

COOPERATIVE BANKS (INDIA) & THE RESERVE BANK – A STUDY OF REGULATORY FRAMEWORK

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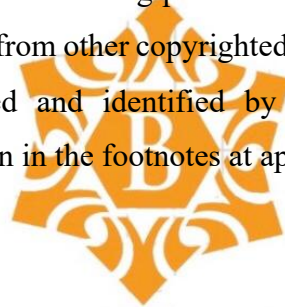
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Abstract

This research work mainly emphasizes on the banking structure and system follows in entire India. This project clearly states the relationship shared by RBI and other banks (either private or public). Whole banking structure is regulated by RBI, RBI determines the financial position of bank. RBI plays important role in boosting banking sector by slashing or increasing Repo rate, Reverse repo rate etc., according to the demand of the situation. There are several functions of banks and powers of RBI discussed further in this research. In short, every decision taken by RBI affects in a way or another banks of India.



Chapter-1

INTRODUCTION

Cooperative banks are an important financial institution that belongs to its associates, who are both owner and consumers of their bank. A cooperative bank is always made by individuals join the same locality who shares a general interest. It generally offers their people with a broad variety of banking services such as loan, deposits, saving and current accounts and ATM facility. A cooperative bank varies from the action bank by their firm, their goals, their importance and their domination. In many nations, it is controlled by banking authority and should obey prudential banking rules, which situate them on an equivalent footing with a shareholder bank.

A co-operative bank is much more significant in India than anyplace else in the globe. The distinguishing nature of it is service at a lesser rate and services without misuse. This bank has achieved its vitality by the position assigned to them, the expectation they are supposed to accomplish and the number of branches they function. Its role in rural finance pursues to be vital gradually, and their dealing in the cities also has risen extraordinarily in recent time chiefly because of the quick raise in the number of prime Co-operative banks. In rural locality, to the extent that the farming and associated activities are considered, the delivery of credits were insufficient, and money lenders would use the poor public in rural locality giving them loans at higher interest rate. Hence, these banks mobilize deposit and rural credits with a broad outreach and give institutional credits to the farmer. Co-operative banks have also been a significant tool for many growth schemes, mainly subsidy-based programme for poor¹.

¹ Paramashiaviah, A Study on Cooperative Sector Banks in India: Problems & Prospects, Ignited Minds Journals, Apr, 2019

Chapter-2

Categories & Functions of Co-operative Bank in India

A co-operative bank is small sized parts which function both in city and non-urban centers. They finance undersized borrowers in commercial and trade sector beside business persons and Govt. servants. Controlled by the R.B.I, they are governed by the “Banking Regulations Act 1949” and “banking laws (co-operative societies) act, 1965”. The co-operative bank composition in India is segregated into types such as²:

2.1 Prime Co-operative Credit Societies

It is a union of borrowers and non-borrower reside in a specific area. The fund of the society is got from the share capitals and deposit of affiliates and loan from state co-operative bank. The lending power of affiliates as well as of the society is fixed. The loan is provided to associates for the buying of cattle, fodders, fertilizer, pesticide, and so on.

2.2 Central Co-operative Bank

This is a federation of primary credit society in districts and is of 2 categories-those have memberships of primary societies only and those having a membership of society over and above people. The funding of the central bank consists of share capitals, deposit, loan and overdraft from state co-operative bank. This bank gives funds to member society in the limit of the borrowing capacities of society. It also conducts all the businesses of joint stocks bank.

2.3 State Co-operative Bank

The state co-operative bank is association of state co-operative banks and performs as a regulator of the co-operative bank system in state. Its funding is got from share capitals, deposit, loan and

² K.V. Nagaraj, A Case Study on Banking Operations in Cooperative Sector, PARIPEX, Volume: 4 | Issue: 8, Aug 2015

overdraft from the R.B.I. The state co-operative bank lends funds to central co-operative bank and prime society and not straight to farmer³.

2.4 Land Development Bank

A Land development bank is functioned in three stages: state, central & primary stage and they convene the long-standing credits need of the farmer for expansion purpose. They are administered and controlled both by the state govt. and R.B.I. In recent times, the administration of land development bank has been supposed by N.A.B.A.R.D. The source of funding for these banks is the debenture issued by both central and states govt.

