Moratorium on Lakshmi Vilas Bank

Why in news?

Reserve Bank of Indiaimposed a 30-day moratorium(temporary suspension of activities) on Lakshmi Vilas Bank Ltd (LVB)&proposed a draft scheme for its amalgamation with DBS Bank India.

Why was LVB put under moratorium and amalgamated with DBS Bank?

- The financial positionwas declining steadily , with continuous losses over the last three years eroding the bank's net-worth.
- Its gross non-performing assets (NPAs) stood 25.4% of its advances as of June 2020, as against 17.3% a year ago.
- It was also experiencing continuous withdrawal of deposits and low levels of liquidity.
- There wasserious governance issues whichhas led to deterioration in its performance.
- The bank management had indicated to the RBI that it was in talks with certain investors, but failed to submit any concrete proposal.
- So it was merged with DBS Bank.
- Also, the RBI has put a cap of Rs 25,000 on withdrawals & assureddepositors of the bank that their interest will be protected.

Are Depositers safe?

- Deposit Insurance and Credit Guarantee Corporation (DICGC) gives insurance cover on up to Rs 5 lakh deposits in banks.
- Merger Proposal will make the bank's CRAR at 12.51% and Common Equity Tier-1 capital at 9.61%.
- The RBI and the government have often assured that the financial system is safe and sound, but a series of failures might affect the confidence of depositors.

What happens to investors?

- The stock price in Yes Bank reduced below Rs 10 per share from a peak of Rs 400 per share.
- Nearly Rs 9,000 crore worth of Additional Tier-1 bonds (AT-1) were fully

written off.

- In LVB, equity capital is being fully written off &existing shareholders face a total loss on their investments.

What are the issues faced by old-generation private banks?

- Most of the banks do not have strong **promoters** leading to mergers or forced amalgamation.
- South Indian Bank and Federal Bank have been operating as board-driven banks without a promoter.
- In KarurVysya Bank, the promoter stake is 2.11%, and in Karnataka Bank, there's no promoter.
- LVB , Yes Bank &Punjab & Maharashtra Co-operative Bank follow the similar issues.

Why Promoters are important?

- Promoters help in raising money for the banks pledging of promoter's shares when they want to expand their operation.
- They exercise their control by taking key decisions of the banks.
- They also provide stability to a bank when other banks are trying to acquire it forcefully.
- Large number of promoters is a reliable predictor of future profitability of banks.
- However, absolute authority can also make the promoter group autocratic.
- According to the RBI's rules, promoters need to reduce their holding to 40% within 3 years of getting a banking license, and then to 20% in 10 years and to 15% within 15 years.

How has the pandemic affected the banking system?

- NPAs in the banking sector are expected to increase as the pandemic affects cash flows of people.
- Companies in sectors such as retail trade, wholesale trade, roads and textiles are facing stress, while NBFCs, power, steel, real estate and construction were already under stress when the pandemic began.
- The Expert committee headed by **K V Kamath** recommended a one-time loan restructuring window for corporate borrowers under stress due to the pandemic.

Source: The Indian Express