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**DAILY EDITORIAL
ANALYSIS**

TOPIC

**RBI AND COOPERATIVE BANKS: A
REGULATORY DILEMMA**

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RBI AND COOPERATIVE BANKS: A REGULATORY DILEMMA

Context

- Recently, the **Reserve Bank of India (RBI)** released a discussion paper seeking public comments on **issuing new licences for cooperative banks**.
- It revived a **long-standing debate** on whether cooperative banks can be effectively regulated within India's modern banking framework.

About Cooperative Banks

- Cooperative banks are **member-owned, democratically governed financial institutions** based on the principles of:
 - ♦ **Open membership** (anyone can join by contributing share capital at par);
 - ♦ **Democratic control** (one member, one vote);
 - ♦ **Mutuality and self-help**.
- Historically, cooperatives have played a **critical developmental role**, especially in **rural and semi-urban India**, by:
 - ♦ Providing affordable credit and savings facilities;
 - ♦ Serving people excluded from mainstream banking;
 - ♦ Operating with lower costs and local trust;
- The **All-India Rural Credit Survey Committee (1954)** famously observed that *'if co-operatives fail, there fails the last hope of rural India'*.

Current Status of Cooperative Banks

- As of **March 31, 2025**, India had **838 cooperative banks with deposits below ₹100 crore** each.
- No new cooperative bank licences have been issued since **2001**, but the idea resurfaces roughly every five years.
- Cooperative banks remain largely **small, fragmented, and locally concentrated**, making regulation complex.
- In contrast, large commercial banks like SBI can be regulated through **system-based supervision and sample inspections**, despite having thousands of branches.

Future Projection of Cooperative Banks

- If new licences are issued, the RBI may face a surge of **small, unitary institutions** requiring individual supervision, significantly increasing regulatory burden without necessarily improving financial stability or inclusion.

Related Issues & Concerns

- **Structural Mismatch:** Cooperative share capital is **withdrawable** and linked to membership, behaving more like a checking account than stable capital.
 - ♦ This structure is **not compatible with capital-centric prudential banking regulations**.
- **Scale vs. Mutuality:** True cooperatives are meant to be **small, neighbourhood-based patronage institutions**.
 - ♦ Banking, however, requires **scale** to provide services like remittances, credit cards, export credit, and corporate finance.
 - ♦ A 'cooperative bank' thus becomes an **oxymoron**, too small to be efficient, too large to remain truly cooperative.
- **Governance Challenges:** Democratic control allows borrower-members to sit on boards, often weakening professional governance.

- ◆ Many large cooperative banks no longer meet cooperative principles like membership is effectively closed, and non-member business dominates member business.
- **Regulatory Burden and Backdoor Licensing:** Issuing cooperative bank licences can become a **backdoor route to banking licences** for promoters who do not qualify for universal banks. RBI faces a paradox like **'too small to regulate effectively'** and **'too large to remain a genuine cooperative'**.

Related Efforts & Initiatives

- Committee Reviews & Recommendations:
 - ◆ **Malegam Committee (2011):** It primarily focused on **financial sector reforms** and institutional structures, **recommended permitting the issue of new licences to Urban Cooperative Banks (UCBs)**, subject to **strict eligibility and prudential conditions**.
 - It argued that **well-governed, professionally managed cooperatives** should not be denied banking licences merely because of their cooperative form.
 - New licences could **promote competition and financial inclusion**, especially in urban and semi-urban areas.
 - Licensing should be **selective**, with emphasis on **sound governance, capital adequacy, and viability**, to avoid weak and politically captured entities.
 - ◆ **R Gandhi Committee (2015) on UCBs:** It **strongly recommended resuming the issuance of new licences to cooperative banks**, but within a **well-defined and differentiated regulatory framework**. It recommended that:
 - **New UCB licences may be issued**, particularly to **professionally managed and financially sound entities**, to strengthen financial inclusion.
 - The sector should move to a **four-tier structure**, with regulation calibrated to size and risk.
 - **Large UCBs should be treated almost on par with commercial banks** in terms of prudential norms, governance, and supervision.
 - **Consolidation through mergers and voluntary transition** of strong UCBs into small finance banks should be encouraged.
 - Governance reforms, including **fit-and-proper criteria for boards and CEOs**, were essential before expansion.
 - ◆ **Vishwanathan Committee (2021):** It took a **cautious and conservative view** on cooperative bank licensing, **shaped by recent failures such as PMC Bank**. It recommended that:
 - **No aggressive issuance of new cooperative bank licences** should be undertaken.
 - The RBI's priority should be **strengthening existing cooperative banks** rather than expanding their numbers.
 - Emphasis should be placed on **better governance, tighter supervision, and early supervisory intervention**.
 - **Consolidation, mergers, and exit mechanisms** should be encouraged for weak and unviable cooperative banks.
 - Regulatory standards should be **risk-based and proportionate**, but with **enhanced powers for the RBI** (enabled by amendments to the **Banking Regulation Act**).
 - ◆ In brief, committees such as **Malegam (2011)** and **Gandhi (2015)** supported new licences, while **Vishwanathan (2021)** urged caution.
- **Umbrella Organisation (UO):** Established to provide shared services to cooperative banks, offering a foundation for a federated structure.
- **Legislative Amendments:** Changes to the **Banking Regulation Act** to strengthen RBI's supervisory powers over cooperatives.
 - ◆ **Banking Regulation Act amendments** have reduced the problem of dual regulation (Centre vs States).

- Internationally, especially in Western economies:
 - ◆ **Primary cooperatives** handle customer relationships;
 - ◆ **Federated institutions** manage sophisticated banking functions;
 - ◆ Regulation aligns federations with universal banks, easing supervisory challenges.

Way Forward

- **Adopt a Federated Cooperative Model:** Encourage the creation of **two or more national-level federal cooperative institutions**.
 - ◆ Sophisticated banking and capital should sit at the federated level, where capital is stable and regulation is feasible.
- **Affiliate, Don't Multiply:** Allow **Tier-IV cooperative banks** (deposits above 10,000 crore) to affiliate smaller cooperatives.
 - ◆ Convert **single-branch cooperative banks** into cooperative societies and cancel their banking licences.
- **Banks of Cooperatives, Not Cooperative Banks:** National entities may carry the word '*cooperative*', but function as **banks for cooperatives**, not as cooperatives themselves.
 - ◆ Provide shared branding, technology, compliance, and value-added services.
- **Ease RBI's Regulatory Burden:** Fewer, well-capitalised federal institutions mean **better supervision** and **lower systemic risk**.
 - ◆ Grassroots financial inclusion can continue through newly formed cooperative societies affiliated to these federations.

Conclusion

- Cooperatives remain indispensable for financial inclusion, but **cooperative banks in their current form strain both governance and regulation**. The RBI now stands at a crossroads: continue with piecemeal licensing or **reimagine cooperative banking through a federated, future-ready model**. Whether it chooses to think boldly remains the central question.

Daily Mains Practice Question

[Q] Discuss the role of the Reserve Bank of India in regulating cooperative banks and analyse the key challenges it faces in aligning the cooperative character of these institutions with modern banking regulation.

[Source: BS](#)

