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Date: 17 August 2020

The Governor
Reserve Bank of India
Central Office
Mumbai -400001

Dear Sir

Voluntary Transition of Primary Urban Cooperative Banks (UCBs) into Small Finance Banks (SFBs)

Reserve Bank of India, in terms of their Circular No. DCBR.CO.LS.PCB.CIR No. 5/07.01.000/2018-19 dated September 27, 2018 has introduced a Scheme of voluntary transition of UCBs into SFBs, subject to compliance with the requirements mentioned in the Scheme. The above Scheme has further been modified and introduced on tap basis vide Circular dated December 05, 2019. Under the Scheme RBI has prescribed base financial benchmarks for eligibility, fit and proper criteria of promoters having association with UCBs, capital requirements and the compliance with the guidelines dated November 27, 2014 for licensing of SFBs in the private sector.

2. The issue of conversion of UCBs into a Joint Stock Bank was examined in detail by the High Powered Committee on UCBs constituted by RBI under the Chairmanship of Shri R. Gandhi, former Dy. Governor, RBI, which submitted its report in July, 2015. The Committee, while recommending conversion of UCBs into private banks, considered arguments in favor of conversion such as high aspiration of UCBs for growth, regulatory arbitrage etc. It was observed that at present no powers are available with RBI for constituting Board of Directors of UCBs, removal of Directors, supersession of the Board, auditing, moratorium, amalgamation and liquidation of UCBs at par with commercial banks. The Committee also observed that UCBs had restricted ability to raise capital and had certain inherent limitations. It was, therefore, felt that the growth of the urban cooperative banking sector should be consistent with the legal framework and regulatory parameters.

3. Due to the lack of level playing field in regulation and supervision of UCBs and in the absence of RBI not having full regulatory powers over UCBs at par with commercial banks, as stated above, the committee under the Chairmanship of Shri R. Gandhi had concluded that the unrestricted growth of UCBs may not be permitted. The Committee had, therefore, recommended voluntary conversion of UCBs into Joint Stock



Companies. Further, it had also recommended restrictions on branch expansion, area of operation of UCBs after a business size of ₹ 20,000 crore has been achieved by the UCBs. The committee, however, was of the view that the conversion of UCBs into commercial banks/SFBs requires amendments in the provisions of the all the State Cooperative Acts. Further, Sec. 17 & Sec. 121(1) of the Multi-State Cooperative Societies Act, 2002 also needed amendment.

4. In this connection, it is submitted that although the requisite amendments in the Cooperative Societies Act of all the states and in the Multi-State Cooperative Societies Act, 2002, as recommended by the Committee were not brought out by the Government of India, RBI in their haste to privatize the cooperative banks, introduced the scheme of voluntary transition of UCBs into SFBs vide their Circulars dated September 27, 2018 and December 05, 2019 *ibid*. We understand that one of the UCBs has already been granted in-principle approval for conversion into SFB.

5. Sir, as you are well aware, UCBs have been conceived as instruments of mobilization of saving from small depositors and dispensation of credit to borrowers of small means. They play a vital role in financial inclusion in the country and have been actively participating in the economic growth of the country. Certain UCBs have grown in size as their clientele vis-a-vis commercial banks have blurred in the recent past.

6. RBI has recently made metamorphic changes in the regulatory and supervisory framework for UCBs by issuing spate of instructions such as:

- Scheme of conversion of UCBs into SFBs;
- Appointment of Board of Management in addition to Board of Director by the UCBs;
- Restricting lending ability of UCBs by limiting exposure ceiling to Tier I capital;
- Prescribing 50% loans up to Rs25.00 lakhs; and
- Revising targets for priority sector lending from 40% to 75% of ANBC and revision of SAF etc.

RBI has also imposed penalties on a number of UCBs. It has, therefore, created fear which is lurking in the minds of all the cooperators in the country and an impression has been created in the sector that the regulator wants to disband urban cooperative banks and encourage them to convert into commercial banks. This has resulted in considerable consternation, concern and anger in the sector that the central bank wants to blow out the flame of cooperation and cooperative solidarity that binds these banks in serving their members and public, especially weaker sections of society in urban and semi-urban areas.

7. It is pertinent that RBI has been seeking powers for regulation and supervision of UCBs at par with commercial banks. In this regard, Government of India has recently promulgated the Banking Regulation (Amendment) Ordinance, 2020 on June 26, 2020 in terms of which the powers of regulation and supervision



of UCBs have been considerably increased and vested in RBI, and such powers have now been practically brought at par with commercial banks as the provisions of Section 10A, 10B(Management), 30(Audit)44, 44A(Amalgamation and Reconstruction), and Section 45(Winding Up) of the Banking Regulation Act, 1949 among others have been made applicable to UCBs.

8.. Now, with the amendments in the law through the above Ordinance which is likely to be converted into an Act of Parliament, there is complete level playing field in the regulation and supervision of UCBs at par with commercial banks by the RBI. The path of restrictions on the size of UCBs charted by the Gandhi Committee and the proposals for transition of UCBs into SFBs has become irrelevant in the wake of additional powers vested with RBI through the above amendments. In view of the above, it is requested that the Circular dated September 27 and December 05, 2010 permitting transition of UCBs into SFBs which is in violation of the provisions of Co-operative Societies Acts of all the states as also the Multi-State Co-operative Societies Act 2002 and the fact that it is also violative of the co-operative principles and the provisions of the Constitution of India may please be withdrawn forthwith. It is also requested that the growth of business of UCBs chartered by them based on their business plans should be freely permitted as in the case of commercial bank to enable UCB sector to withstand the onslaught of competition by SCBs, SFBs, NBFCs and Fintech companies due to technological advancements. We are sure that with the establishment of Umbrella Organization UCB sector will chart their growth path on sound and professional lines for which NAFCUB is fully committed.

9. As regards exercising powers by RBI under the Ordinance it is humbly submitted that the co-operative entities have a heterogeneous character in our country. There are unit banks, UCBs with two or more branches operating in more than one district, uni-state banks as also multi-state UCBs operating in different states. Thus the heterogeneity exists in geographical and financial parameters. The policy of one size fits all regulation and supervision may not be appropriate for implementation in such a situation. It is therefore imperative that a calibrated approach is formulated for revising the existing regulatory and supervisory framework. A revision of Vision Document 2005 is the need of the hour for which it is suggested to constitute a Committee of experts in the field with appropriate representation to all the stakeholders. We trust that the above proposal will find favor with RBI.

Yours faithfully

(Jyotindra Mehta)