

Ref.No. : NF/P-11/2022-23/

Dated: November 29, 2022

Respected Smt. Nirmala Sitharamanji,

**Sub: Submission in respect of Urban Cooperative Banking Sector
for Pre Budget consideration for the year 2023-24**

On behalf of the National Federation of Urban Cooperative Banks and Credit Societies (NAFCUB), I would like to enclose a memorandum covering the following issues for your kind consideration in preparation of the Union Budget for the year 2023-24.

A. ISSUES CONCERNING MINISTRY OF FINANCE, GOVT. OF INDIA

I. INCOME TAX RELATED ISSUES

1. URBAN COOPERATIVE BANKS (UCBs)

- a. Restoration of Deduction u/s 80P(2) to UCBs that was withdrawn in 2006-07 by introduction of Sec80(P)(4)
- b. Sec.80(c)(xxi) of the Income Tax Act 1961 – Inclusion of deposits with non-scheduled cooperative banks for eligibility

2. COOPERATIVE CREDIT SOCIETIES

- a. Applicability of Section 269SS & Section 269T to Cooperative Credit Societies
- b. Interpretation of applicability of Section 269ST to Cooperative Credit Societies
- c. Applicability of provisions of GST Act to Co-op. Credit Societies

II. URBAN COOPERATIVE BANKING ISSUES

1. Exclusive section for UCBs in Ministry of Finance (DFS).
2. Creation of a post of Deputy Governor in RBI for Co-operative Banking Sector
3. Further amendment to DICGC Act to help revival/rehabilitation/merger of stressed UCBs that will mitigate sufferings of non-insured deposit account holders.

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4. Inclusion of UCBs in Pradhan Mantri Awas Yojana and in Pradhan Mantri MUDRA Yojana (PMMY)
5. Amendment in Banking Regulation Act 1949
 - i. Directions of RBI on appointment of Managing Director (MD)/ Whole Time Director (WTD) in Primary Urban Cooperative Banks
 - ii. Terms of Directors of Primary Urban Co-operative Banks
6. Constitution of Appellate Authority by RBI for hearing cases of imposition of penalties
7. Introduction of differential regulations for UCBs of different size by RBI
8. Cooperative banks not to be corporatized and no scheme for conversion of strong UCBs to Small Finance Banks or private commercial banks be approved.
9. Review of restrictive policy of issuance of licenses to UCBs for opening branches, and aligning with the policy for commercial banks by RBI
10. Non restoration of policy of “on tap” licences for promotion of new UCBs, that was discontinued in 2006.
11. UCBs be permitted to finance primary cooperatives engaged in different sectors of economy
12. UCBs also to be permitted to sell their stressed assets to ARCs.
13. UCBs also be permitted to classify wilful defaulters as per RBI definition.

With kind regards,

Yours Sincerely,



Jyotindra Mehta

Smt. Nirmala Sitharaman
Hon'ble Union Finance Minister
New Delhi

**SUBMISSION TO HON'BLE FINANCE MINISTER
ISSUES FOR PRE BUDGET (2023-2024)
URBAN COOPERATIVE BANKING & CREDIT SECTOR**

NAFCUB is apex level promotional body of urban cooperative banks (UCBs) and credit societies of the country comprising 1534 UCBs and over 60000 cooperative credit societies. UCBs are self-reliant banks without any financial support from the Government. They play crucial role in meeting the credit needs of lower and middle income groups of the society. Credit Societies are largely responsible for helping people in moving away from dependence on private lenders.

In the last couple of years, the Government has amended two laws i.e. Banking Regulation Act 1949 and the Deposit Insurance & Credit Guarantee Act 1961 extensively that has greatly influenced the working of the Urban Cooperative Banking Sector.

