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To,

Shri Shakti Kant Das
Governor
Reserve Bank of India
Central Office
Shaheed Bhagat Singh Marg
Mumbai-400 0051

Sir,

Reg : Constitution of Board of Management (BoM) in Primary (Urban) Co-operative Banks (UCBs)

As you are aware that Reserve Bank of India has issued instructions vide their circular DOR (PCB).BPD.Cir.No.8/12.05.002/2019-20 dated December 31st, 2019 advising UCBs to constitute a BoM by making suitable amendments in their bye-laws. Although the circular states that the instructions have been issued after taking into consideration the responses received from the sector, RBI however appears to have implemented the guidelines notwithstanding serious reservations of a large number of UCBs with regard to the concept of having a BoM in addition to BoD in Urban Cooperative Banks. We therefore feel dismayed that RBI has chosen to overlook the overwhelming resentment expressed by a very wide section of the UCBs sector against the proposal to have a BOM in addition to BOD. In this connection we reiterate our opposition to the above guidelines issued to UCBs with a deposit size of Rs.100.00 crore and above to constitute a BoM in addition to the Board of Directors of the Bank. We also once again take this opportunity to explain our point of view in this regard as under :-

1. Legal Aspects

The report of the expert committee on licencing of new urban cooperative banks (Malegam Committee) at para 4.6 (c) has observed that it is true that specific provisions relating to regulation of the management of banks under the Banking Regular Act have not been made applicable to UCBs particularly sections 10, 10A, 10B, 10BB, 10C, 10D, 35B, 36AA & 36AB. It, therefore, stated that the constitution of Board of Management in addition to the Board of Directors can be made applicable as a licencing condition to the new banks before applying to the RBI for a banking licence. Thus the issue of guidelines for constitution of BoM in addition to BoD is contrary to the extant provisions of the B.R. Act 1949 (AACs) and the more appropriate way forward would have been the amendment of the B.R. Act 1949 vesting specific powers on RBI in this regard.

2. RBI Powers over BoM & CEO

The guidelines require UCBs having deposits of Rs.100.00 crore and above to obtain prior approval of RBI for appointment of CEO and RBI shall have powers to remove any members of the BoM and/or the CEO if the person is found to be not meeting the criteria prescribed by RBI or acting in a manner detrimental to the interest of the bank or depositors or both. The BoD shall seek concurrence from RBI before removing any



member of the BoM / accepting the resignation tendered by any member of BoM. RBI shall have powers to supersede the BoM if the functions of the BoM are found to be unsatisfactory. As already stated that the powers regarding appointment and removal of CEO & the members of the BoM have not been replicated while amending Section 56 of the Banking Regulation Act 1949. As such the above arrangement regarding prior approval of RBI for appointment and removal of the CEO and the members of the BoM as also the supersession of the BoM by RBI may not stand the scrutiny of law. The prior approval of appointment of CEO by RBI for about 650 UCBs will be a time consuming exercise leading to disruptions in the normal functioning of the UCBs in the country.

3. Amendment to the Bye-laws of the UCBs.

As per the RBI instructions UCBs shall make suitable amendments to their byelaws with the approval of General Body and Registrar of Cooperative Societies to provide for constitution of BoM in addition to BoD. In this connection it is submitted that there are no provisions in the B.R. Act 1949 (AACs) to constitute the BoM in addition to BoD. Further, the provisions in the Multi-State Co-operative Societies Act 2002 as also the State Cooperative Societies Act do not provide for constitution of BoM. Even the model bye-laws as applicable to UCBs also do not provide for constitution of BoM in addition to BoD. In such a situation how the UCBs shall make amendments in their bye-laws which are inconsistent with the applicable statutes is not clear and such amendments may be void ab initio.

4. Functions of BoM and their Accountability

The functions of BoM as prescribed by RBI inter-alia include rendering expert advice for sanctions of loans, recommending action for recovery of NPAs, OTS, overseeing management of funds, internal control, risk management, computerisation, internal audit/ inspection, grievance redressal as also assisting the Board in formulation of policies relating to banking functions. Needless to mention that UCBs are already discharging these functions through constitution of expert committees operating under the Board of Directors of the bank. Adding another layer of BoM under these committees will create a complicated & complex organisational structure leading to avoidable delays in the decision making process of the bank; thereby adversely impacting their operational efficiency. The accountability of the members of the BoM is a very serious issue as there is no clarity with regard to their status in the bank vis-à-vis delegation of powers to the BoM. The exercise of delegated powers is accompanied by responsibility and accountability in the banking system. As the members of the BoM will not be in the employment of the bank and will be operating under the expert committees constituted by the Board of Directors in different functional areas of banking, what type of accountability for their acts of omission and commission and malfeasance can be fixed is not clear so far. Whether the accountability will be joint & several in cases where decisions are taken by the Top Management on the recommendation of the BoM is also a moot question at this stage.

