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LEGAL FRAMEWORK AND CHALLENGES OF COOPERATIVE BANKING IN INDIA

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Abstract

Cooperative banking in India occupies an important place in the country's financial system, particularly in rural and semi-urban areas. Cooperative banks function on the principles of mutual assistance, democratic management, and financial inclusion. These institutions play a significant role in providing affordable credit to farmers, small traders, artisans, and weaker sections of society. The legal framework governing cooperative banks in India is complex because cooperative banks are regulated by both banking laws and cooperative society laws. The Reserve Bank of India (RBI), National Bank for Agriculture and Rural Development (NABARD), state governments, and Registrars of Cooperative Societies jointly supervise cooperative banks. Despite their contribution to rural development and financial inclusion, cooperative banks face several legal and operational challenges such as dual regulation, political interference, weak governance, corruption, financial instability, and rising non-performing assets (NPAs). This research paper examines the legal framework governing cooperative banks in India and analyses the major challenges faced by the sector.

1.1 Introduction

Cooperative banking refers to a banking system organized and managed on cooperative principles of self-help, mutual assistance, and democratic functioning. Cooperative banks are owned by their members and are established to serve the financial needs of local communities rather than earning maximum profits.

In India, cooperative banks were established to provide institutional credit to rural populations and weaker sections of society who were exploited by private moneylenders. Over time, cooperative banks became important institutions for agricultural finance, rural development, and financial inclusion.

a. The cooperative banking structure in India consists of:

b. Primary Agricultural Credit Societies (PACS)

c. District Central Cooperative Banks (DCCBs)

d. State Cooperative Banks (SCBs)

e. Urban Cooperative Banks (UCBs)

The legal framework governing cooperative banks is unique because these institutions function both as cooperative societies and banking institutions. Therefore, they are governed by cooperative laws as well as banking regulations. This creates a system of dual control involving state governments and the Reserve Bank of India.

2. Research Methodology

The present study is doctrinal and analytical in nature. The research is based on secondary sources such as books, RBI reports, NABARD reports, government publications, committee reports, journals, and online legal resources related to cooperative banking in India.

2.1 Meaning and Nature of Cooperative Banks

Cooperative banks are financial institutions established under cooperative principles to provide banking services to their members. These banks are owned and controlled by members who have equal voting rights irrespective of shareholding.

The important features of cooperative banks include:

- a. Democratic management
- b. One member one vote principle
- c. Service-oriented objectives
- d. Local area operation
- e. financial assistance to weaker sections
- f. Cooperative banks play an important role in promoting financial inclusion and rural development in India.

3. Constitutional Framework of Cooperative Banking

Under the Constitution of India, “cooperative societies” fall under Entry 32 of the State List of the Seventh Schedule. Therefore, state governments have legislative authority over cooperative societies operating within the state. Cooperative societies operating in more than one state are governed by central legislation.

The Constitution (97th Amendment) Act, 2011 granted constitutional recognition to cooperative societies and promoted:

- a. Voluntary formation of cooperative societies
- b. Democratic control
- c. Autonomous functioning
- d. Professional management
- e. The Amendment inserted Article 43B in the Directive Principles of State Policy and added Part IX-B relating to cooperative societies.

4. Legal Framework Governing Cooperative Banks

1. Cooperative Credit Societies Act, 1904

The Cooperative Credit Societies Act, 1904 was the first legislation relating to cooperative institutions in India. It aimed to provide affordable credit to farmers and rural populations.

Main objectives:

- Removal of rural indebtedness
- Promotion of self-help and cooperation
- Institutional credit facilities for farmers

This Act laid the foundation for cooperative banking in India.

2. Cooperative Societies Act, 1912

The Cooperative Societies Act, 1912 expanded the scope of cooperative institutions by recognizing non-credit cooperative societies and central cooperative organizations.

The Act strengthened the cooperative movement and improved supervision and management.

3. Banking Regulation Act, 1949

The Banking Regulation Act, 1949 is one of the most important laws governing cooperative banks. Certain provisions of this Act were extended to cooperative banks in 1966.

The RBI regulates banking functions such as:

- a. Licensing
- b. Branch expansion
- c. Capital adequacy
- d. Prudential norms
- e. Auditing and inspections
- f. The Banking Regulation (Amendment) Act, 2020 significantly strengthened RBI’s supervisory powers over cooperative banks.

4. Reserve Bank of India Act, 1934

The Reserve Bank of India Act, 1934 established the RBI as the central banking authority. RBI supervises cooperative banks to ensure financial stability and sound banking practices.