A. ISSUES CONCERNING MINISTRY OF FINANCE, GOVT. OF INDIA

I. Income Tax related issues

1. Urban Cooperative Banks

a. Restoration of Deduction u/s 80P(2) to UCBs, that was withdrawn in 2006-07 by introduction of Sec80(P)(4)

Till 2006 the UCBs were enjoying benefits of Income Tax Deduction u/s 80P(2) of Income Tax Act, 1961. However the insertion of sub-section (4) to section 80P of this Act w.e.f. 01.04.2007 has deprived UCBs from this vital deduction available to them under this section till A.Y. 2007-08. This has led to higher tax liabilities for UCBs which is eating into their Reserves. Since majority of UCBs are small and member-driven banks, they are finding it difficult to pay higher income tax. On behalf of our member-UCBs, **this is requested that the said sub-section (4) of section 80P be abolished so that the deduction available u/s 80P(2) prior to A.Y. 2008-09 is restored to UCBs and they are enabled to effectively serve the large strata of poor population of India who are**

capable of affording cheap banking with UCBs only as compared to costly banking with Nationalised/Private Banks.

b. Sec.80(c)(xxi) of the Income Tax Act 1961 – Inclusion of deposits with non-scheduled cooperative banks for eligibility

The clause (xxi) was introduced to Sec.80(C) of the Act in 2006 to include term deposit for a fixed period of not less than 5 years with a scheduled bank to be included as investments eligible for deduction for the purposes of Sec.80(c). Of the 1534 urban cooperative banks, only 54 are scheduled banks. The non-scheduled urban cooperative banks are excluded from this benefit and they are disadvantaged on account of this discrimination as compared to Scheduled UCBs and Nationalized Banks. This is leading to shifting of Deposits from non-scheduled cooperative banks to scheduled banks. Since very few centres in the Country that have scheduled cooperative banks, the lower/middle class depositors from far-off cities in Countryside are finding not much options to invest in such deposits with. However the non-scheduled cooperative banks being large in numbers and spread over almost in every town, are better placed to serve such depositors in a localized environment and easy-accessibility at a very low cost and efforts. In case the non-scheduled cooperative banks are extended the eligibility to accept deposits enjoying deduction u/s 80C of Income Tax Act, 1961, such depositors will have not only higher number of options but also find it easy to invest in those non-scheduled UCBs available in their neighbourhood or are having easy proximity. **Accordingly it is submitted that the clause (xxi) be amended to include the words “and a cooperative bank” after “scheduled bank”;**

Add in the explanation

“and a cooperative bank means a State Cooperative Bank, a Central Cooperative Bank and a Primary Cooperative Bank, as defined in Sec.5 (as modified by Sec.56(AACS) (cci) of the Banking Regulation Act 1949”.

2. Cooperative Credit Societies

a. Applicability of Section 269SS & Section 269T to Cooperative Credit Societies

Co-operative credit societies are expected to provide facilities to their members in the same way as in case of banks and so they accept deposits from members in cash and also repay deposit in cash. Society is also required to give loans in cash to their members to fulfill immediate needs. But as per section 269SS, no person, subject to certain exceptions can accept loans or deposit of money otherwise than by account payee cheque or draft and in similar way as per section 269T of Income Tax Act. Deposit cannot be repaid otherwise than by cheque or draft. The applicability of section 269SS & 269T is not only limited to single cash transaction of Rs. 20,000/- but it covers even aggregate of cash transactions which exceeds Rs. 20,000/-. The banks are exempted from Section 269SS & 269T and so banks are accepting and repaying deposit in cash. But Co-operative Credit Societies are not fall in the list of exceptions of Sec. 269SS and 269T. Co-operative Credit Societies are subject to control of Co-operative Registrar and also subject to audit by auditor appointed by Co-operative Department of State Government. KYC documents of all the members have to be obtained by the society and if the society found making mischief of accepting deposit without KYC, tax can be levied on such cash deposit u/s 68. The intention of Section 269SS and 269T is only for the curbing practice of reflecting huge cash deposit found during search actions. So, applying sections 269SS and 269T to co-operative credit societies is not in consistent with intention of the law.