2.5 Urban Co-operative Bank

The word U.C.B, even if not officially defined, refers to PCBs placed in urban and city area. UCBs, till 1996, were permitted to borrow funds only for non-agricultural purpose. UCBs were conventionally centered on societies, areas, workplace members. They basically loan to SME sector firms. Nowadays, scope of UCB's operation has broadened significantly. They offer credits to MSMEs, salaried workers, and other urban and city residents⁴.

2.6 Functioning of a Co-operative Bank

A Co-operative bank does the fundamental bank function of banking but it varies from commercial bank.

a. A commercial banks is joint-stock company as per the companies act, 1956, or PCB in a specific act whereas a co-operative bank was set up in the co-operative society act of various state Govt.s⁵.

³ Subashchandra Bose, P. Nagarajan, Current Scenario of State Co-Operative Bank in India and Its' Working Performance, IJSR, Impact Factor (2017): 7.296

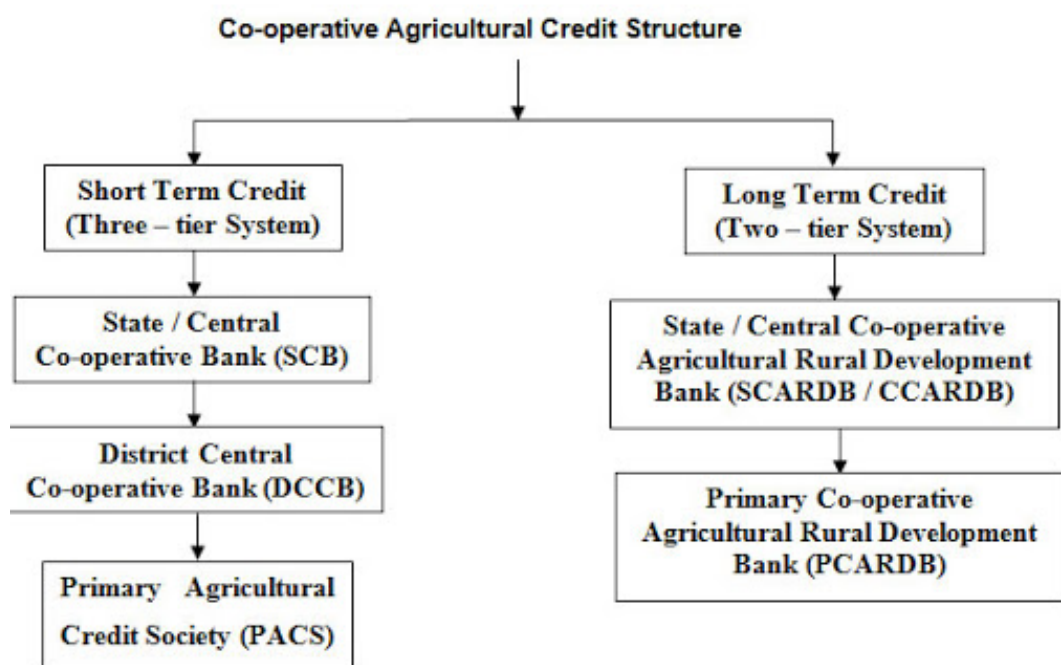
⁴ K.V. Nagaraj, A Case Study on Banking Operations in Cooperative Sector, PARIPEX, Volume: 4 | Issue: 8, Aug 2015

⁵ https://blog_media.testbook.com/blog/wp-content/uploads/2017/12/All-About-Cooperative-Banks-in-India-GK-Notes-for-SSC-Banking-Exams-in-PDF.pdf

b. Commercial bank structure is branch banking structure whereas co-operative banks have a three-tier setup, with state co-operative bank at apex level, central / district co-operative bank at district level, and primary co-operative societies at rural level.

c. Only some of the sections of banking regulation act of 1949 (fully applicable to commercial banks), are applicable to co-operative banks, resulting only in partial control by R.B.I of co-operative banks and

d. Co-operative banks function on the principle of cooperation and not entirely on commercial parameters.



