Banking Regulation (Amendment) Ordinance, 2020 - Co-operative Banks

Why in news?

- The Centre recently passed the Banking Regulation (Amendment) Ordinance, 2020.
- It gives the RBI more regulatory powers over urban co-operative banks (UCBs) and multi-State co-operative societies.

What does the amendment mean in practice?

- The Ordinance amends the Banking Regulation Act, 1949 as applicable to cooperative banks.
- With respect to UCBs and multi-State co-operative societies, the RBI will now have powers to -
  i. supersede boards
  ii. restructure managements
  iii. formulate resolution plans
- The change will subject 1,544 co-operative banks to greater RBI supervision.
- It will also partly address the problem of dual regulation by registrars of co-operative societies.
- Notably, the dual regulation is often cited as the reason for the string of co-operative bank failures.
- The Centre has expressed hope that this decision would reassure the 8.6 crore depositors in these banks about the safety of their money.

What are the concerns though?

- **RBI** - The RBI already has enough responsibilities in monitoring regulatory compliance by the following under its watch:

i. 86 scheduled commercial banks
ii. 10 small finance banks
iii. 53 regional rural banks
iv. thousands of NBFCs
v. housing finance companies (recently been added)

- So, the addition of over 1,500 new constituents is unlikely to make its task easier.

- **Role of UCBs** - The UCBs were originally conceptualised to further financial inclusion.
- But it is questionable if the UCBs are faithfully fulfilling this mandate.
- A 2014 study in this regard shed some light.
- It finds that smaller, unscheduled UCBs were indeed focussed on sub-Rs.10-lakh loans
- The larger scheduled UCBs actually make up for the bulk of the deposit and asset base of the co-operative banking sector.
- But these have stayed quite far from their original mandates.
- These were actively vying with commercial banks in extending non-priority sector loans to commercial borrowers.
- In the process, they have availed themselves of numerous regulatory concessions.
- UCBs do cater to smaller depositors ignored by commercial banks.
- But the failure of players such as PMC Bank shows that their lax lending practices can put depositors' money at risk.
- **Approach** - Banking correspondents, Mudra loans and Jan Dhan accounts, apart from microfinance NBFCs and small finance banks are active in the banking landscape.
- Given this, the UCBs seem less relevant.
- There are better alternatives to balance macro financial inclusion objectives with depositor interests.
- It is perhaps for this reason that the RBI has refrained from granting new UCB licences in recent years.

How has RBI dealt with it?

- RBI has tried to implement the recommendations that UCBs be actively encouraged to convert into small finance banks.
- By doing so, the regulatory arbitrage can be bridged.
- Since the PMC Bank failure, the RBI has ushered in several new rules to tighten governance structures at UCBs.
- It has sought more disclosures of loan books and constituted new boards of management.
- However, given the deep-rooted issues at many UCBs, it is doubtful if they will be able to manage the transition.

Source: BusinessLine