It is therefore suggested that Co-operative Societies be treated at par with Co-operative Banks for this purpose and Co-operative Credit Societies be added in exceptions provided in item (b) of first proviso to Section 269SS and exceptions provided in item (ii) of second proviso to Section 269T.

b. Interpretation of applicability of Section 269ST to Cooperative Credit Societies

Co-operative Society gives loan of even more than 2 lacs to its members and repayment of loan is made by members in cash even by way of installments of less than 2 lacs and in all such situations, violation of section 269ST occurs. Cash recovery of installment of loan is essential for financial activity but due to Sec. 269ST, it is difficult for the credit society to do activity of credit facility with the members. It is worth to mention that Co-operative Banks are covered in exception in item no. (i)(b) of proviso to section 269ST of Income Tax Act but co-operative societies are not included in exceptions. So, inclusion of co-operative society along with co-operative bank should be made and remove undue hardship on credit society by treating them at par with Cooperative Banks. Alternatively, Government may issue notification as Government is empowered by item no. (iii) of proviso to sec. 269ST and Government can exclude any class of person from the applicability of provisions of section 269ST.

c. Applicability of provisions of GST Act to Co-op. Credit Societies

In most of the cases of co-operative societies, liability of GST arises of very nominal amount on levy of service charges from members which are of meager sums. Since the co-operative societies have interest as their dominant revenue as compared to these small charges, these societies are required to charges GST only on these small charges. It is to be noted that the Interest income is classified under exempt supply by virtue of the entry no. 27 of Notification no. 12/2017- Central Tax (Rate). This notification has prescribed the list of services exempted from GST. As the interest is covered in the notification related exemption on services, no GST is required to be charged on this interest. However since the interest is defined as a “supply” being covered under the scope of supply, the same is counted in annual turnover of the society. Now, since Cooperative Credit societies have mainly interest income and very nominal amounts of service charges etc. from their members, they are still required to obtain GST registration as their annual turnover inclusive of such interest

(which is otherwise exempt as stated above) generally exceeds the prescribed quantum of Rs. 40.00 Lacs. If the societies are having only interest income below Rs. 40 lakh, they are not liable to take registration by taking benefit of Sec. 23(1)(a) of CGST Act as it is engaged exclusively in the supply of service wholly exempt from tax. But due to having nominal amounts of service charges from members (which are taxable) mainly in nature of reimbursement or compensatory, societies are required to obtain registration under GST as per Sec. 22 and comply with all the requirements of filing various returns under GST Act. In case of default, heavy late fees and penalties are levied. So, it is undue hardship to the society without any revenue to government. So, to remove this difficulty, Government may issue notification under sec. 23(2) or alternately, Government may consider issuing notification u/s. 9(3) and including the services of Co-op. credit society in the category of taxable supply of services (on which tax is to be paid) on reverse charge basis by the recipient of the service. This will relieve the societies from cumbersome GST compliances and the onus of paying GST will shift to recipient of services whose amounts are very nominal.

II. Urban Cooperative Banks issues

1. Exclusive section for the UCBs in Ministry of Finance (DFS)

The DFS in the Finance Ministry has historically been much more familiar with the three tier rural cooperative banking sector. It did not have many instances of going in detail about the issues relating to the urban cooperative banking sector, although cooperative banks came under Banking Regulation Act way back in 1966. It was only first in 2002-03 (Madhavapura Bank crises) and then in 2017-18 (PMC Bank Crises) that the Finance Ministry got some detailed information about the issues of the UCB sector.

With the Hon'ble Prime Minister announcing "Sahakar Se Samridhi" as an integral part of economic policy and with the formation of separate Ministry of

cooperation, the cooperative banking is seen to join the mainstream of financial intermediation. Hon'ble Minister has announced vision of "at least one urban bank at every urban centre". A standing arrangement of interaction among RBI, Ministry of Cooperation. and DFS is envisaged for improved management/ regulation/ development of cooperative banking sector. **It is therefore requested that a separate section for dealing with issues of UCBs headed by an official of appropriate seniority may kindly be created in the DFS.**

2. Creation of a post of Deputy Governor in RBI exclusively for co-operative banking sector

Cooperatives across the World have earned kudos for generally proving to be more resilient than other forms of business enterprises, during the 2008 crisis, as well as in the recent economic downturn triggered primarily by Covid 19 and now, by the Ukraine conflict. This is very pronounced in respect of financial cooperatives *vis-à-vis* commercial banks. Also, cooperatives the world over are being looked upon as very important vehicles of achieving sustainable development goals.

