, self-help and cooperation among agriculturists, artisans and persons of limited means.”

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<sup>1</sup> Banking Structure in India- The Way Forward, Discussion Paper, Reserve Bank of India, 2013, [https://rbidocs.rbi.org.in/rdocs/PublicationReport/Pdfs/DPBS27082013\\_F.pdf](https://rbidocs.rbi.org.in/rdocs/PublicationReport/Pdfs/DPBS27082013_F.pdf).

<sup>2</sup> <https://www.legalserviceindia.com/legal/article-9653-co-operative-banks-a-critical-analysis.html>

<sup>3</sup> Paramashiaviah, A Study on Cooperative Sector Banks in India: Problems & Prospects, Ignited Minds Journals, Apr, 2019

Many cooperative credit societies were set up under this Act. The Cooperative Societies Act, 1912<sup>4</sup> recognised the need for establishing new organisations for supervision, auditing and supply of cooperative credit. These organisations were-

- (a) A union, consisting of primary societies;
- (b) the central banks; and
- (c) provincial banks.

Although beginning has been made in the direction of establishing cooperative societies and extending cooperative credit, but the progress remained unsatisfactory in the pre-independence period. Even after being in operation for half a century, the cooperative credit formed only 3.1 per cent of the total rural credit in 1951-52.

## What are cooperative banks?

A co-operative bank is a financial entity which belongs to its members, who are at the same time the owners and the customers of their bank. It is often established by people belonging to the same local or professional community having a common interest. It is formed to promote the upliftment of financially weaker sections of the society and to protect them from the clutches of money lenders who provide loans at an unreasonably high-interest rate to the needy. The co-operative structure is designed on the principles of cooperation, mutual help, democratic decision making and open membership. It follows the principle of 'one shareholder, one vote' and 'no profit, no loss'. Cooperatives Banks are registered under the Cooperative Societies Act, 1912. These are regulated by the Reserve Bank of India and National Bank for Agriculture and Rural Development (NABARD) under the Banking Regulation Act, 1949 and Banking Laws (Application to Cooperative Societies) Act, 1965.

### Importance of Cooperative Banks:

The cooperative banking system has to play a critical role in promoting rural finance and is specially suited to Indian conditions.

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<sup>4</sup> Report of the Expert Committee on Licensing of New Urban Co-operative Banks (Chairman: Y. H. Malegam), 2011, <https://rbidocs.rbi.org.in/rdocs//PublicationReport/Pdfs/MFR120911RF.pdf>.

- It has an extensive branch network all over the country, making credit easily available even to rural areas. It accounts for 67 per cent of total rural credit.
- It is an integral source for credit to agriculturalists.
- It conforms to the requirements of democratic planning and economic progress.
- It provides support to small and marginal farmers for buying inputs, storage and marketing assistance.

## **Types of Cooperative Banks in India<sup>5</sup>**

The co-operative banking structure in India is divided into the following 5 categories:

### **1. Primary Co-operative Credit Society**

- The Primary Co-operative Credit Society is an association of borrowers and non-borrowers residing in a particular locality.
- The funds of the society are derived from the share capital and deposits of members and loans from central co-operative banks.
- Borrowing constitutes the most important element of their working capital.

### **2. Central Co-operative Banks**

These are the federations of primary credit societies in a district and are of two types:

1. Those having a membership of primary societies only.
2. Those are having a membership of societies as well as individuals.

### **3. State Co-operative Banks**

- The state co-operative bank is a federation of central co-operative bank and acts as a watchdog of the co-operative banking structure in the state.

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<sup>5</sup> Developments in Co-operative Banking, Report on Trends and Progress in Banking 2018-19, Reserve Bank of India, [https://rbidocs.rbi.org.in/rdocs/Publications/PDFs/05CHPT5\\_24122019878A5AF64EB74900B7AD6FF7\\_093EE45F.PDF](https://rbidocs.rbi.org.in/rdocs/Publications/PDFs/05CHPT5_24122019878A5AF64EB74900B7AD6FF7_093EE45F.PDF).

- It procures funds from share capital, deposits, loans and overdrafts from the Reserve Bank of India.

#### **4. Land Development Banks**

- These are organized in 3 tiers, namely; state, central, and primary level with the objective to meet the long term credit requirements of the farmers for developmental purposes.
- National Bank for Agriculture and Rural Development (NABARD) supervises Land development banks.

