**Syllabus subtopic:** Indian Economy and issues relating to planning, mobilization of resources, growth, development and employment.

**Prelims and Mains focus:** About the RBI’s move: reasons and merits; about PMC crisis; UCBs and their significance

**News:** The Reserve Bank of India (RBI) has decided to impose restrictions on urban cooperative banks (UCBs) for deterioration of financial position, in line with the *prompt corrective action (PCA) framework* that is imposed on commercial banks.

**Context:** The move comes in the wake of the recent crisis at the PMC Bank.

**What are these restrictions?**

- Under this revised *Supervisory Action Framework (SAF)*, UCBs will face restrictions for worsening of three parameters:
  1. when net non-performing assets exceed 6% of net advances,
  2. when they incur losses for two consecutive financial years or have accumulated losses on their balance sheets, and
  3. if capital adequacy ratio falls below 9%.

- Action can be also taken if there are serious governance issues.
- For breach of such risk thresholds, UCBs will be asked to submit a *board-approved action plan* to correct the situation like reducing net NPAs below 6%, for restoring the profitability and wiping out the accumulated losses, and increasing capital adequacy ratio to 9% or above within 12 months.
- The board of the UCB will be asked to review the progress under the action plan on quarterly/monthly basis and submit the postreview progress report to the RBI.
- The RBI may also seek a board-approved proposal for merging the UCB with another bank or converting itself into a credit society if CAR falls below 9%. It can impose restrictions on declaration or payment of dividend or donation without prior approval if any one of the risk thresholds is breached.
- Some of the other curbs include restricting fresh loans and advances carrying riskweights more than 100% on incurring capital expenditure beyond a specified limit and on expansion of the balance sheet.
What does the RBI say?

The RBI said actions such as imposition of allinclusive directions under **Section 35A of the Banking Regulation Act, 1949**, and issue of showcause notice for cancellation of banking licence may be considered when continued normal functioning of the UCB is no longer considered to be in the interest of its depositors/public.

What are Cooperative Banks

Cooperative banks were set up to supplant indigenous sources of rural credit, particularly money lenders, today they mostly serve the needs of agriculture and allied activities, rural-based industries and to a lesser extent, trade and industry in urban centres. They work under the "**No Profit No Loss**" model.

Co-operative banks in India are registered under the **States Cooperative Societies Act**. The Co-operative banks are also regulated by the Reserve Bank of India (RBI) and governed by the

- **Banking Regulations Act 1949**
- **Banking Laws (Co-operative Societies) Act, 1955.**

Features of Cooperative Banks:

- **Customer Owned Entities**: Co-operative bank members are both customer and owner of the bank.
- **Democratic Member Control**: Co-operative banks are owned and controlled by the members, who democratically elect a board of directors. Members usually have equal voting rights, according to the cooperative principle of “one person, one vote”.
- **Profit Allocation**: A significant part of the yearly profit, benefits or surplus is usually allocated to constitute reserves and a part of this profit can also be distributed to the co-operative members, with legal and statutory limitations.
- **Financial Inclusion**: They have played a significant role in the financial inclusion of unbanked rural masses.

Classification of Cooperative Banks
1. Urban Cooperative Banks
2. Rural Cooperative Banks

- State Cooperative Banks
- District: Central Cooperative banks
- Village: PACS (Primary agricultural cooperative society)