MC Explains | RBI's new regulatory framework for urban cooperative banks: 5 questions answered

The central bank's four-tier regulatory structure aims to tighten rules governing UCBs and simplify the process for better scrutiny as well as protection of depositors' interests

SIDDHI NAYAK

JULY 20, 2022 / 03:58 PM IST

The **Reserve Bank of India** (RBI) on July 19 said it has decided to adopt a simple four-tier **framework** for **urban cooperative**

banks (UCBs) with differentiated regulatory prescriptions depending on the size of the deposits.
UCBs are primary cooperative banks located in urban and semi-urban areas. These banks were traditionally centred around communities, localities and workplace groups and typically lent to small borrowers and businesses. At present, their scope of operations has widened considerably. There are currently 1,534 UCBs in India, as per RBI data.

Why now?
The RBI has been tightening its grip on regulated entities, specifically cooperative banks, to ensure that appropriate corporate governance practices are followed. The RBI's Financial Stability Report released in June underlined the vulnerability of certain UCBs to credit risk or liquidity shocks in the central bank's stress testing models.

The revised regulations on UCBs come specifically after the collapse of the erstwhile crisis-hit Punjab and Maharashtra Co-operative (PMC) Bank. In September 2019, the RBI had superseded the board of PMC Bank and placed it under regulatory restrictions after the detection of some financial irregularities. The restrictions included caps on deposit withdrawals by its customers, leading to panic among depositors.

Thereafter, the RBI, in February 2021, had set up a committee to examine the issues arising from this and to provide a roadmap for strengthening the sector. The eight-member panel, headed by former RBI deputy governor NS Vishwanathan, recommended the new regulations.

What is new?
Under the new norms, UCBs are divided into four categories—ranging from tiers 1 to 4—depending on the deposit size, net worth and capital to risk-weighted assets ratio (CRAR).

Through these regulations, the RBI has stipulated higher regulatory capital requirements or limits fixed for the larger UCBs. It has laid out a glide path for non-complying UCBs to meet the minimum capital thresholds within a stipulated time frame.

UCBs that meet the revised financially sound and well-managed (FSWM) criteria can open up to 10 percent of the number branches that they had at the end of the previous financial year. The process of opening new branches will be simplified to reduce the time taken.

Further, with respect to housing loans, there will be assigned risk weights on the basis of loan to value (LTV) ratio alone, which would result in capital savings. This will be applicable to all tiers of UCBs.

Will these norms help?

The regulations are aimed at enhancing the capitalisation level and quality of capital of UCBs. Over recent years, the duality of supervision of UCBs between the Registrar of Cooperative Societies or the Central Registrar of Cooperative Societies and the RBI had led to weaker oversight of the sector. These norms are intended to remedy that.

"This (new regulations) is on back of fallouts witnessed among UCBs in the past due to which (the) central bank had to take measures such as merger and amalgamation of UCBs, imposing restrictions like a cap on withdrawals for depositors, acceptance of fresh deposits and others," said Aniket Dani, director at CRISIL Research. "The increase in instances of failure among UCBs had suggested the need of closer supervision by RBI."

Further, the RBI probably wants to bring regulations of UCBs in line with those of small finance banks and commercial banks, said Aditya Acharekar, associate director at CARE Ratings.

The RBI has already introduced a similar scale-based regulatory approach for non-banking financial companies (NBFCs) to prevent systemic risks as posed by the outcome of the Infrastructure Leasing & Financial Services and Dewan Housing Finance Corporation Ltd. crises.

Are all the recommendations of the committee accepted?
No. The RBI has not accepted all the recommendations put out by the Vishwanathan committee. While it did accept many recommendations, it also modified a few. Some were not accepted at all while some others are under further examination.

The revised instructions, wherever necessary, will be issued separately in due course, the central bank has said.

What do experts say?
With the introduction of tighter regulations, the RBI is aiming to strengthen the sector and ensure that a PMC Bank-like situation does not occur, said experts. These norms also make it easy for the central bank to supervise these entities and identify irregularities at an early stage and mitigate them accordingly, thereby safeguarding depositors' interests.

"These measures are expected to ensure UCBs toe the line when it comes to maintaining better capital, which is a welcome move," said Aashay Choksey, assistant vice-president, financial sector ratings, ICRA.

"Further, tightening of prudential exposure limits as well as higher priority sector lending targets laid out in the RBI's March 13, 2020, circular is retained, which is a positive as UCBs will remain guided to keep single-borrower risk or concentration at lower levels."

Although the norms are a step in the right direction, implementation will be a challenge due to the large number of UCBs, said experts.

Moreover, the RBI may have to follow up with more regulations to detect frauds early and further tighten its grip on the sector, they added.