

Other Related Issues

9.1 As discussed at [para 1.29](#) of [Chapter I](#) of the Report, during the Committee's interaction with the urban cooperative bankers, their federations etc. certain issues were thrown up which though outside the realm of Terms of Reference are of great importance for UCBs in their day to day operational matters. The Committee, therefore, addresses these issues briefly in this Chapter.

Nominal Membership

9.2 In Urban Cooperative Banks, there are 2 classes of members i.e. regular members and nominal members. Regular members subscribe to the share capital of the bank, participate in the affairs of the bank, have right to contest to the Management Committee and can avail of any type of loan facility. Nominal membership in Urban Cooperative Banks was introduced only to enable borrowers to occasionally borrow against pledge of tangible securities such as gold, government securities and NSCs, etc. Besides, if a person has to stand as a surety to a borrower, he has to necessarily be a nominal member under the cooperative law. Thus, nominal members are those, who are not interested in the management of the bank but desire to avail of loan facilities at infrequent intervals, who do not subscribe to the share capital of the bank, and hence, are not eligible for dividend. Besides, they also do not have voting rights, nor can they contest elections to the Boards of the Banks. Under the existing policy of RBI, nominal membership should not exceed 20% of the regular membership.

9.3 There have been representations to the Committee that the present ceiling on nominal membership should be enhanced by RBI as it restricts the ability of UCBs to profitably extend their lending operations.. The issue of nominal membership was addressed in the past by Madhava Das Committee. It felt, "the nominal membership should be restricted to co-parceners, non-borrowing sureties and persons who borrow occasionally against tangible securities. In banks where nominal membership is already high, they should take concrete steps to reduce such membership by enrolling regular members, persons other than those who are permitted to be nominal members i.e. non borrowing sureties, co-parceners or those who borrow occasionally against tangible securities. In banks where nominal membership is already high, they should take concrete steps to reduce such membership by enrolling regular members, persons other than those who are permitted to be nominal members i.e. non borrowing sureties, co-parceners or those who borrow occasionally against gold, government securities."

9.4 This Committee feels that the issue of nominal membership should be examined in the context of preserving the cooperative character of UCBs. The Committee is of the view that the essence of cooperative character is that a cooperative is an institution where there is an identity between the share holders and borrowers and that the members elect the board of directors of UCBs on the quintessential dictum of "one member - one vote" irrespective of a member's share holding.

9.5 Ideally all the borrowers of an UCBs should be regular members and should have a stake in the affairs of the banks. However, it is recognised that with the increasing volume of operations and spread of net work, if all the borrowers become members, it would place considerable strain on requirements attached to the rights of members to elect boards of management and to participate in the governance of the bank. Therefore, the concept of nominal membership has developed, whereby, a borrower, without contributing to share capital, can borrow limited sums

at infrequent intervals against tangible securities. It must also be recognised that a large scale enrolment of nominal members endangers the cooperative character of UCBs. Besides, it could lead to a situation where some vested interests may not enroll others as regular members but only as nominal members so as to restrict access of members to management. This apart, enrolment of large number of members as nominal members would also restrict the efforts of banks to augment the share capital as nominal members do not contribute to share capital.

9.6 The Committee, therefore, is of the view that the existing ceiling of 20% on nominal membership is quite reasonable and need not be enhanced.

Currency Chests

9.7 One of the daunting operational problems of UCBs brought to the notice of the Committee, during its visits to various states, is the inadequacy of currency chest facilities. It has been suggested that as a result of this inadequacy:

(i) there is reluctance of existing currency chests and even RBI offices to accept cash deposits on many occasions on the ground that there is inadequate storage capacity in the vaults

(ii) there is reluctance to accept small denomination notes for the same reason.

9.8 As a consequence of the above, UCBs are often required to carry, as an unproductive asset, far more cash than they need for their day to day requirements, infringing on their profitability.

9.9 It has, therefore, been suggested that either some of the UCBs should be allowed to maintain currency chests on behalf of RBI or additional currency chests should be established.

9.10 The Committee finds merit in the above suggestions. Currency chests cannot refuse to accept cash deposits irrespective of the denomination in which such cash is tendered since currency notes and coins are legal tender. Moreover, it is the responsibility of RBI not only to ensure adequate supply of currency notes but also to ensure that there are adequate facilities for exchange of soiled notes and acceptance of currency deposited with it.