Chapter-3

Cooperative Banks & R.B.I

In recent times, the Central Govt. sanctioned Ordinances to take every urban and multi-state co-operative bank in the direct supervisions of R.B.I. The verdict arrives after many instances of frauds and severe financial misdeeds comprising the key scams at the PMC and Kerala Banks. So far, every cooperative bank as per dual regulations of the R.B.I and the Registrars of Cooperative Society, causing regulatory and managerial drops at these banks. The R.B.I have no authorities to preparing enforceable schemes of reform of co-operative banks. Though hence onward the urban and state co-operatives would come as per the administration of R.B. I⁶.

3.1 REGULATORY FUNCTION OF R.B.I

The R.B.I as the Central Bank of India was set up on Apr 01, 1935 as per R.B.I Act, 1934. R.B.I was established as shareholder bank and its paid-up capital was Rs. 5 crores. The Bank captures the functions of currency problem from the GOI and the authority of credits manages from the then Imperial Bank of India. It was nationalized in 1948. It has a central administering structure had then become essential to manage a run off inflations raging in India as 1939, control inflations in India successfully.⁷

R.B.I is mainly concern with organization of a strong and well business banking structure, ensure effectual synchronization and controls over credits during suitable economic and credit policy pursued from time to time. R.B.I is though, considered with growth of rural bank, endorsement of financial companies and expansion of rural financing, support of financial institution and expansion of capital markets⁸.

⁶ <https://www.drishtias.com/daily-updates/daily-news-analysis/co-operative-banks-under-R.B.I-supervision>

⁷ Tannan M.L., "Tannan's Banking Law and Practice in India", Wadhwa and Company Nagpur, 21st Edn., Reprint 2007, p. 163.

⁸ T. R. Radhakrishnan, Supervision of co-operative banks by R.B.I, Tax Guru, 02 Jul 2020

3.2 CONTROL & DIRECTION BY R.B.I OVER COOPERATIVE BANK

The BR Act, 1949 allows the R.B.I to provide guidance, to cooperative bank generally and to any CB particularly, concerning any phase of the functioning of the co-operative bank considered. Whilst S.21 grants power to provide guidance regarding advance by CBs, S.35A includes every aspect of the function of CBs. These 2 secs jointly have provided power to the R.B.I to provide every direction on each matter regarding the operations of co-operative banks particularly, or all CBs, or group of CBs, generally.

Besides carrying out usual scrutiny in these sections, the R.B.I is also authorized to do an inquiry of the dealings of the CB, at any time it is concerned essential to do so. Considerably, the N.A.B.A.R.D has also been constitutionally empowering to conduct the scrutiny of CBs than, but prime CBs however such authorities have been provided, lacking unfairness to the power of R.B.I, to do such inspections. (S.35)

The R.B.I is empowered to depute, in case it is considered essential to do so, for the reorganization or extension of credits on strong lines, many of its officials to observe the proceeding at any conference of the BODs of any CBs comprised by it and need these banks to offer a chance to the officers, so deputized, will be listened to at these conferences. The R.B.I might assign more than 2 of its officials to watch the way in which the dealings of banks or its divisions are being carried out, need such officials to make a brief statement thereon.⁹

3.3 OTHER APPROPRIATE PROVISIONS

Sec.22(4):

- Cancellations/rejections of licenses

Sec.23 (4A):

- Cooperative banks looking consent of R.B.I for division opening is needed to forward application to R.B.I via N.A.B.A.R.D;

⁹Id, p. 227.

- N.A.B.A.R.D will provide its remarks on the value of the case and forward to R.B.I copy of the applications will be forwarded by the Cooperative bank directly to the R.B.I.

Sec.24-A:

- R.B.I had authority to let off CBs from the whole of or every division of the provision of Sec.18 or Sec.24 of the Acts.

Sec.35 A:

- **Power of R.B.I to provide guideline:** R.B.I is allowed to provide direction to CBs generally or to CBs particularly on every aspects of functioning of these banks.

Sec.45:

- As per sec.45, the R.B.I may suggest to the Union Govt., to array a suspension regarding cooperative Banks. The power to issue such a moratorium however rests with the Central Govt.

Sec.46:

- As per sec.46, various penalties that may be imposed on cooperative banks, for rebelliousness with the different provisions of the B.R. Act, have been mentioned.