5. Size of BoM

As per the instructions issued by RBI the minimum number of members of BoM shall be 5 (excluding CEO) and maximum members in BoM shall not exceed 12. In this connection it is pertinent to mention that the instructions regarding appointment of professional directors in UCBs were issued by RBI in 2002. In view of the heterogeneous



character of the UCBs with regard to their size, geography, financial strength and scale of operation, there are still certain small size UCBs which have not been able to appoint professional directors due to the non-availability of such expert directors at the place of their business as also the cost considerations which such appointment entails. In such a scenario taking on an average of 8 members of BoM in 650 UCBs, availability of about 5200 professional members of the BoM in addition to the BoD as per the fit & proper criteria of RBI will be a herculean task for a large number of UCBs apart from additional cost considerations.

6. Branch Expansion

The instructions issued by RBI envisage that constitution of BoM will be mandatory requirement for such UCBs for expanding area of operation and opening of branches. In this connection NAFCUB has been vehemently opposing the linking of branch expansion with the constitution of BoM. UCBs have already witnessed stagnation in their branch expansion activities for the last two years whereas other banks including differentiated banks have been liberally allowed to open branches without even approaching RBI. As the constitution of BoM has been mandated to be undertaken within a period of one year from the date of the circular i.e. 31st December, 2019, it means the opening of the branches by UCBs will be further delayed by one more year as per the directions issued by RBI in this regard. This is discriminatory vis-à-vis the Small Finance Banks / Payment Banks which have only recently been set up for less than one year and have not yet established their credibility as against the UCBs which have history of more than 100 years of successful operations in the country.

7. Role of Existing Professional Directors

It may be recalled that UCBs were directed to appoint two professional directors in the Board of Directors of the Bank w.e.f. 2002. In the guidelines issued for constitution of BoM it has been envisaged that the elected members of BoD can be members of the BoM provided they meet the fit & proper criteria prescribed by RBI. Further, not more than 50% of BoM members shall be from BoD. Under all circumstances, BoM shall have at-least 2 members from outside the BoD. In such a situation in case the existing professional directors have been co-opted as members of the BoD, they will be rendered ineligible to be members of the BoM as only elected members of BoD who meet the specified criteria are considered eligible for BoM. Thus the existing professional directors on the BoD though may be meeting the fit & proper criteria of BoM will be deprived of giving their professional inputs in the banking functions of the UCBs.

8. Conflict of Interest

As per the instructions issued by RBI, a member of BoM can be appointed in more than one bank, subject to maximum of three UCBs provided there is no overlapping in the area of operation. As per the extant instructions contained in Master Circular dated 1st July, 2015 on Board of Directors, it has been prescribed that the directors engaged in activities similar to the activities of a UCB are ineligible in terms of clause (b)(ii) of the Model bye-laws No.9 and / or the provisions contained in the Cooperative Societies Act concerned. Further, the members of the BoD are expected to ensure confidentiality of the bank's information under oath of secrecy and fidelity. In such a situation the members of the BoM being appointed in more than one bank will tantamount to conflict of interest and is contrary to the spirit of the instructions issued by RBI in this regard. It

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PRESIDENT



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may not be always possible to maintain confidentiality of information by all the members of BoM and their role in one bank may be in conflict with the other UCB in matters of different banking functions i.e. deposits, investments, fund management etc. which are permitted to be undertaken even beyond the area of operation of the bank .

9. Sitting Fees

The guidelines provide that the members of the BoM may be paid allowances / sitting fees as may be provided for in the bye-laws of the UCBs or with the approval of the BoD of the Bank. In view of the small scale of operations of the UCBs the payment of allowances / sitting fees will be an additional cost to the bank and will also create unhealthy competition in the UCB sector; thereby jeopardizing the economic interest of members.

In view of the above, it is our considered belief that the concept of having a BoM in addition to BoD will create complex & complicated structure and is bound to create a lot of confusion in the UCB sector. The distinction in the role of BoM vis-à-vis BoD remains blurred due to overlapping of functions to be discharged by both. The concept of supervisory Board and Executive Board as prevalent in certain UCBs in European countries may not be relevant in view of the small scale of operations of the UCBs in our country. Further, BoD may always not be able to ensure that there are no conflict in powers delegated to the committees of the Board and the BoM. It would, therefore, be necessary to examine the above aspects and reconsider the decision regarding implementation of constituting Board of Management in addition to Board of Directors in the UCBs.

In case despite our opposition to the proposal for appointment of BoM, RBI considers it necessary to implement the above guidelines, it is suggested that the constitution of BoM may be made applicable initially for 84 large UCBs having deposit size of Rs.1000.00 crore as against 650 UCBs having deposit size of Rs.100.00 crore and above for the time being. This will cover 60% of the total deposits of UCBs in the country. We look forward to your favourable consideration of our above proposal and modification of the guidelines issued by RBI vide their Circular DOR(PCB) BPD.Cir.No.8/12.05.002/2019-20 dated 31st December, 2019 and oblige.

Regards,

Yours sincerely,


(JYOTINDRA MEHTA)

Copy to:

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