

CO-OPERATIVE BANKS - ECONOMY

NEWS: *The RBI's restrictions on New India Co-operative Bank highlight ongoing vulnerabilities within the urban cooperative banking sector.*

WHAT'S IN THE NEWS?

Definition and Characteristics of Cooperative Banks

- Cooperative Banks are financial institutions within the Indian banking system that operate on the principles of **cooperation, mutual assistance, and collective benefit** for their members.
- These banks are **owned and controlled by their members**, who serve as both **owners and customers**.
- They function based on the principle of "**one person, one vote**," ensuring democratic decision-making.
- Along with providing financial assistance through lending, Cooperative Banks also **accept deposits** from members and the general public.

Regulation of Cooperative Banks in India

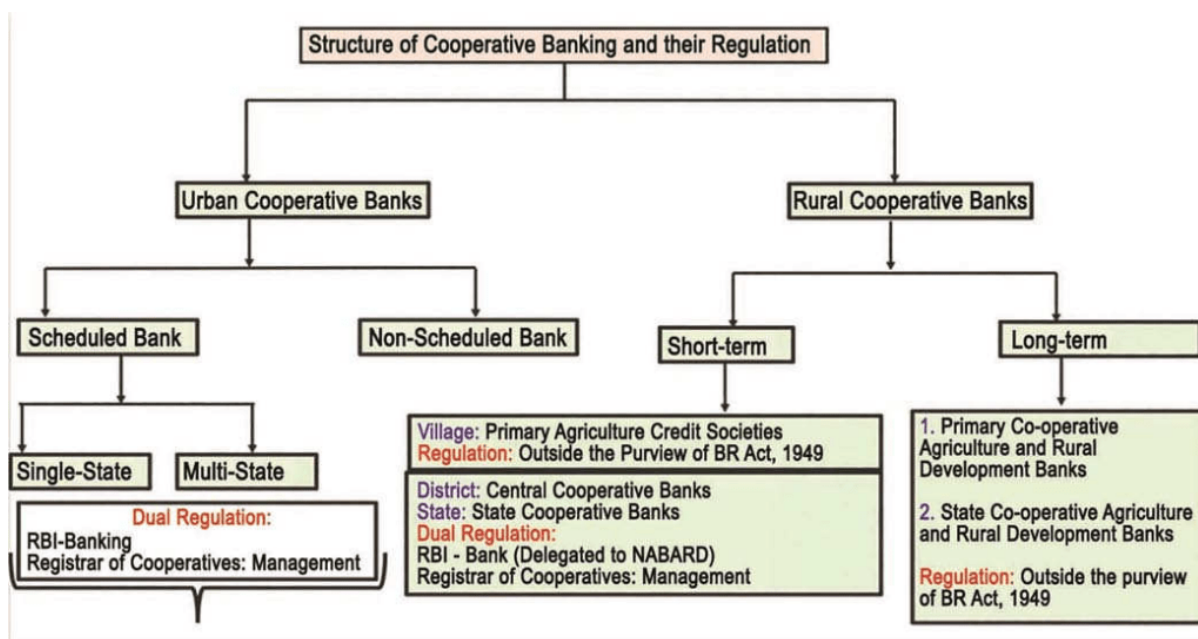
Cooperative Banks in India come under a **dual regulatory framework**, which involves:

1. Reserve Bank of India (RBI)

- Under the **Banking Regulation Act, 1949**, and the **Banking Laws (Application to Cooperative Societies) Act, 1965**, the RBI regulates the banking functions of cooperative banks.
- The RBI oversees key aspects such as **capital adequacy, lending norms, risk management, and liquidity control** to ensure financial stability.

2. Registrar of Cooperative Societies (RCS)

- The **Registrar of Cooperative Societies (RCS)**, operating under either the **respective State Government or the Central Government**, regulates the management-related aspects of cooperative banks.
- The RCS is responsible for functions such as **incorporation, registration, governance, audit, supervision, dissolution of the board of directors, and liquidation** of cooperative banks.