#### **5. Urban Co-operative Banks<sup>6</sup>**

- It refers to primary cooperative banks located in urban and semi-urban areas.
- Earlier the scope of these banks was restricted, which now has been considerably widened.

### **Control & Direction By R.B.I Over Cooperative Bank**

The BR Act, 1949 allows the R.B.I to provide guidance, to cooperative bank generally and to any CB particularly, concerning any phase of the functioning of the co- operative bank considered. Whilst S.21 grants power to provide guidance regarding advance by CBs, S.35A includes every aspect of the function of CBs. These 2 secs jointly have provided power to the R.B.I to provide every direction on each matter regarding the operations of co-operative banks particularly, or all CBs, or group of CBs, generally.

Besides carrying out usual scrutiny in these sections, the R.B.I is also authorized to do an inquiry of the dealings of the CB, at any time it is concerned essential to do so. Considerably, the N.A.B.A.R.D has also been constitutionally empowering to conduct the scrutiny of CBs than, but prime CBs however such authorities have been provided, lacking unfairness to the power of R.B.I, to do such inspections. (S.35)

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<sup>6</sup> <https://blog.iplayers.in/cooperative-banking-system-in-india/>

The R.B.I is empowered to depute, in case it is considered essential to do so, for the reorganization or extension of credits on strong lines, many of its officials to observe the proceeding at any conference of the BODs of any CBs comprised by it and need these banks to offer a chance to the officers, so deputized, will be listened to at these conferences. The R.B.I might assign more than 2 of its officials to watch the way in which the dealings of banks or its divisions are being carried out, need such officials to make a brief statement thereon.<sup>7</sup>

## **Various Advantages Of Cooperative Credit Institutions Are Given Below:<sup>8</sup>**

### **I. Alternative Credit Source:**

The main objective of cooperative credit movement is to provide an effective alternative to the traditional defective credit system of the village money lender. The cooperative banks tend to protect the rural population from the clutches of money lenders. The money lenders have so far dominated the rural areas and have been exploiting the poor people by charging very high rates of interest and manipulating accounts.

### **II. Cheap Rural Credit:**

Cooperative credit system has cheapened the rural credit both directly as well as indirectly:(a) Directly, because the cooperative societies charge comparatively low interest rates, and (b) Indirectly, because the presence of cooperative societies as an alternative agency has broken money lender's monopoly, thereby enforcing him to reduce the rate of interest.

### **III. Productive Borrowing:**

An important benefit of cooperative credit system is to bring a change in the nature of loans. Previously the cultivators used to borrow for consumption and other unproductive purposes. But, now, they mostly borrow for productive purposes. Cooperative societies discourage unproductive borrowing.

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<sup>7</sup> Id, p. 227

<sup>8</sup> M.L. Jhingan, "Money, Banking, International Trade and Public Finance", Vrinda Publication Pvt. Ltd., 7th Edn., Reprint 2007

#### **IV. Encouragement to Saving and Investment:**

Cooperative credit movement has encouraged saving and investment by developing the habits of thrift among the agriculturists. Instead of hoarding money the rural people tend to deposit their savings in the cooperative or other banking institutions.

#### **V. Role of Cooperative Banks before 1969:<sup>9</sup>**

Till the nationalisation of major commercial banks in 1969, cooperative societies were practically the only institutional sources of rural credit. Commercial banks and other financial institutions hardly provided any credit for agricultural and other rural activities. Cooperative credit to the agriculturists as a percentage of total agricultural credit increased from 3.1 per cent in 1951-52 to 15.5 per cent in 1961-62 and further to 22.7 per cent in 1970-71.

On the other hand, the agricultural credit provided by the commercial banks as a percentage of total agricultural credit remained almost negligible and fell from 0.9 percent in 1951-52 to 0.6 percent in 1961-62 and then rose to 4 per cent in 1970-71.

#### **Categories & Functions Of Co-Operative Bank In India**

A co-operative bank is small sized parts which function both in city and non-urban centers. They finance undersized borrowers in commercial and trade sector beside business persons and Govt. servants. Controlled by the R.B.I, they are governed by the “Banking Regulations Act 1949” and “banking laws (co-operative societies) act, 1965”. The co-operative bank composition in India is segregated into types such as<sup>10</sup>

#### **Prime Co-operative Credit Societies**

It is a union of borrowers and non-borrower reside in a specific area. The fund of the society is got from the share capitals and deposit of affiliates and loan from state co-operative bank. The lending power of affiliates as well as of the society is fixed. The loan is provided to associates for the buying of cattle, fodders, fertilizer, pesticide, and so on.