Functions of RBI regarding cooperative banks include:

- a.Regulation and supervision
- b.Issuing directions
- c.Inspection and auditing
- d.Licensing of banks
- e.Ensuring financial discipline

5. NABARD Act, 1981

The National Bank for Agriculture and Rural Development (NABARD) was established in 1982 for promoting agricultural and rural development.

NABARD performs the following functions:

- a.Refinance support to cooperative banks
- b.inspection and supervision
- c.Rural development financing
- d.Policy guidance
- e.NABARD plays a major role in strengthening rural cooperative credit institutions.

f.Reserve Bank of India +1

6. Multi-State Cooperative Societies Act, 2002

This Act governs cooperative societies operating across multiple states.

Main objectives:

- a. Democratic functioning
- b. Autonomous management
- c.Proper administration and governance
- d.The Act regulates incorporation, management, and winding up of multi-state cooperative societies.

4.2Challenges Faced by Cooperative Banks in India

1. Dual Control and Regulatory Conflicts

The dual regulatory structure creates overlapping authority between RBI and state governments. This weakens supervision and accountability.

Many experts believe that dual regulation is one of the biggest problems affecting cooperative banking institutions.

2. Political Interference

Political influence in management and loan distribution negatively affects cooperative banks. Elections and appointments are often influenced by political interests.

Political interference leads to:

- Corruption
- . Mismanagement
- . Irregular loan approvals
- . Weak governance

3. Financial Weakness and NPAs

Many cooperative banks suffer from low capital adequacy and rising non-performing assets (NPAs).

Reasons include:

- . Poor recovery mechanisms
- . Weak credit appraisal systems
- . Agricultural loan defaults
- . Financial mismanagement
- . Several district cooperative banks have faced financial crises due to heavy NPAs.

4. Corruption and Fraud

Cases of fraud and corruption have damaged public confidence in cooperative banks.

Examples include:

- . Loan frauds
- . Forged documentation
- . Misappropriation of funds
- . Illegal transactions
- . Recent fraud cases in cooperative banks have highlighted weaknesses in governance and supervision.

5. Poor Governance and Lack of Professional Management

Many cooperative banks are managed by individuals who lack banking expertise and professional skills.

Problems include:

- . Inefficient administration
- . Poor decision-making
- . Weak risk management
- . Inadequate staff training

6. Technological Backwardness

Many cooperative banks lag behind commercial banks in digital banking and technological infrastructure.

Challenges include:

- . Lack of modern banking systems
- . Weak cybersecurity
- . Limited digital services
- . Poor online banking facilities
- . Modernization has become essential for the survival of cooperative banks.

7. Limited Capital Resources

Cooperative banks face difficulty in raising fresh capital because of their cooperative structure and one member one vote principle.

This affects:

- . Expansion
 - . Financial stability
 - . Competitiveness
- #### Recent Reforms in Cooperative Banking
- . The Government and RBI have introduced several reforms to strengthen cooperative banks.

Important reforms include:

- . Banking Regulation (Amendment) Act, 2020
- . Stronger RBI supervision
- . Fraud management directions
- . Prompt Corrective Action (PCA) framework
- . Ombudsman scheme for cooperative banks

. These reforms aim to improve transparency, governance, accountability, and depositor protection.

. Press Information Bureau

5. Suggestions for Improvement

1. Removal of Dual Control

A uniform regulatory framework should be established for effective supervision.

2. Professional Management

Qualified banking professionals should be appointed in management positions.

3. Strengthening RBI Powers

RBI should have stronger supervisory and enforcement powers over cooperative banks.

4. Technological Modernization

Cooperative banks should adopt digital banking and cybersecurity measures.

5. Better Audit Systems

Regular auditing and transparent financial reporting should be ensured.

6. Reduction of Political Interference

Management and elections should be free from political influence.

6. Conclusion

Cooperative banking in India has played a crucial role in promoting rural development, agricultural finance, and financial inclusion. The legal framework governing cooperative banks includes constitutional provisions, cooperative laws, banking legislation, RBI regulations, and NABARD supervision. However, the system of dual control, weak governance, political interference, corruption, and financial instability continue to affect the efficiency of cooperative banks.

Recent reforms such as the Banking Regulation (Amendment) Act, 2020 and stronger RBI supervision have improved regulation and accountability. Nevertheless, further reforms are required to ensure professional management, transparency, technological modernization, and financial stability.

With proper legal reforms and stronger governance mechanisms, cooperative banks can continue to contribute significantly to India's economic growth, rural development, and social welfare.

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