Lakshmi Vilas Bank: A Stitch in time

The RBI has let the situation linger at Lakshmi Vilas Bank linger for too long. It cannot afford another accident in the financial sector after IL&FS, PMC and Yes Bank.

Last week marked the first anniversary of the Punjab and Maharashtra Cooperative Bank debacle. Even as stories of its depositors struggling to repay loans or depending on their friends for charity continued to hog headlines, a solution to the bank's insolvency remains elusive. Policy makers may take comfort in the passage of the Banking Regulation (Amendment) Bill 2020, which brings cooperative banks directly under the ambit of the Reserve Bank, but depositors are still waiting for their money.

PMC Bank's collapse last year was followed by the near-death experience of Yes Bank Ltd. The contagion-risk from the impending collapse of the lender adversely impacted

depositor confidence across other banks and prompted regulatory intervention. An RBI led bail-out was announced for Yes Bank, to stem the systemic fallout.

Even before PMC Bank and Yes Bank, there was the collapse of IL&FS in 2018.

Given the steady stream of bad news emanating from the financial sector, the RBI has gone out on a limb to reassure deposit holders. Importantly, it has promised swift and proactive action to eliminate systemic shocks.

It now needs to back this with decisive action and intervene before it is engulfed in another crisis – one which can be potentially brought on by Lakshmi Vilas Bank.

For those unfamiliar with the lender's situation, it has now been struggling with losses and low levels of capital for some time now. A search for a suitor for the bank to merge with, drags on.

A statement made by the auditors of Laxmi Vilas Bank as part of its June 30, 2020 results sums up the situation:

> *The Bank had incurred a loss of Rs 836.04 crore during the year ended 31st March 2020. The Bank has been incurring losses for the past 10 quarters and has incurred loss of Rs 12.28 crore for the period under review. The Reserve Bank of India has initiated Prompt Corrective Action in September 2019, which inter alia prescribes the Bank to bring in additional capital, restrict further lending to corporates, reduce NPAs and improve the Provision Coverage Ratio to 70%. There has been a steady decline in the Bank's deposit base since September 2019 and increase in the NPA ratios. The Bank's Tier 1 Capital ratio has turned negative, at (0.88)% and (1.83)% as at 31st March 2020 and 30th June 2020 respectively, as compared to the minimum requirement of 8.875%.*

Tier-1 capital ratio negative. Losses for last 10 quarters. Eroding deposit base. High NPAs. Low provision coverage. It rarely gets this ugly. Yet Lakshmi Vilas Bank powers on, backed only by the promise that it will shortly inject capital.

The bank, in the past, has been wooed by SREI Capital. It even (almost) walked down the aisle with India Bulls Housing Finance, till RBI objected. The most recent merger proposal has come from AION-backed Clix Capital and discussions with them continue.

With each new announcement, and rumour, depositors and investors hold on to hope.

But it is unclear that the bank (or the regulator) is doing all it needs to do to give a new investor confidence.

For instance, the forthcoming shareholder meeting would have been an ideal opportunity to address issues at the board level. A strong board would have enabled the bank to break from the past and give confidence to the buyers that they are free to address legacy issues. It would have attracted serious investors who, with ownership issues addressed, could have re-written the destiny of the bank. This chance has been muffed.

Instead, the bank is proposing to re-appoint some old hands back to its board, at its AGM on Sept. 25. These include:

- N Saiprasad, 56, as a non-executive non-independent director. He served on the board from March 1990 to 1998 and from March 2006 to 2014. He was brought back to the board in March 2019.
- Raghuraj Gujjar, 65, who is proposed to be re-appointed non-executive non-independent director, is a Chartered Accountant. He served as Non-Executive Chairperson from April 2013 to April 2015. Lakshmi Vilas Bank proposes to appoint him as non-executive non-independent director from Dec. 2, 2019.
- KR Pradeep, 59, is proposed to be appointed as a non-executive non-independent director. He was appointed on the board in January 2020. In the past he has served on the bank's board from February 2009 to 2017.
- B Manjunath has been an independent director on the board from August 2008 to January 2015. After a cooling off period, he was appointed as independent director and part-time chairperson of the bank from June 7, 2017, to June 5, 2020. He was appointed as additional director on June 10, 2020.

IiAS recommends voting AGAINST all four appointments.

While some may argue that it is the independent directors and two RBI nominees that will set the agenda, if the past is a guide, it is a tall ask.

Meanwhile, even as the depositors of PMC Bank are bounced door-to-door, Lakshmi Vilas Bank continues to raise fresh deposits. This is to say nothing of existing public depositors, who have entrusted the lender with more than Rs 15,000 crore – on a wing and a prayer.