<sup>9</sup> <https://razorpay.com/blog/business-banking/cooperative-banking/>

<sup>10</sup> K.V. Nagaraj, A Case Study on Banking Operations in Cooperative Sector, PARIPEX, Volume: 4 | Issue: 8, Aug 2015

## **Central Co-operative Bank .**

This is a federation of primary credit society in districts and is of 2 categories- those have memberships of primary societies only and those having a membership of society over and above people. The funding of the central bank consists of share capitals, deposit, loan and overdraft from state co-operative bank. This bank gives funds to member society in the limit of the borrowing capacities of society. It also conducts all the businesses of joint stocks bank.

## **State Co-operative Bank <sup>11</sup>**

The state co-operative bank is association of state co-operative banks and performs as a regulator of the co-operative bank system in state. Its funding is got from share capitals, deposit, loan and overdraft from the R.B.I. The state co-operative bank lends funds to central co-operative bank and prime society and not straight to farmer.<sup>12</sup>

## **Urban Co-operative Bank**

The word U.C.B, even if not officially defined, refers to PCBs placed in urban and city area. UCBs, till 1996, were permitted to borrow funds only for non- agricultural purpose. UCBs were conventionally centered on societies, areas, workplace members. They basically loan to SME sector firms. Nowadays, scope of UCB's operation has broadened significantly. They offer credits to MSMEs, salaried workers, and other urban and city residents.<sup>13</sup>

## **Functioning of a Co-operative Bank**

A Co-operative bank does the fundamental bank function of banking but it varies from commercial bank.

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<sup>11</sup> <https://www.drishtiiias.com/daily-updates/daily-news-analysis/co-operative-banksunder-R.B.I-supervision>

<sup>12</sup> Subashchandra Bose, P. Nagarajan, Current Scenario of State Co-Operative Bank in India and Its' Working Performance, IJSR, Impact Factor (2017): 7.296

<sup>13</sup> K.V. Nagaraj, A Case Study on Banking Operations in Cooperative Sector, PARIPEX, Volume: 4 | Issue: 8, Aug 2015

- a. A commercial banks is joint-stock company as per the companies act, 1956, or PCB in a specific act whereas a co-operative bank was set up in the co-operative society act of various state Govt.s.<sup>14</sup>
- b. Commercial bank structure is branch banking structure whereas co-operative banks have a threeter setup, with state co-operative bank at apex level, central / district co-operative bank at district level, and primary co-operative societies at rural level.
- c. Only some of the sections of banking regulation act of 1949 (fully applicable to commercial banks), are applicable to co-operative banks, resulting only in partial control by R.B.I of cooperative banks.

### **Case of Punjab and Maharashtra Cooperative Bank (PMC Bank)**

- The PMC Bank had Rs 11,617 crore in deposits as on March 31, 2019. It had violated Reserve Bank of India (RBI) norms by lending heavily to one client-real-estate firm Housing Development and Infrastructure Limited (HDIL), which itself is facing bankruptcy proceedings. PMC Bank has extended 73 per cent of their assets to HDIL.
- The former chiefs of the bank and the promoters of HDIL have been booked for cheating, and lookout notices have also been issued against them.
- The PMC Bank crisis shows how the watchdogs -the bank's auditors, the RBI and the government were lousy in doing their jobs and taking responsibility.
- An action was taken by RBI under sub-section (1) of Section 35A of the Banking Regulation Act,1949 read with Section 56 of the Act which deals with the power of RBI to give directions.
- PMC Bank cannot grant or renew any loans or advances or to make any investments or accept any new deposits without the prior approval of RBI for the next six months.

### **Other Provisions**

Sec.22(4): Cancellations/rejections of licenses

Sec.23 (4A): Cooperative banks looking consent of R.B.I for division opening is needed to forward application to R.B.I via N.A.B.A.R.D;<sup>15</sup>

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<sup>14</sup> 5 [https://blog\\_media.testbook.com/blog/wp-content/uploads/2017/12/All-About-Cooperative-Banks-in-India- GKNNotes-for-SSC-Banking-Exams-in-PDF.pdf](https://blog_media.testbook.com/blog/wp-content/uploads/2017/12/All-About-Cooperative-Banks-in-India- GKNNotes-for-SSC-Banking-Exams-in-PDF.pdf)

<sup>15</sup> <https://www.drishtias.com/daily-updates/daily-news-analysis/co-operative-banks-under-R.B.I-supervision>

- N.A.B.A.R.D will provide its remarks on the value of the case and forward to R.B.I copy of the applications will be forwarded by the Cooperative bank directly to the R.B.I.