9.11 The Committee, therefore, recommends that RBI urgently address itself to this problem. It needs to assess the availability of currency chests at present and the need to create new currency chests either by itself or with commercial banks and even with urban cooperative banks. It has been suggested to the Committee that urban banks, may be reluctant to maintain currency chests owing to prohibitive initial expenditure and subsequent operational expenses. The Committee suggests that RBI might review the economics of maintaining currency chests and reimburse these costs to the banks authorised to maintain currency chests as doing so would be in discharge of the fundamental obligation of RBI.

Investment of SLR Balances with Scheduled Commercial Banks

9.12 UCBs have represented to the Committee regarding their difficulties in restricting investment of their SLR funds only with DCCBs, SCBs and in approved securities under the

provisions of Section 24 of B.R. Act 1949 (AACS).

9.13 Many of the UCBs have represented that most of the DCCBs and SCBs give them step motherly treatment. Being captive investments by UCBs, DCCBs and SCBs are stated to offer lower rates of interest as compared to the rates offered by other banks. Another difficulty expressed by UCBs and some independent observers of the urban banking movement is that a good number of DCCBs are themselves weak and nearly 100 DCCBs have negative networth. The UCBs, therefore, argue that it is ironical that stronger UCBs have to invest their SLR funds with weak DCCBs whose financial position is far from satisfactory. UCBs and their federations have, therefore, suggested that the B.R. Act should be amended and UCBs should be allowed to invest their SLR funds in other cooperative banks or in commercial banks.

9.14 The Committee finds some merit in the representation made by the UCBs. It recognises that by virtue of their location, UCBs may often find it difficult to make investments in Government securities. While it has no evidence in support of the claim that DCCBs and SCBs give a step motherly treatment to UCBs, there is always the risk that a monopoly situation where UCBs can make deposits only with DCCBs and SCBs and the absence of competition could result in unattractive rates being offered on such deposits. At the same time, the Committee is not in favour of an unrestricted freedom to UCBs to maintain their SLR funds with other cooperative and commercial banks. The Committee also finds merit in the submission made before it that as far as possible funds belonging to the cooperative banks should remain within the cooperative fold. Some experts argue, with impeccable logic, that keeping SLR funds with DCCBs and SCBs is itself an indefensible dispensation. By their very nature, SLR funds should be kept in Government or quasi-Government securities and they cannot be placed in commercial or scheduled UCBs. They say that if UCBs located in semi-urban areas do not have access to government securities, the answer is to urge RBI to improve secondary market for these securities rather than allow UCBs to keep SLR funds with DCCBs and much less to extend this facility to scheduled UCBs.

9.15 Having regard to the above factors, the Committee recommends that the B.R. Act may be amended to provide that UCBs may be permitted to invest their SLR funds in scheduled cooperative banks and if there is no head office or branch of such a scheduled UCB in the place where the UCB is located, then in a commercial bank till secondary market for Government securities is improved and the facility of UCBs keeping SLR funds with DCCBs and SCBs is discontinued.

9.16 The Committee recognises that if such an amendment is made, there could be a flight of deposits from DCCBs and SCBs. In some states like Maharashtra and Gujarat about 25% of the deposits of DCCBs and SCBs are stated to be from UCBs and the impact of withdrawal of deposits by UCBs can be serious. The Committee is informed that for the rural sector the Government of India has set up a Task Force under the Chairmanship of Shri Jagdish Capoor, Dy. Governor, Reserve Bank of India, to study the functioning of Cooperative Banks and to suggest suitable package for their revival / restructuring. RBI may like to consider our recommendations in the context of the recommendations of the said Task Force.

Priority Sector Advances

9.17 Priority sector lending discipline was not prescribed for UCBs until 1983. Having recognised the significant role Urban Cooperative Banking Sector was playing in credit dispensation to the lower and middle income groups of urban and semi urban areas, RBI decided to apply the priority sector discipline to UCBS also, in 1983. Under the existing policy, commercial banks are required to deploy 40% of their credit to priority sector segments. Recognising the role played by Urban Cooperative Banks, their size, operational area and nature of clientele, RBI thought it fit to prescribe a higher target for them. Accordingly, Urban Cooperative Banks are required to deploy a minimum of 60% of their advances to the priority sector.