Exhibit 1: Board of Lakshmi Vilas Bank

1	S.Sundar - Managing Director & CEO (From 01.01.2020) *
2	G.Sudhakara Gupta
3	**N.Saiprasad * #**
4	Gorinka Jaganmohan Rao (From 02.12.2019) *
5	**Raghuraj Gujjar (From 02.12.2019) * #**
6	Shakti Sinha (From 02.12.2019) *
7	Satish Kumar Kalra (From 02.12.2019) *
8	Meeta Makhan (From 23.01.2020) *
9	**K.R.Pradeep (From 23.01.2020) * #**
10	**B.K.Manjunath (From 10.06.2020) * #**
11	Y.N.Lakshminarayana Murthy (From 30.07.2020) *
12	Rajnish Kumar – RBI nominee, Additional Director
13	Sundaram Shankar – RBI nominee, Additional Director (From 18.11.2019)

*Additional directors, put up for shareholder approval on 25 September 2020
Have past association with the bank in the past

Everything that can possibly go wrong with a bank, has gone wrong with Lakshmi Vilas Bank. And while no one is calling the bank insolvent, this is what the bank truly is. RBI hopefully has a contingency plan ready, although it is not obvious what it will take for the regulator to set it in motion.

RBI needs to be 'proactive'. It cannot afford to view Lakshmi Vilas Bank merely as a small bank based on the size of its deposits. It needs to prepare for the systemic shock that the collapse of this lender can cause among the old generation private sector banks – most of whom need of capital.

With the Covid-19 pandemic, RBI has more than enough on its hands. It does not need a potential accident with Lakshmi Vilas Bank to distract it. If it is reading the writing on the wall, it should not be in reactive mode, but on the front-foot setting the agenda.

Bloomberg Quint

This modified version of this blog appeared in Bloomberg Quint on 22 September 2020. You can access it by clicking on this link or typing the following on your url: https://www.bloombergquint.com/opinion/lakshmi-vilas-bank-a-stitch-in-time

Disclaimer

This document has been prepared by Institutional Investor Advisory Services India Limited (IiAS). The information contained herein is solely from publicly available data, but we do not represent that it is accurate or complete and it should not be relied on as such. IiAS shall not be in any way responsible for any loss or damage that may arise to any person from any inadvertent error in the information contained in this report. This document is provided for assistance only and is not intended to be and must not be taken as the basis for any voting or investment decision. The user assumes the entire risk of any use made of this information. Each recipient of this document should make such investigation as it deems necessary to arrive at an independent evaluation of the individual resolutions referred to in this document (including the merits and risks involved). The discussions or views expressed may not be suitable for all investors. The information given in this document is as of the date of this report and there can be no assurance that future results or events will be consistent with this information. This information is subject to change without any prior notice. IiAS reserves the right to make modifications and alterations to this statement as may be required from time to time. However, IiAS is under no obligation to update or keep the information current. Nevertheless, IiAS is committed to providing independent and transparent recommendation to its client and would be happy to provide any information in response to specific client queries. Neither IiAS nor any of its affiliates, group companies, directors, employees, agents or representatives shall be liable for any damages whether direct, indirect, special or consequential including lost revenue or lost profits that may arise from or in connection with the use of the information. The disclosures of interest statements incorporated in this document are provided solely to enhance the transparency and should not be treated as endorsement of the views expressed in the report.

Confidentiality

This information is strictly confidential and is being furnished to you solely for your information. This information should not be reproduced or redistributed or passed on directly or indirectly in any form to any other person or published, copied, in whole or in part, for any purpose. This report is not directed or intended for distribution to, or use by, any person or entity who is a citizen or resident of or located in any locality, state, country or other jurisdiction, where such distribution, publication, availability or use would be contrary to law, regulation or which would subject IiAS to any registration or licensing requirements within such jurisdiction. The distribution of this document in certain jurisdictions may be restricted by law, and persons in whose possession this document comes, should inform themselves about and observe, any such restrictions. The information provided in these reports remains, unless otherwise stated, the copyright of IiAS. All layout, design, original artwork, concepts and other Intellectual Properties, remains the property and copyright of IiAS and may not be used in any form or for any purpose whatsoever by any party without the express written permission of the copyright holders.

Other Disclosures

IiAS is a SEBI registered research entity (proxy advisor registration number: INH000000024) dedicated to providing participants in the Indian market with independent opinions, research and data on corporate governance issues as well as voting recommendations on shareholder resolutions of about 750 listed Indian companies (https://www.iiasadvisory.com/iias-coverage-list). Our products and services include voting advisory reports, standardized services under the Indian Corporate Governance Scorecard, and databases (www.iiasadrian.com and www.iiascompayre.com). There are no significant or material orders passed against the company by any of the Regulators or Courts/Tribunals.

This article is a commentary on general trends and developments in the securities market.

About IiAS

Institutional Investor Advisory Services India Limited (IiAS) is an advisory firm, dedicated to providing participants in the Indian market with independent opinions, research and data on corporate governance issues as well as voting recommendations on shareholder resolutions for about 800 companies that account for over 95% of market capitalization.

IiAS provides bespoke research, valuation advisory services and assists institutions in their engagement with company managements and their boards.

IiAS has equity participation by Aditya Birla Sunlife AMC, Axis Bank, Fitch Group Inc., HDFC, ICICI Prudential Life Insurance, Kotak Mahindra Bank, RBL Bank Limited, Tata Investment Corporation, UTI Asset Management Company Limited and Yes Bank.

IiAS is a SEBI registered research entity (proxy advisor registration number: INH000000024).