Sec.53:

- Powers to except; The Union Govt. may, in the proposal of R.B.I, except any bank or any class of banks from any or every provision of these BR Act.
- Prime farming society is excluded from the range of the BR Act 1949;
- the least capital requirements are only Rs. 1,00,000 for banking institutions;
- Cooperative banks can't employ in every trading activities;
- A Cooperative bank has to keep a cash reserve ratio of 3 percent of N.D.T.L in cash and current accounts by R.B.I and another important bank. SCBs have to keep CRR in the R.B.I rule in a report by R.B.I. In general, the cash reserve ratio requirement is less than that for a commercial bank¹⁰;

¹⁰ Subashchandra Bose, P. Nagarajan, Impact Factor (2017): 7.296

- CBs require to keep constitutional liquidity ratio of 25 percent of N.D.T.L in the form of gold, balance by state CBs and on unencumbered sanctioned security;
- CBs can't hold above 5 percent of private capitals of all others cooperative societies;
- R.B.I may decide the banking policies for the advance to be done through a cooperative bank;
- A CB must has applied for licenses from R.B.I to continue banking businesses;
- CBs have to present many returns to R.B.I in regards to C.R.R./S.L.R, asset and liability, unsecured loan to director, advance to priorities and rural and backward sectors, shareholding in cooperative societies, NPAs and balance sheets, P&L accounts of constitutional audit reports as stated by the periodicity described for various declarations¹¹.

3.4 REFORMS IN THE BR ACT, 1949:

Resulting on the execution of suggestions of Committees on revitalization of the cooperative societies, some revisions to the B.R. Act would be needed and this will include:

- All CBs should be on balance with conventional bank to the extent that regulatory standards are considered;
- R.B.I will set down fit and appropriate criterion for voting to Board of CBs. These criterions would though not be in conflict with the nature of memberships of main cooperative banks which comprise the memberships of the D.C.C. Bs and S.C. Bs;
- Though, as a financial institution, such Boards should require least assistance at the Board level. So, the R.B.I shall set criterion in favor of professionals will be on the Board of CBs. Suppose a member with such professional qualification or experience don't get selected in the usual voting processes, then the board to be needed to appoint such professional to the boards and they would have complete voting right;

¹¹ Paramashiaviah, A Study on Cooperative Sector Banks in India: Problems & Prospects, Ignited Minds Journals, Apr, 2019

- The C.E. Os of a cooperative bank should be employed by the particular financial institutions himself and not by the State Govt. Though, as such banks, R.B.I would set the least qualifications of the C.E.O to be selected and the name suggested by CBs for the post of C.E.O would have will be sanctioned by R.B.I;
- Cooperatives other than CBs as sanctioned by R.B.I will not recognize non-elected member deposit. These types of cooperatives will also not employ terms such as “bank”, “banking”, “banker” or no other derivatives of the term “bank” on their listed names.¹².

Regulatory Frameworks

In India, a cooperative bank is registered in the specific State cooperative society act and managed by State Govt. via the Registrars of Cooperative Society regarding incorporations, registrations, management, audits and liquidations. They are ruled and controlled by R.B.I as per BR Act, 1949 and the BR (Co-operative Societies) Rule, 1966. N.A.B.A.R.D has simultaneous power to scrutinize S.C.Bs and D.C.C.Bs. P.A.C.S is only in the purviews of N.A.B.A.R.D. As a result, there is variety of domination.

3.5 The Banking Regulation Amendment Bill, 2020

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The BR Amend bill looks to impose stricter banking regulations by R.B.I on CBs whereas management problems and challenges are still directed by the Registrars of Cooperative Society. The "Declaration of Object and Reason" make obvious the legal intention to carry CBs on parity with regulations and growth in banking industry and to have superior control, raised professionalisms, accesses to capitals, progress governance and guard depositor interest¹³. Key features of the Bill are:

In this Act, R.B.I might, after placing banks in freeze organize a plan for rebuilding or incorporation of banks to safe its appropriate administration, or in the concern of investors, the common people or the banks. This Bill permits R.B.I to start schemes for renovation or incorporation without impose moratoriums. If moratoriums are forced, the Bill inserts that bank

¹² T. R. Radhakrishnan, Supervision of co-operative banks by R.B.I, Tax Guru, 02 Jul 2020