Sec.24-A: R.B.I had authority to let off CBs from the whole of or every division of the provision of Sec.18 or Sec.24 of the Acts.

Sec.35 A: Power of R.B.I to provide guideline: R.B.I is allowed to provide direction to CBs generally or to CBs particularly on every aspects of functioning of these banks.

Sec.45: As per sec.45, the R.B.I may suggest to the Union Govt., to array a suspension regarding cooperative Banks. The power to issue such a moratorium however rests with the Central Govt.

Sec.46: As per sec.46, various penalties that may be imposed on cooperative banks, for rebelliousness with the different provisions of the B.R. Act, have been mentioned.

Sec.53: Powers to except; The Union Govt. may, in the proposal of R.B.I, except any bank or any class of banks from any or every provision of these BR Act.

- Prime farming society is excluded from the range of the BR Act 1949;
- the least capital requirements are only Rs. 1,00,000 for banking institutions;
- Cooperative banks can't employ in every trading activities;
  - A Cooperative bank has to keep a cash reserve ratio of 3 percent of N.D.T.L in cash and current accounts by R.B.I and another important bank. SCBs have to keep CRR in the R.B.I rule in a report by R.B.I. In general, the cash reserve ratio requirement is less than that for a commercial bank.<sup>16</sup>
- CBs require to keep constitutional liquidity ratio of 25 percent of N.D.T.L in the form of gold, balance by state CBs and on unencumbered sanctioned security;
- CBs can't hold above 5 percent of private capitals of all others cooperative societies;
  - CBs have to present many returns to R.B.I in regards to C.R.R./S.L.R, asset and liability, unsecured loan to director, advance to priorities and rural and backward sectors, shareholding in cooperative societies, NPAs and balance sheets, P&L accounts of constitutional audit reports as stated by the periodicity described for various declarations.<sup>17</sup>

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<sup>16</sup> Subashchandra Bose, P. Nagarajan, Impact Factor (2017): 7.296

<sup>17</sup> Paramashiviah, A Study on Cooperative Sector Banks in India: Problems & Prospects, Ignited Minds Journals, Apr, 2019

### **Reforms In The BR Act, 1949:**

Resulting on the execution of suggestions of Committees on revitalization of the cooperative societies, some revisions to the B.R. Act would be needed and this will include:

- All CBs should be on balance with conventional bank to the extent that regulatory standards are considered;
- R.B.I will set down fit and appropriate criterion for voting to Board of CBs. These criterions would though not be in conflict with the nature of memberships of main cooperative banks which comprise the memberships of the D.C.C. Bs and S.C. Bs;
- Though, as a financial institution, such Boards should require least assistance at the Board level. So, the R.B.I shall set criterion in favor of professionals will be on the Board of CBs. Suppose a member with such professional qualification or experience don't get selected in the usual voting processes, then the board to be needed to appoint such professional to the boards and they would have complete voting right.
- The C.E.Os of a cooperative bank should be employed by the particular financial institutions himself and not by the State Govt. Though, as such banks, R.B.I would set the least qualifications of the C.E.O to be selected and the name suggested by CBs for the post of C.E.O would have will be sanctioned by R.B.I;
- Cooperatives other than CBs as sanctioned by R.B.I will not recognize non-elected member deposit. These types of cooperatives will also not employ terms such as "bank", "banking", "banker" or no other derivatives of the term "bank" on their listed names.<sup>18</sup>

### **Regulatory Frameworks <sup>19</sup>**

In India, a cooperative bank is registered in the specific State cooperative society act and managed by State Govt. via the Registrars of Cooperative Society regarding incorporations, registrations, management, audits and liquidations. They are ruled and controlled by R.B.I as per BR Act, 1949 and the BR (Co-operative Societies) Rule, 1966. N.A.B.A.R.D has

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<sup>18</sup> T. R. Radhakrishnan, Supervision of co-operative banks by R.B.I, Tax Guru, 02 Jul 2020

<sup>19</sup> Report of the High Powered Committee on Urban Cooperative Banks (Chairman: R. Gandhi), 2015, <https://rbidocs.rbi.org.in/rdocs//PublicationReport/Pdfs/HPC3934E91FA21241B8B0ABC4C4DBF28A40>. PDF.

simultaneous power to scrutinize S.C.Bs and D.C.C.Bs. P.A.C.S is only in the purviews of N.A.B.A.R.D. As a result, there is variety of domination.

