4-Tier Structure for Urban Cooperative Banks

Why in News

Recently, a **Reserve Bank of India** (RBI)-appointed committee has suggested a **four-tier structure for the Urban Cooperative Banks (UCBs).**

- In June 2020, the Central government approved an Ordinance to bring all **urban and multi-state co-operative banks under the direct supervision of the RBI.**
- In January 2020, the RBI **revised the Supervisory Action Framework (SAF) for UCBs.**

Key Points

- **Categorisation of UCBs:**
  - Based on the cooperativeness' of the banks, availability of capital and other factors, UCBs may be **categorised into four tiers for regulatory purposes:**
    - **Tier 1** with all unit UCBs and salary earner's UCBs (irrespective of deposit size) and all other UCBs having **deposits up to Rs 100 crore.**
    - **Tier 2** with UCBs of **deposits between Rs 100 crore and Rs 1,000 crore.**
    - **Tier 3** with UCBs of **deposits between Rs 1,000 crore and Rs 10,000 crore.**
    - **Tier 4** with UCBs of **deposits more than Rs 10,000 crore.**
  - The minimum **Capital to Risk-Weighted Assets Ratio (CRAR)** for them could vary from 9% to 15% and for Tier-4 UCBs the **Basel III** prescribed norms.
- **Umbrella Organisation:**
  - The committee has proposed **setting up an Umbrella Organisation (UO) to oversee co-operative banks** and suggested that they should be allowed to open more branches if they meet all regulatory requirements.
  - The **UO should be financially strong** and be well governed by a professional board and senior management, both of which are fit and proper.

- **Reconstruction:**
  Under the Banking Regulation (BR) Act, 1949 the **RBI can prepare a scheme of compulsory amalgamation or reconstruction of UCBs,** like banking companies.
- **Supervisory Action Framework:**
  - SAF **should follow a twin-indicator approach –** it should consider only asset quality and capital measured through Net **Non-Performing Assets** and CRAR – instead of triple indicators at present.
    The **objective of the SAF should be to find a time-bound remedy to the financial stress of a bank.**
  - **If a UCB remains under more stringent stages of SAF** for a prolonged period, it may have an **adverse effect on its operations** and may further erode its financial position.
- **Need of Reform:**
  - **Restrictive Policies:**
    Owing to **lack of the desired level of regulatory comfort** on account of the structural issues including 'capital' and the gaps in the statutory framework, the **regulatory policies for co-operative banks have been restrictive** with regard to their business operations, which, to some extent, has been one of the reasons affecting their growth.
      With the enactment of the **Banking Regulation (Amendment) Act, 2020**, the statutory gaps have been addressed to a very large extent.
  - **Financial Inclusion:**
    Given the importance of the sector in **furthering financial inclusion and considering the large number of its customer base,** it is **imperative that the strategies adopted for the regulation of the sector are comprehensively reviewed** so as to enhance its resilience and provide an enabling environment for its sustainable and stable growth in the medium term.

Co-operative Banks

- **About:**
  - **Co-operative Banks**, which are **distinct from commercial banks,** were born out of the concept of co-operative credit societies where members from a community group together to **extend loans to each other, at favourable terms.**
  - Co-operative Banks **are broadly classified into Urban and Rural co-operative banks** based on their region of operation.
  - They are **registered under the Co-operative Societies Act** of the State concerned or under the **Multi-State Co-operative Societies Act, 2002.**
  - The Co-operative banks are governed by the
    - Banking Regulations Act, 1949.
    - Banking Laws (Co-operative Societies) Act, 1955.

- **Features of Co-operative Banks:**
  - **Customer Owned Entities:** Co-operative bank members are both customer and owner of the bank.
  - **Democratic Member Control:** These 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. They provide cheap credit to masses in rural areas.

Basel III Norms

- **About:**
  - Basel III is an **internationally agreed set of measures** developed by the **Basel Committee on Bank Supervision** in response to the financial crisis of 2007-09. The measures aim **to strengthen the regulation, supervision and risk management of banks.**
  - BCBS members are committed to implementing and applying standards in their jurisdictions within the time frame established by the Committee.
- **Three Pillars:** Basel 3 measures are based on three pillars:
  - **Pillar 1:** Improve the banking sector's ability to absorb ups and downs arising from financial and economic instability
  - **Pillar 2:** Improve risk management ability and governance of banking sector
  - **Pillar 3:** Strengthen banks' transparency and disclosures

Source: IE