In India, the vision of our Hon'ble Prime Minister, of "*Sahakar se Samridhi*" and creation of a new exclusive Ministry of Cooperation under Hon'ble Home Minister Sh. Amitbhai Shah as Minister In-charge of the Ministry, cooperative sector would get its due importance. The Ministry is drawing up schemes and road maps for rejuvenation of 95000 PACs, encouraging formation of large number of cooperative entities in the unorganized sector. **Hon'ble Co-operation Minister has also envisioned every urban centre having at least one urban cooperative bank in near future.** Such a number is very much required to provide credit to large number of micro enterprises functioning in unorganised sector who are still dependent on private financiers. Cooperative banks and credit societies are lifelines for all of them. From the above, it can be easily inferred that cooperative banks can no longer

be treated as *foot note* entities to commercial banks and need to be given more importance by RBI.

Largest number of licensed banks are cooperative banks, being over 85% of the total number of banks. They may account for a very small share of banking business in terms of amounts, but they cater to a very large segment of population, most of whom would not be entertained by the commercial banks. So, there is need for Regulator bestowing undivided attention in forming regulatory policies, supervisory norms and more importantly understanding their needs rather than imposing identical or with slight variation, regulatory norms that are applicable to commercial banks.

For this to happen, an exclusive set up headed by a Deputy Governor in the RBI will go a long way in providing the much needed support to the entire cooperative banking sector of the Country. The absence of such an arrangement where there is very little understanding of the problems/shortcomings of the sector resulting in imposition of harsh and at times unrelated regulatory norms, only hasten failures and shrinkage of sector. Concept of uniform regulation and supervision amongst different types of banks for the purpose of preventing *regulatory arbitrage* in Indian context is not the best of ideas.

It is therefore our fervent request to you that the Govt. may kindly consider creation of a separate post of Deputy Governor in the RBI for the long term good of the cooperative banking sector in the Country.

3. Amendment to DICGC Act to help revival/rehabilitation/merger of stressed UCBs that will mitigate sufferings of non- insured deposit account holders

Pursuant to the amendments in the DICGC Act, the Corporation has been paying up to Rs.5 lacs to all depositors of those insured banks which have been

placed under directions by RBI under Sec35A of the Banking Regulation Act 1949, within 90 days.

Depositors of a large number of urban cooperative banks that are under directions, are being paid by DICGC this year. After the payment of insured deposits, RBI, invariably, in course of time cancels the licence of such banks, because there is little scope for these banks to be either revived or merged, after over 97 per cent of the depositors have closed their accounts.

It may kindly be recalled that before the amendment to DICGC Act facilitating payment to insured deposits within 90 days of imposition of directions under Sec35A of Banking Regulation Act curtailing withdrawals, all depositors faced hardships till the cancellation of licence, which took a long time. While all the account holders benefitted from prompt payment of insured deposit amounts, for the 2 to 3 percent of depositors with amounts above insured limits which account for over 25 per cent of total deposits, the doors are shut and they have to perforce lose their deposits.

NAFCUB had been representing time and again for providing the depositors of cooperative banks the same degree of comfort as is provided to the depositors of commercial banks, wherein RBI takes timely action either to change management or to facilitate merger well in time. It was with this purpose to arm RBI with requisite powers that the sector had been requesting appropriate amendments to Banking Regulation Act. The Govt. responded by bringing in the Banking Regulation (Amendment) Act 2020.

However, since the amendments to Banking Regulation Act and the DICGC Act, there has been a significant increase number banks wherein the insured depositors of banks under direction are getting their payments in a very short time. But at the same time the banks themselves are getting pushed to a point where they can neither be revived nor merged. It is leaving those depositors of such banks who have more than insured amounts high and dry, thus still

perpetrating step motherly treatment to them as compared to depositors of commercial banks.

From the Annual Report of DICGC, it is revealed that 98% of accounts are fully protected. In respect of cooperative banks 60% of the total amount of deposits is insured. This means that about 2% of the account holders who account for nearly 40 percent of the deposits are at far greater risk of losing their deposits than any other depositor in the banking system. Their risk is now increased multiple times with the provision of Rs.5 lacs being paid within 90 days by DICGC, as all avenues of revival or merger are effectively eliminated.

