5. Reopening Of UCB Licensing- Economy

RBI proposes reopening urban co-operative banks' licenses; favours large credit societies After a 20-year hiatus, the RBI has proposed reopening the licensing window for Urban Co-operative Banks (UCBs) to allow sound credit societies to transition into banks under stricter financial criteria. This move is bolstered by the Banking Regulation (Amendment) Act, 2020, which empowers the RBI to address historical governance lapses and dual-control challenges.

Context- Reopening of UCB Licensing

Current Development- The Reserve Bank of India (RBI) has proposed reopening the licensing window for Urban Co-operative Banks (UCBs).

Historical Context- This move comes after a hiatus of nearly two decades. The licensing was suspended approximately 20 years ago following a wave of financial failures among newly licensed small UCBs.

Objective- The reopening aims to allow financially sound co-operative credit societies to transition into banks, subject to strict criteria.

1. About Urban Co-operative Banks (UCBs)

Definition and Nature

Co-operative Societies- UCBs are primarily co-operative societies that undertake banking activities.

Core Activities- Their functions include accepting deposits and lending money.

Target Demographic- They primarily serve members of the co-operative and the general public located in urban and semi-urban areas.

Ownership Structure

Member-Owned- They operate on a member-owned model.

Democratic Principle- UCBs function on the principle of 'one member, one vote'.

Differentiation- This voting right exists regardless of the amount of share capital held by the member, unlike commercial banks which operate as joint-stock companies (where voting power is proportional to shareholding).

2. Legal and Regulatory Framework

The governance of UCBs is unique due to a dual control structure involving both the RBI and Co-operative Registrars.

Regulatory Body	Relevant Act	Key Responsibilities
Reserve Bank of India (RBI)	Banking Regulation Act, 1949 (Part V)	Regulates banking functions. Oversees lending, deposits, liquidity, and prudential norms.
Registrar of Co-operative Societies	Co-operative Societies Acts (State or Central Act, 2002)	Governs administrative aspects. Manages registration, management, elections, and audits.

3. Objectives and Role of UCBs

Financial Inclusion- To promote inclusion among specific groups such as small traders, artisans, and salaried employees in urban/semi-urban regions.

Affordable Credit- Providing credit facilities to members at reasonable and affordable interest rates.

Resource Mobilization- Mobilizing local savings to be used for productive and social development.

Co-operative Spirit- Strengthening core principles like mutual help and democratic management within the financial sector.

4. Structural Profile of UCBs (As of March 31, 2025)

Composition and Tiers

Total Count- India has 1,457 UCBs.

Tier-wise Breakdown

a. **Tier 1-** 838 banks (57.5% - Majority are small).
b. **Tier 2-** 535 banks.

c. **Tier 3-** 78 banks.
d. **Tier 4-** 6 banks.

Financial Distribution

Asset & Deposit Growth

a. Aggregate Assets- ₹7.38 lakh crore (FY25) (Up from ₹4.35 lakh crore in 2015).
b. Total Deposits**-** ₹5.84 lakh crore (FY25) (Up from ₹3.55 lakh crore in 2015).

Concentration of Wealth

1. Large UCBs- Only 7% of UCBs hold deposits >₹1,000 crore, yet they control 62.5% of total deposits.
2. Small UCBs- 52% of UCBs hold deposits <₹100 crore, contributing only 5.6**%** to total deposits.

5. Eligibility Criteria for New Licensing

The High-Powered Committee on Urban Co-operative Banks, led by the RBI Deputy Governor, recommended strict norms to ensure only stable entities enter the sector.

Target Entities - New licenses are restricted to large co-operative credit societies rather than starting new entities from scratch.

Mandatory Criteria

1. Operational History- Must be operational for at least 10 years.
2. Financial Track Record- Must maintain a good financial track record for at least five years.
3. Capital Adequacy- Must possess a Capital to Risk-Weighted Assets Ratio (CRAR) of not less than 12%.
4. Asset Quality- Must maintain Net Non-Performing Assets (NNPA) at not more than 3%.

5. Related Concerns & Issues

Overlapping Authority (Dual Control)- The split between the RBI (banking) and Co-operative Societies Acts (management) creates compliance challenges. This often leads to gaps in governance and supervision.

Governance Limitations- The 'one member, one vote' system discourages significant capital investment since large investors get no extra control. The entry and exit of shareholders at face value removes incentives for investors, making UCB shares financially unattractive.

Capital Constraints- Capital is difficult to raise because co-operative share capital is non-perpetual (it can be withdrawn/refunded). Capital is often linked to borrowing, rather than long-term investment.

Operational Failures- Analysis of license cancellations (2020–2025) highlights recurring issues Management fraud, Governance lapses, and Director-related lending violations.

7. Strengthening UCBs- Policy and Reforms

A. Regulatory Framework

Graded Approach- RBI has classified UCBs into four tiers (Tier 1 to Tier 4) based on deposit size and risk. Benefit- Ensures proportionate regulation; smaller banks are not overburdened, while larger ones face stricter scrutiny.

Banking Regulation (Amendment) Act, 2020- Gave RBI enhanced powers to

a. Approve appointments of CEOs and board members.
b. Supersede management boards in cases of failure.
c. Initiate mergers or reconstruction to protect depositors.

B. Governance and Management

Professionalization- Boards must now include domain experts (Law, Accountancy, Banking) to improve oversight.

Conflict of Interest- Strict prohibition on director-related lending (loans to directors or their relatives) to prevent insider abuse.

C. Financial Resilience

New Capital Instruments- RBI encourages Tier-II capital instruments and debt-like products to build capital buffers (overcoming the limitation of refundable shares).

Consolidation- Encouragement of voluntary mergers where weak UCBs merge with stronger ones to ensure sustainability.

D. Risk Management & Technology

Risk Protocols- Mandatory implementation of

a. Risk-based supervision.
b. Early Warning Systems (EWS) for credit risk.
c. Stress testing for liquidity and capital.

Digital Transformation

a. Adoption of Core Banking Solutions (CBS).
b. Integration with UPI and NEFT.
c. Robust cybersecurity and data protection norms.

E. Depositor Protection - Deposits are insured by the Deposit Insurance and Credit Guarantee Corporation (DICGC) up to ₹5 lakh per depositor.

8. Road Ahead

For long-term success, UCBs must move beyond government dependence and focus on-

1. Diversification- Expanding revenue sources while keeping lending prudent.
2. Internal Controls- Building robust auditing mechanisms.
3. Modernization- Embracing green finance and digital banking opportunities.
4. Self-Sustainability- Positioning themselves as strong, inclusive pillars of India's financial architecture.

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