### **The Banking Regulation Amendment Bill, 2020<sup>20</sup>**

The BR Amend bill looks to impose stricter banking regulations by R.B.I on CBs whereas management problems and challenges are still directed by the Registrars of Cooperative Society. The "Declaration of Object and Reason" make obvious the legal intention to carry CBs on parity with regulations and growth in banking industry and to have superior control, raised professionalisms, accesses to capitals, progress governance and guard depositor interest.<sup>21</sup>

## **Highlights of the Bill**

- Co-operative banks are exempted from several provisions of the Banking Regulation Act, 1949<sup>22</sup>. The Bill applies some of these provisions to them, making their regulation under the Act similar to that of commercial banks.
- Co-operative banks may raise equity or unsecured debt capital from the public subject to prior RBI approval.
- RBI may prescribe conditions on and qualifications for employment of Chairman of co-operative banks. RBI may remove a Chairman not meeting 'fit and proper' criteria and appoint a suitable person. It may issue directions to reconstitute the Board of Directors in order to ensure sufficient number of qualified members.
- RBI may supersede the Board of Directors of a co-operative bank after consultation with the state government.
- The Bill allows RBI to undertake reconstruction or amalgamation of a bank without imposing a moratorium.

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<sup>20</sup> The Banking Regulation (Amendment) Bill,

2020, [https://www.prsindia.org/sites/default/files/bill\\_files/The%20Banking%20Regulation%20%28Amendmen%29%20Bill%2C%202020.pdf](https://www.prsindia.org/sites/default/files/bill_files/The%20Banking%20Regulation%20%28Amendmen%29%20Bill%2C%202020.pdf).

<sup>21</sup> Niloufer Lam, India: Co-operative Banks In India: Heading Towards Reform, Mondaq, 22 June 2020

<sup>22</sup> Report of the Working Group to examine issues relating to augmenting capital of UCBs (Chairman: N. S. Vishwanathan), 2006, <https://rbidocs.rbi.org.in/rdocs//PublicationReport/Pdfs/74324.pdf>.

## Key features of the Bill are:

- Co-operative banks provide banking facilities to people of small means. However, absence of regulatory oversight by RBI on par with commercial banks has contributed to the poor performance of co-operative banks. The Bill seeks to extend RBI regulation of co-operative banks with respect to management, capital, audit and winding up.
- ‘Banking’ is a Union List subject in the Constitution and ‘incorporation, regulation and winding up’ of co-operative societies’ is in the State List. The question is whether regulation of management, audit, capital and winding up of co-operative banks are essential to regulating the activity of banking, and therefore whether the Bill falls within the legislative competence of Parliament.
- The Bill enables co-operative banks to issue equity shares to members and to persons residing within the banks’ area of operation. Since co-operative societies raise capital from members, it is unclear what it means to raise equity capital from the public. Further, restrictions on redemption of share capital by members may limit their option to exit.<sup>23</sup>

## Conclusion

Failure of cooperative banks would signify breakdown of best expectation for rural people. It is anticipated that the provisos recommended in this study will not only make sure the independent and self-ruled working of CBs, but also guarantee the responsibility of administration to the associates and other stakeholder and will give for prevention for infringement of the provision of Act. A cooperative bank is at present in the double management of cooperative society with R.B.I. Although the responsibility of the cooperative societies comprises incorporation, registrations, managements, audits, supersession of BODs and liquidations, R.B.I is accountable for legal functions. The reform in the recent Bill would cause fewer State Govt. interventions and will initiate up skill in administration and professionalism in the capability to function CBs. There should be more attention on the boards and supervision and thorough review of capital necessities and fund raising for CBs. As there are future needs for scheduled share offering and as a cooperative seem at fund raisings in open market,

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<sup>23</sup> Paramashiaviah, A Study on Cooperative Sector Banks in India: Problems & Prospects, Ignited Minds Journals, Apr, 2019

this would cause more lucidity and disclosures on the economic position and processes of CBs. The judiciary now has power concern completing proceeding of CBs in some cases, which was previous vest with the Registrars of Cooperative Society. Units would be incentivized to lift up their standard to be healthier because of superior level of inspection. To expect further regulations by R.B.I on administration and rule of the CBs more in line with banking regulations. The power and potency of R.B.I, will make sure CBs avoid a PMC like catastrophe in the future.

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