A solution therefore is needed where both, the insured and the uninsured depositors of cooperative banks find the same levels of safety as same categories of depositors of commercial banks.

It is also seen that till 2020-2021, DICGC has settled claims of 365 banks of around Rs.5762 crores. It has been able to recover around Rs.3435 Cr, which amounts to 60 per cent recovery. Now with the liability of DICGC going up five fold with increase in insured amount to Rs.5lacs, there will naturally be a drastic reduction in percentage of recovery by the DICGC.

The situation calls for some more reforms in DICGC role. A provision whereby participation of DICGC to the extent of its liability in any revival or merger scheme that may be approved by RBI with provision of repayment to DICGC within say, 10 or 15 years would be a win- win for all concerned. Time period for submission of such a proposal of revival/ merger may be pegged at 120 days from the date of imposition of directions under Sec35A by RBI. While this is a simple off the cuff suggestion, a serious study in this direction could be made to mitigate the situation.

In any case, the sector is extremely worried about this practice of RBI imposing directions, then DICGC making payment and the bank being routinely taken to liquidation with no avenue for the non- insured depositors to get their deposits even if they are willing to make some sacrifices and participate in any acceptable revival/merger proposal.

After all, closing of banks in such a routine manner would not be in keeping with the spirit vision of “SAHAKAR SE SAMRIDHI” of the Hon’ble Prime Minister and vision of “an urban bank in every urban centre” of the Hon’ble Cooperation Minister

4. Inclusion of UCBs in Pradhan Mantri Awas Yojana and in Pradhan Mantri MUDRA Yojana (PMMY)

NAFCUB acknowledges with thanks, the approval by Govt. of India to include all urban cooperative banks as eligible Lending Institutions (LIs) under the CGTMSE scheme. Since the UCBs cater predominantly to the lower middle class segment of the population, and also to the unorganized sector, they are eminently suitable for being included to participate in the two important schemes of the Govt. Pradhan Mantri Awas Yojana (PMAY) and the Pradhan Mantri MUDRA Yojana (PMMY). The 1534 strong UCBs with over 11000 branches across the Country can be used for being outlets for the schemes besides the commercial banks, SFBs and RRBs. It is requested that their inclusion be announced in this year’s budget proposals.

5. Amendment in Banking Regulation Act 1949

i. RBI Directions on Appointment of Managing Director (MD)/ Whole Time Director (WTD) in Primary Urban Cooperative Banks

ii. Terms of Directors of Primary Urban Co-operative Banks

Consequent upon enactment of the Banking Regulation (Amendment) Act 2020, RBI has issued circulars regarding appointment of MD/WTDs and has implemented the provisions of Sec10 (2A)(i) on tenure of BOD, which are at

variance with the State Cooperative Societies Acts, the Multistate Cooperative Societies Act and the provisions of 97th Constitution Amendment, which have created chaos and confusion in the sector affecting all the 1534 UCBs and their board members numbering over 25000, without consideration for the practical difficulties involved. While some banks have obtained a stay from High Courts, the RBI, instead of finding a solution through discussions, approached the Supreme Court, which has ordered all cases to be heard by the Madras High Court.

The apprehension of the sector is that there would be many more such issues thrown up if the RBI continues to issue directions in application of all the provisions of the Banking Regulation Act Amendment, without any discussions/deliberations with the sector.

This was expressed by NAFCUB as soon as the amendment was passed by the Parliament and we had requested for constitution of an Implementation Committee that had members from RBI, the Government and the sector to ensure avoidance of crises. **It is therefore requested that the Government may announce to constitute a committee for implementing the provisions of the amendment at the earliest.**

6. Constitution of Appellate Authority by RBI for hearing cases of imposition of penalties

It has been observed that there is often dispute between the Inspecting Authority (RBI) and Urban Cooperative Banks on certain issues. As a result, UCBs are being penalized by RBI imposing huge monetary penalty to them. Since there is no such mechanism to redress the grievances of UCBs, it is submitted that an appellate authority in this regard may be constituted by RBI to resolve such issues.