Structure of Cooperative Banks in India

Cooperative Banks in India are primarily classified into two broad categories:

1. Rural Cooperative Banks (RCBs)

- These banks cater mainly to **farmers, agricultural laborers, and rural small-scale businesses**.
- They further operate at different levels:
 - **State Cooperative Banks (SCBs)** – Apex-level institutions at the state level.
 - **District Central Cooperative Banks (DCCBs)** – Operating at the district level, serving as intermediaries between SCBs and Primary Agricultural Credit Societies.
 - **Primary Agricultural Credit Societies (PACS)** – Grassroots-level institutions directly providing credit to farmers and rural businesses.

2. Urban Cooperative Banks (UCBs)

- UCBs operate mainly in **urban and semi-urban areas**, catering to **small businesses, traders, and lower-income groups**.
- Based on their regulatory status, UCBs are further divided into:
 - **Scheduled Urban Cooperative Banks** – Included in the RBI's schedule and subject to stricter banking regulations.
 - **Non-Scheduled Urban Cooperative Banks** – Smaller banks that do not meet the criteria for scheduled status.

Challenges Faced by Urban Cooperative Banks (UCBs)

Despite their significance in financial inclusion, UCBs face several operational and financial challenges, including:

1. Low Capitalization and Financial Vulnerability

- Many UCBs operate with **low capital adequacy ratios (CAR)**, making them vulnerable to financial distress.

- High levels of **Non-Performing Assets (NPAs)** reduce profitability and weaken their financial position.

2. History of Financial Scams and Bank Failures

- Several large cooperative banks have collapsed due to fraud and mismanagement.
- Notable examples include:
 - **Punjab and Maharashtra Cooperative (PMC) Bank** – Collapsed due to massive financial fraud involving undisclosed bad loans.
 - **Guru Raghavendra Cooperative Bank** – Failed due to fund mismanagement and irregularities.
 - **Maharashtra State Cooperative (MSC) Bank** – Involved in scams related to political interference and misallocation of funds.

3. Regulatory Arbitrage and Weak Oversight

- Compared to commercial banks, cooperative banks **face relatively lenient regulatory scrutiny**.
- Dual regulation by the RBI and the RCS creates **loopholes**, allowing financial mismanagement to go unchecked.

4. Political Interference and Governance Issues

- Many cooperative banks are **influenced by local politicians**, leading to poor governance and misuse of funds.
- Appointments to the board are often **politically motivated**, rather than based on financial expertise.

5. Limited Technological Adoption

- Many UCBs **lack digital infrastructure**, making them vulnerable to cyber threats and operational inefficiencies.
- Weak IT systems also hinder their ability to compete with technologically advanced commercial banks.

6. Weak Risk Management and Internal Controls

- Poor risk assessment leads to **unchecked lending**, resulting in **increasing NPAs and financial instability**.
- Inadequate fraud detection mechanisms further expose these banks to **financial irregularities**.

Measures to Strengthen the Cooperative Banking Sector

1. Strengthening Capital Adequacy Norms

- Cooperative Banks should maintain **higher capital buffers** to withstand financial shocks.
- Stricter regulations on **loan disbursements, risk assessment, and financial health** should be enforced.

2. Promoting Technology Adoption

- Cooperative banks should **modernize their banking infrastructure** by implementing:
 - Digital banking services for customers.
 - Advanced fraud detection and cybersecurity measures.

- Core Banking Solutions (CBS) to enhance operational efficiency.

3. Merging Weak Banks with Stronger Institutions

- Financially unstable cooperative banks should be **consolidated with larger, well-functioning banks**.
- This will improve **financial stability, operational efficiency, and customer trust**.

4. Strengthening Governance and Regulatory Frameworks

- **Board members must have financial expertise** rather than political affiliations.
- **Independent audits and stricter supervision** should be implemented to reduce mismanagement and fraud.
- The RBI should be given **greater regulatory authority** over cooperative banks to ensure uniform compliance with banking norms.

Conclusion

Cooperative Banks play a **crucial role in India's financial system**, particularly in rural and semi-urban areas. However, **governance issues, weak financial management, and political interference** have led to recurring challenges in the sector. Strengthening **capital norms, governance frameworks, technological infrastructure, and risk management mechanisms** is essential for ensuring the long-term sustainability and efficiency of cooperative banks in India.

Source: https://www.business-standard.com/finance/news/rbi-restricts-new-india-cooperative-bank-loans-deposits-withdrawals-125021401067_1.html