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FINANCIAL TRENDS OF URBAN COOPERATIVE BANKS (UCBS) IN INDIA (2016-24)

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Abstract

Urban Cooperative Banks (UCBs) in India continue to evolve within a dynamic regulatory and financial ecosystem. Recognizing their systemic importance and the challenges they face, the Reserve Bank of India (RBI) has introduced several reforms to strengthen their financial health and governance. A key reform involved the classification of UCBs into four tiers based on deposit size, enabling more structured regulatory oversight. Another notable recommendation was to create an Umbrella Organization (UO), aimed at fostering sector-wide financial resilience.

The article also highlights amendments to the Banking Regulation Act, 1949, enabling the listing of co-operative bank-issued instruments as securities. The adoption of a refined Supervisory Action Framework, later replaced by the Prompt Corrective Action (PCA) framework effective April 2025, focuses on Net NPA, CRAR and profitability as the primary triggers for regulatory intervention. Furthermore, post the failure of a major UCB, the DICGC Act was amended to enhance deposit insurance coverage and achieve quicker claim settlements.

Efforts to improve compliance have also included penal actions through RBI's Enforcement Department. However, UCBs now face heightened competition from Small Finance Banks and Scheduled Commercial Banks in semi-urban regions. To remain relevant, UCBs must prioritize credit risk management, digital infrastructure investment, fintech collaboration, and innovation in customer engagement.

The article suggests consolidation of smaller UCBs as a strategic move to ensure long-term viability, supported by the UO through liquidity support and shared technological platforms. It further

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emphasizes the need for UCBs to improve capital adequacy and compliance practices to remain competitive and sustainable.

In conclusion, while UCBs continue to show signs of growth, challenges persist. Their ability to embrace regulatory reforms, adopt modern technologies, and build stronger governance systems will determine their future trajectory in India's evolving financial landscape.

Key words: Urban Cooperative Banks (UCBs), Deposit Insurance (DICGC), Umbrella Organization (UO), Banking Regulation Act amendments, capital adequacy (CRAR), Net NPA, asset quality, governance, liquidity support, technological adoption and consolidation.

Introduction

Urban Cooperative Banks (UCBs) have been an integral part of India's banking ecosystem, catering primarily to small businesses and urban borrowers. Over the past decade, UCBs have undergone significant changes due to regulatory shifts, asset quality challenges, and increasing competition from Scheduled Commercial Banks (SCBs). This article provides a year-on-year (YoY) financial trend analysis of UCBs since 2016, a comparative study with SCBs, insights into areas where UCBs lag behind, steps taken for improvement along with further recommendations for bridging the gap.

Year-on-Year Financial Trends of UCBs (2016-2024)

1. Number of UCBs and Structural Changes

The total number of UCBs have declined from 1,574 in 2016 to 1,472 in 2024. The reduction was primarily due to mergers and license cancellations (70 UCB licenses were cancelled during this period) which resulted in steady decline in the number of Non-Scheduled UCBs. However, Scheduled UCBs remained relatively stable (~52-54), reflecting an overall gradual consolidation in the sector.

In 2017, the Tier I: Tier II UCBs ratio stood at 69:31[1] which changed to 54:46 by the end of FY 2022*, a marked

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change that indicated growth in size of UCBs and a shift towards a more resilient banking structure. Based on the recommendations of the Expert Committee, under the chairmanship of Shri N. S. Vishwanathan, former Deputy Governor, RBI, a four-tiered regulatory framework was adopted from December 2022 while Tier I UCBs continue to be the smaller size UCBs with deposits less than ₹ 100 Crore.

2. Deposits, Advances, and Asset Growth

Deposits in UCBs increased by 4.30% (CAGR), reaching ₹ 5.55 lakh crore in 2024 from ₹ 3.92 lakh crore in 2016[2]. Advances, on the other hand, grew at a much slower pace at 3.60%, from ₹ 2.44 lakh crore in 2016 to ₹ 3.46 lakh crore in 2024[3]. The total asset size increased by 4.10% during this period from ₹ 4.78 lakh crore in 2016 to ₹ 7.07 lakh crore in 2024, reflecting modest growth [4].