¹³ Niloufer Lam, India: Co-operative Banks In India: Heading Towards Reform, Mondaq, 22 June 2020

can't no loan or make investment in any credit instrument throughout the freeze period. In addition, the bill offers that CBs can provide equities, preferences, or special share on face values or at premium to their member or to some other persons living in its locality of operations. It might deliver unsecured debenture or bond or comparable securities with maturity of 10 or more years to these individuals. Such issuance will be put through the previous sanction of the R.B.I. In this bill, no individual shall be allowed to order payments towards give up of share provide to him by CBs. In addition, CBs can't decrease or withdraws their share capitals, excluding as mentioned by the R.B.I. As per the Bill provisions, R.B.I might exempt CBs from some provision of the Act via notifications. These provisos concern constraints of some categories of service qualification of the BODs and, the appointment of chairman. As per this bill, CBs can't use someone who is bankrupt or has been criminal comprising ethical turpitude as Chairman. R.B.I shall have the authority to eliminate the Chairman if he/she is not well and appropriate and employ an appropriate individual if the banks don't do so. Also, the BODs should have at least 51 percent of memberships with particular skill or experiences in fields like accounting, banking, economics or legal studies. The R.B.I might guide banks to reconstitute their Boards if it doesn't match to the necessities. If banks don't fulfill, R.B.I might eliminate person directors and employ appropriate person.¹⁴

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The bill bans banks from permitting unsecured loan or advance to their director and private companies where the bank director or chairman is an interested party. This bill had mentioned situations in which unsecured loan or advance can be allowed with the way in which the loans maybe report to R.B.I. The Bill skips these provisions from the Bill.¹⁵ The achievement and presentation of UCBs relied not only on the introduction of technologies except the excellence of human resource. The economic outcomes are produced not by machines and technology but individuals behind the machines and technology coupled with quality of leadership. Therefore, it is very important that measures are to be taken to re-engineer the complete human resource comprising the BODs administering the CBs with delegated power and monitoring mechanisms

¹⁴ Sangeeta Nair, Parliament passes Banking Regulation (Amendment) Bill, 2020, Jagran josh, Sep 22, 2020

¹⁵ Niloufer Lam, Mondaq, 22 June 2020

as prevailing between commercial bank and they must be made liable to the consumers, shareholder, stakeholders, R.B.I and the Govt.¹⁶

So far R.B.I has been providing notices and circular identified to commercial banks and UCBs independently which made a doubt whether multi-state CBs and UCBs are coming in the purview of BR Act. With the introduction of the ordinance bringing the urban co-operative banks and multi-state co-operative banks in the purview of BR Act to be executed via R.B.I, hereafter R.B.I require provide notification and circular via common circulars identifying to commercial banks, multi-state cooperative banks and UCBs rather than separate notification and circular. It is expected that bringing the urban co-operative banks as per the R.B.I supervisions and the BR Act would lead in a dynamic paradigm change in the working of a Co-operative bank.



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¹⁶ Paramashiaviah, A Study on Cooperative Sector Banks in India: Problems & Prospects, Ignited Minds Journals, Apr, 2019

Chapter-4

Conclusions & Suggestions

Failure of cooperative banks would signify breakdown of best expectation for rural people. It is anticipated that the provisos recommended in this study will not only make sure the independent and self-ruled working of CBs, but also guarantee the responsibility of administration to the associates and other stakeholder and will give for prevention for infringement of the provision of Act.

A cooperative bank is at present in the double management of cooperative society with R.B.I. Although the responsibility of the cooperative societies comprises incorporation, registrations, managements, audits, supersession of BODs and liquidations, R.B.I is accountable for legal functions.

The reform in the recent Bill would cause fewer State Govt. interventions and will initiate up skill in administration and professionalism in the capability to function CBs. There should be more attention on the boards and supervision and thorough review of capital necessities and fund raising for CBs. As there are future needs for scheduled share offering and as a cooperative seem at fund raisings in open market, this would cause more lucidity and disclosures on the economic position and processes of CBs. The judiciary now has power concern completing proceeding of CBs in some cases, which was previous vest with the Registrars of Cooperative Society. Units would be incentivized to lift up their standard to be healthier because of superior level of inspection. To expect further regulations by R.B.I on administration and rule of the CBs more in line with banking regulations. The power and potency of R.B.I, will make sure CBs avoid a PMC like catastrophe in the future.

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