Co-operative banks: RBI's inclusivity pitch runs into regulatory dilemma

The RBI needs to think out of the box vis-a-vis cooperative banks

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Cooperatives represent the true dilemma of the Reserve Bank of India (RBI). The RBI is a full-service central bank, charged with three main functions: Managing monetary policy and public debt; regulating banks and financial institutions; and a developmental role (including but not limited to financial inclusion).

Cooperatives are effective neighbourhood institutions, operate on self-help and mutuality, have lower costs, and provide service to people left out of mainstream banking. Promoting cooperatives as a “developmental” activity was emphatically affirmed in 1954 by the All-India Rural Credit Survey Committee, which said that “if co-operatives fail, there fails the last hope of rural India”.

The RBI gets into a dilemma when it is unable to square up the form of incorporation of a cooperative and the regulatory imperatives. Regulations are designed towards capital-centric widely-held listed entities. While no new licences for cooperative banks were issued since 2001, the talk of issuing new licences crops up every five years: The Malegam Committee (2011) and the Gandhi Committee (2015) suggested that new licences be given, while the Vishwanathan Committee (2021) was a bit circumspect. Five years later, in 2026, the RBI again brought up the issue and placed a discussion paper inviting comments on the nature of new licences for cooperative banks.

Cooperatives operate on the principles of open membership, democratic control, and mutuality. Open membership allows anyone to contribute to share capital (at par) at any time. It also allows members to withdraw their share capital on termination of membership — again at par — making the capital of a cooperative almost like a checking account.

Democratic control technically allows any member (including borrower members) to be elected to the governing board. If a cooperative becomes a bank — and thereby a large institution with a national footprint — it loses the core of mutuality. Therefore, cooperatives in general, and cooperative banks in particular, have always been fraught, with some notable exceptions like the Ahmedabad-based Shri Mahila Sewa Sahakari Bank, promoted by Magsaysay awardee Ela Bhatt and Mann Deshi Cooperative Bank, based in Satara.

The design of cooperatives envisages patronage-based organisations in small neighbourhoods running on the principle of mutual benefit. Cooperative societies fit this idea of providing the basic service of loans and savings. However, it does not have the scope to provide modern banking service (like remittances, credit cards, export credit, and any form of corporate funding) if the organisation were to be truly member-centric. All these come with scale. A cooperative bank is, therefore, an oxymoron. A cooperative as a patronage-based institution is to deal with members (who contribute to share capital and vote). And a bank is to deal with the public at large. A small cooperative society makes sense. A cooperative bank does not.

This is where the dilemma of the RBI comes in. If the RBI were to issue more licences, then the applicants ought to be small unitary institutions with a low capital base. The regulator will have to deal with several independent institutions with one or a few branches. As on March 31, 2025, there were 838 cooperative banks having deposits of less than ₹100 crore. All these were to be independently regulated. Compare this with State Bank of India, a single bank that would have more than 23,000 branches where regulation can be done on the basis of their systems and inspections of sample branches.

The nature of incorporation of the cooperatives — with share capital that can be withdrawn and open membership — is not amenable to the usual prudential regulations of banking. Most of the cooperatives are under state laws, given that cooperation falls on the State List (of the Constitution). While the duality of regulation has been addressed through amendments to the Banking Regulation Act, it will be difficult for the RBI to regulate a large number of newer institutions effectively — a situation where a cooperative is too small to be regulated by the RBI, and, if it grows big, it is too large to be a cooperative. Historically using the banking licence, cooperative banks have grown to be behemoths. They possibly fail on the twin tests of being a true cooperative: Membership is not truly open; and the non-member business is more significant than the member business. In the process, issuing licences to cooperative banks is nothing but issuing banking licences through the back door to a set of promoters (with closed membership) and do not qualify for a regular bank.

In this context, the RBI needs to think out of the box vis-à-vis cooperative banks. In the western world, the individual client interface happens through cooperative societies, while sophisticated banking happens at federated level. This is a possible solution. Capital at federated level is more stable. Individual primary cooperatives hardly walk out of the federation using the open-membership principle. Governance and regulatory architecture could be completely aligned with those of universal banks.

Instead of issuing more licences to primary banks, the RBI should look at encouraging setting up at least two federal institutions nationally and/or permitting Tier-IV cooperative banks (having more than ₹10,000 crore as deposits) to affiliate smaller cooperatives. The "umbrella organisation", already in existence, could become a federal cooperative bank. With a choice of affiliation available to the primaries, the RBI should cancel the licences of unitary (single-branch) cooperative banks and convert them into cooperative societies. These can seek banking service from national behemoths.

These national entities could carry the word “cooperative”, with an understanding that they are banks of cooperatives rather than being cooperative banks. They would provide value-added service to neighbourhood cooperatives, under a common brand. New cooperative societies can be continually promoted and affiliated with any of these federal institutions. This eases the RBI’s regulatory burden while providing an open path for new inclusion efforts at the grassroots. Will the RBI think boldly? That is quite a question.

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