3. Asset Quality Trend: Rising NPAs

One of the most critical concerns for UCBs was the deterioration in asset quality. Gross NPAs in absolute amount deteriorated massively by 19.40% (CAGR) from ₹ 15,000 crore in 2016 to ₹ 37,996 crore in 2021, however, moderated and improved to ₹ 25,411 crore by 2024[5]. Net NPAs followed a similar trajectory, rising by 26.80% (CAGR) from ₹ 5,100 crore in 2016 to ₹ 16,783 crore in 2021, however, improving significantly to ₹ 3,913 crore by 2024[6]. During the corresponding periods, the Gross NPAs in percentage terms moved from 6.10% to 12.10% and to 7.30%, respectively while the Net NPAs moved from 2.20% to 5.80% and eventually to 1.20% on account of adequate provisions which reflected in the Provision Coverage Ratio (PCR) improving from 65.90% in 2016 to a comfortable 84.60% by 2024[7].

4. Capital Adequacy and Regulatory Compliance

The Capital to Risk-Weighted Assets Ratio (CRAR) of UCBs remained relatively stable and improved in the last five years. During the Covid year, 2020, the CRAR stood at 12.20% and gradually improved to 17.50% by 2024[8]. Although, the number of non-

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compliant UCBs reduced from 132 (8.45% of total UCBs) in 2017 to 57 in 2024, it still formed 3.87% of the total UCBs [9].

5. Profitability Trends and Operational Efficiency

UCBs faced profitability challenges, particularly in 2020 due to the failure of a big Scheduled UCB in Maharashtra that resulted in a reported net loss of ₹ 5,566 crore for the sector [10]. This was largely due to significant provisioning requirements for the said bank and the repercussion of provision requirements pertaining to the exposure that other UCBs had with the failed UCB. Despite, Covid pandemic first wave in 2020-21, profitability improved in 2021 to ₹ 1,558 crore and gradually increased to ₹ 4,729 crore by 2024[11].

Comparison of UCBs with SCBs

1. Deposits and Advances

While UCBs had grown, their market share compared to SCBs has declined over the years. In 2024, Deposits in UCBs were ₹ 5.55 lakh crore, while SCBs had deposits at ₹ 217.33 lakh crore [12]; Advances in UCBs were ₹ 3.47 lakh crore, whereas SCBs' advances stood at ₹ 171.42 lakh crore[13]; UCBs' total asset size stood at ₹ 7.07 lakh crore compared to ₹ 280.81 lakh crore forming only 2.52% of the latter, a fall from 19.40% in 2004-05[14].

2. Credit Quality and NPA Management

SCBs witnessed an upward trajectory in their GNPA ratio from 7.50% in 2016 to 11.20% in 2018 but subsequently had managed to reduce their Gross NPA ratio significantly to 2.70% in 2024[15]. The improvement in asset quality in SCBs was mainly due to better credit risk assessment, stricter regulatory oversight, efficient recovery mechanisms, regulatory prescriptions to clean the balance sheet, etc. By way of comparison, UCBs too witnessed a spike in their GNPA ratio from 6.10% in 2016 to 12.10% in 2021 and in the last three years, there was a gradual improvement in the Gross NPAs from 10.30% in 2022 to 7.30% in 2024, though the same was

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significantly higher compared to SCBs[16].

3. Technological Adoption and Digital Banking

SCBs had embraced the fintech partnerships, **digital lending**, and **UPI-based transactions much earlier compared to the UCBs**, which had significantly improved their operational efficiency. UCBs, on the other hand, find it difficult to catch up due to limited financial resources and infrastructure constraints.

4. Profitability and Capital Strength

SCBs had remained consistently profitable, leveraging their economies of scale. UCBs, however, had faced periods of financial stress due to higher provisioning requirements and operational inefficiencies [17]. As per the National Federation of Urban Cooperative Banks and Credit Societies Limited (NAFCUB) 122 UCBs came out of Supervisory Action Framework (SAF) in FY 2024. Despite the same, presently, a little over 500 UCBs are under SAF while none of the SCBs are under PCA [18].