7. Introduction of differential regulations for UCBs of different size by RBI

There is wide heterogeneity in the UCB Sector. There are large number of UCBs that are very small and unit banks which operate at the lower scale and run on cooperative principles. Whereas others are medium size UCBs and around 6% are large size UCBs. Keeping in view the different size of UCBs that operates at different scales, it is desired that RBI may introduce differential regulations to UCBs as per their scale of operations. This has been recommended by the Expert Committee on UCBs constituted by RBI itself.

8. Cooperative banks not to be corporatized and no scheme for conversion of strong UCBs to Small Finance Banks or private commercial banks be approved

By cooperative principles, the accumulated funds by way of reserves belong to the cooperative, and it is universally classified as *inter-generational fund*. By approving a cooperative bank to be converted into a company by any means, and allowing the existing shareholders to profit from the fund, is against cooperative principles. Also by converting good cooperative banks to SFBs and commercial banks, the authorities would be a party to the weakening of cooperative sector which is not desirable. There should be no provision for this kind of transition.

It is therefore requested that RBI may be persuaded to withdraw the circular that permits a healthy urban cooperative bank to a small finance bank.

Only merger of a weak/unviable UCB may be allowed to be merged with another UCB or commercial bank/SFB.

9. Review of restrictive policy of issuing of licenses to UCBs for opening branches, and aligning it with the policy for commercial banks, by RBI,

Regular approvals for UCBs to open branches were stopped way back in 2002 after Madhavapura Bank episode. Till date it has not been resumed completely. This has affected the growth rate of the sector very significantly. After all no sector can thrive if such blanket prohibition is placed on growth for almost two decades. Resumption of issuance of new branch licenses without pre conditions is very essential for growth of the sector.

RBI has recently permitted only what it terms as FSWM banks (Financially sound and well managed banks) to open branches freely while others have to apply for branches and wait. The FSWMs are very few in number as the conditions are very stiff and subjective. Banks need to be permitted to open branches freely unless they are classified as weak banks. The rate of reduction of number of branches on account of cancellation of licences by RBI is greater than rate of opening of new branches, which means that the numbers of branches are actually reducing. This situation needs to be stopped.

We therefore request that RBI applies conditions that are same as those applied for commercial banks/SFBs for opening branches, without any additional conditions.

10. Restoration of policy of “on tap” licences for promotion of new UCBs, that was discontinued way back in 2006

Grass roots level banking institutions like cooperative banks/credit unions exist in large numbers in many countries and they benefit the economically less privileged sections of society. RBI has stopped issuing licences for establishing new urban cooperative banks in 2003 and officially discontinued it in policy statement of 2006. It is almost two decades since any new urban cooperative bank has been established. A large number of districts in the country are

devoid of any urban cooperative bank which affects the unorganised sector directly. There should be a clear laid out policy for people to submit applications to promote localised urban cooperative banks and RBI should issue licences if they meet the criteria, in a time bound manner.

11. UCBs be permitted to finance primary cooperatives engaged in different sectors of economy

A big section of clientele of urban cooperative banks belongs to the unorganised sector. In many cases the individuals in the unorganised sector get together to form cooperatives for their collective benefit. As such there are cooperatives in almost every segment of economic activity. Unfortunately, the Banking Regulation Act defines UCBs as “primary cooperative bank” and prohibits them from lending to other cooperatives. This needs to be revised as cooperative banks understand the cooperative societies better than the commercial banks. This can be done by modifying Sec 56(AACS), clause(c) sec5(ccv) (3) to read as *“the bye laws of which do not permit any cooperative credit society as member”*.

12. UCBs also to be permitted to sell their stressed assets to ARCs

While the commercial banks are permitted to cleanse their balance sheets by selling stressed assets to ARCs, the UCBs are not allowed to do so. It is submitted that the permission may be given to UCBs also, so that those UCBs who are in a position to sell their stressed assets to ARCs may do so.

13. UCBs also be permitted to classify wilful defaulters as per RBI definition

The commercial banks are required to classify some delinquent borrowers as wilful defaulters if the banks consider that the defaults have been committed wilfully. The process of dealing with such accounts is more intense and stringent. There is no such system put in place for UCBs, who should also be permitted to classify those accounts as wilful defaulters and follow the prescribed procedure for dealing with them.