9.18 Some UCBs and federations have represented to the Committee that in large cities and metros, UCBs are experiencing difficulties in meeting this 60% target. They pleaded that RBI should keep in view the ground realities and suggest a lesser target for UCBs in the interest of a level playing field vis-à-vis Commercial Banks.

9.19 The Committee has examined this request in the back drop of asset and deposit size of the urban cooperative banks and also their performance in the deployment of credit to the priority sector. Of the 1499 reporting UCBs as at the end of March 1999, as many as 779 UCBs were functioning with deposit base of Rs.10 crores and less. Similarly 1369 of the 1499 reporting banks at the aforesaid date were functioning with owned funds of Rs.10 crores or less. The very size of UCBs with such small deposit base indicates that they essentially mobilise deposits from persons of smaller means and deploy resources to lower income groups. In a sample survey commissioned by the Committee in respect of 13 UCBs, of the 103 individuals who were interviewed, an overwhelming segment of 85% replied that since they had no access to commercial banks, they had to necessarily resort to UCBs, where they were welcomed. Besides, of the 1241 UCBs which reported priority sector data, for the year ended 31 March 1998, as many as 1044 banks (84.1%) have deployed 60% or more of their aggregate credit to priority sector. When UCBs are given a preferential treatment of lower CRR (3% for non-scheduled and 6% of scheduled UCBs as against 9% prescription for commercial banks), when their interest rates on advances are completely deregulated subject to a minimum lending rate of 13% p.a., their income is also exempt from income tax provisions, their avowed objective is to cater to the needs of lower and middle income groups, the demand for a lower target for priority sector advances does not carry much weight. Unlike in the case of commercial banks, UCBs do not have a target of deployment of 10% of their advances to export sector.

9.20 The Committee has also noted that commercial banks are required, in addition to 40% of their advances to the priority sector, to have 10% advances to the export sector. Therefore, even on grounds of a level playing field, the gap between the priority sector lending of UCBs and of commercial banks is not very large.

9.21 Having regard to these factors, the Committee recommends that the target of priority sector lending as presently prescribed for UCBs need not be revised.

Non-voting shares

9.22 Dr. M.L. Abhyankar, a member of the Committee has suggested that UCBs should be allowed to issue non-voting shares to a new class of shareholders. In support of this suggestion

he has submitted the following:

(i) In case member of an UCB resigns, he has to return his shares to the UCB only, and the bank has to buy back its shares at face value. As a result, the share value does not reflect the inherent financial strength of the bank.

(ii) Since last 5-6 years, cooperators and those associated with urban banking movement have suggested for issue of non-voting shares. These shares may be permitted to be traded in the stock exchanges or suitable platforms. Once these shares are listed/traded in stock market, the value of the stock will be determined by the financial strength of the bank. As market forces determine the value of stock, the UCBs will have to necessarily improve their performance and image in order to sustain value of their stock in the market.

9.23 The Committee has considered Dr. Abhyankar's suggestion. It believes that the issue of non-voting shares is an issue of wider impact than as applicable to UCBs. Under the Companies Act, non-voting shares are not presently permitted nor do they exist in the case of the State Bank of India or the nationalised banks. There is currently an on-going debate about feasibility of introducing non-voting shares under the Companies Act and the merits of such an issue and the safeguards needed are being worked out. In the opinion of the members of the Committee (other than Dr. Abhyankar), it is at the moment pre-mature to permit UCBs to issue non-voting shares.

9.24 These members of the Committee also note that as suggested by Dr. Abhyankar, the investors in such non-voting shares will be (i) a separate class of investors (ii) will be permitted to trade in such shares on the stock exchange or any suitable platform at a market determined price and (iii) will not be interested in exercising their rights in the management of the institution. In the opinion of these members of the Committee, all of these factors seriously damage the cooperative character of UCBs.

9.25 The Committee (other than Dr. Abhyankar) are, therefore, not in favour of allowing UCBs to issue non-voting shares at present. The full text of the Note of Dissent of Dr. Abhyankar is at [Annexure XIV](#).



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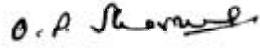
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