Recent steps taken/Suggested recommendations to improve UCBs

Recent steps taken:

a) An Expert Committee on UCBs under the chairmanship of Shri N. S. Vishwanathan, former Deputy Governor, RBI was set up to examine the issues in UCBs and to provide a road map for strengthening the sector, leveraging on the amendments to the Banking Regulation Act, 1949 (As Applicable to Co-operative Societies). The following were the key recommendations.

1. Tier Based Differential Regulation: The Expert Committee on UCBs recommended introducing differential regulation of UCBs by categorizing them into four tiers based on size of deposits. The same came into effect in 2021-22.

2. Minimum Capital Requirement: The Committee recommended a minimum capital of ₹ 300 crore for the Umbrella Organization (UO) to be financially strong with adequate capital.

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3. Listing of Securities: The Committee suggested suitable amendments to the Banking Regulation Act, 1949, to enable the RBI to notify instruments issued by co-operative banks as "securities" for listing and trading on recognized stock exchanges. The same culminated in the amendment of the BR Act in 2020.

4.Supervisory Action Framework: The Committee recommended adopting a refined approach, using Net NPA, Profitability and CRAR as triggers, to take remedial action for weak UCBs, which came into effect in 2020. Further, on July 26, 2024, RBI introduced PCA framework for UCBs, replacing the existing Supervisory Action Framework (SAF), effective from April 1, 2025.

b) Post the failure of a big UCB, the Deposit Insurance Credit Guarantee Corporation (DICGC) Act was amended in 2020. With the amendment and increase in the insured amount from ₹ 1.00 lakh to ₹ 5.00 lakh, settlements in case of UCBs under RBI directions had taken place actively, thereby superseding the earlier time-consuming liquidation process for settlement of claims. DICGC settled claims worth ₹ 752 crore in 2022-23 and ₹ 1,432 crore in 2023-24. These claims pertained entirely to co-operative banks placed under liquidation or All-Inclusive Directions (AID)[19].

c) Post the formation of Enforcement Department in 2017, RBI had also taken important steps such as imposition of penalty for violations to strengthen governance and compliance in UCBs [20].

Suggested recommendations

1. Strengthening Credit Risk Management

Serving the semi-urban areas was once a niche business opportunity for the UCBs. However, with advancement in technology, requirements of financial inclusion and priority sector norms, other entities such as Small Finance Banks and SCBs have also entered into semi-urban and remote areas posing severe competition for the UCBs. UCBs need to adopt stricter credit appraisal mechanisms, implement better loan recovery mechanisms, introduce innovative products, employ effective risk management and good governance practices and leverage the level-playing

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guidelines issued by RBI from time to time to stay in business. They could consider investing in digital banking infrastructure, collaborate with fintech firms for digital payments, credit underwriting, and AI-based fraud detection to enhance operational efficiency. Expanding their customer base beyond their traditional cooperative members can boost their growth.

2. Capital Infusion and Compliance Improvements

UCBs should focus on maintaining strict adherence to CRAR norms to ensure long-term stability. Umbrella Organisation could engage with UCBs to guide and advise them regarding strategies for improving their capital and other financial parameters as also strengthen their compliance and assurance functions.

3. Encouraging Consolidation for Greater Resilience

Smaller, financially weak UCBs could consider mergers with stronger entities to improve their sustainability. Liquidity support and technological infrastructure could be provided by the umbrella organization for UCBs.

Conclusion

The financial trends of UCBs over the past decade show gradual growth but persistent challenges in terms of asset quality, regulatory compliance, and technological adoption. Compared to SCBs, UCBs have a smaller market share, weaker NPA management, and lower profitability. However, by focusing on risk management, digital transformation, and capital strengthening, UCBs can enhance their financial position and bridge the gap with SCBs. The future of UCBs depends on their ability to innovate, collaborate, and adapt to the evolving banking landscape in India

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