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LIC has lost Rs 17,000 crore in PSBs in a year; mergers could worsen erosion

Radhika Merwin | September 04, 2019 BUSINESSLINE

Centre's big bank merger move would only hurt the insurer more in the coming months

BL Research Bureau

LIC, that has seen its investment in IDBI Bank (classified as a private bank now) erode by more than half over the past year or so, has also seen the value of its investments in other PSU banks plunge. The sharp fall in the price of PSU bank stocks and dilution of its stake owing to capital infusion by the government, has eroded its wealth in these banks. LIC has lost over Rs 17,000 crore of its wealth in PSBs over the past year. Excluding IDBI Bank, it has lost over Rs. 4,800 crore in other PSBs.

The Centre's big bank merger move would only hurt the insurer more in the coming months. A sharp 20-30 per cent dilution in the book value of the merged entities — PNB, Canara Bank, Union Bank and Indian Bank — over the next year or so, will lead to LIC's value of holdings in PSU Banks erode further.

Infusion at abysmal valuations

The government infusing capital year after year into public sector banks, has eroded value for investors. This is because most PSU banks trade at a steep discount to their book value, and hence the government infusing capital at such low valuations, immediately leads to dilution in equity base.

In FY19, the Centre infused Rs. 1.06 lakh crore into banks, most of which were trading at 0.4-0.6 times their book value. The dilution in book value owing to the government's capital infusion has hurt minority shareholders including LIC.

For instance, in case of Corporation Bank, the government infused Rs. 11,641 crore in FY19. For this, it was allotted shares in the bank in two tranches — 86.9 crore shares at Rs. 29.4 each in October 2018 and 340 crore shares at Rs. 26.68 in March 2019. The book value of the bank in the December 2018 quarter stood at Rs. 54.9 (as per the bank's presentation) — double that of the price at which shares were issued.

LIC that was holding 13 per cent stake in Corporation Bank as of June-Sept 2018 (before the infusion) saw its stake in the bank fall to just 3.6 per cent by end of FY19. The huge dilution in its stake alongside a sharp fall in stock price during this period, led to substantial fall in its value of holdings.

Again, in the case of Oriental Bank of Commerce, LIC's stake has fallen from 7.4 per cent last June to 3.4 per cent currently. The government had infused about ☐6,600 crore into the bank in FY19.

Over the past year, price of many PSU bank stocks have plummeted 20-40 per cent. Dilution owing to government's capital infusion has further eroded LIC' wealth in these banks.

In the recently announced PSU bank mergers, LIC could again lose wealth in these banks. This is because, there could be a sharp 20-30 per cent dilution in the book value of the resultant merged entity. LIC is among the minority shareholders that holds stakes in these PSU Banks — in PNB for instance, LIC owns 7.3 per cent stake, while in Union Bank, it holds 6.4 per cent stake.

Post merger, LIC's stake in these banks could come down significantly to 3-5 per cent.

IDBI Bank debacle

LIC had stepped in to bail-out IDBI Bank last fiscal, infusing a massive amount of Rs. 21,624 crore and acquiring 51 per cent stake in the bank. With the current price of IDBI Bank less than half the price at which LIC was allotted shares in the bank (Rs. 60-61), the insurer has already lost over half of the value of its investments.

Owing to rise in slippages and huge provisioning, IDBI Bank's Tier-1 capital ratios fell sharply in the June 2019 quarter, failing to meet the RBI's regulatory requirement.

LIC has stepped in once again to bail out the ailing bank by committing to infuse Rs. 4,743 crore. Another Rs. 4,557 crore would be pumped in by the government, which holds about 46.5 per cent in IDBI Bank currently.

The Rs. 9,300 crore capital infusion into IDBI Bank, which trades at a sharp (0.5 times) discount to its book value, would lead to about 10 per cent dilution in the book value, hurting LIC.

If IDBI Bank continues to underperform and requires further capital infusion in the coming months, the pain would only accentuate for the largest life insurer.

Why LIC-owned IDBI Bank's troubles are far from over

Radhika Merwin | BUSINESSLINE

Persisting bad loan issues and weak capital ratio in the June quarter, have weighed on the stock

BL Research Bureau

Bailing out IDBI Bank has cost Life Insurance Corporation (LIC) very dear. The massive Rs 21,624 crore of capital that LIC infused into the ailing bank last fiscal, has been sucked into the bank's losses.

What's more, the bank's bad loan troubles don't appear to be easing any time soon. In the latest June quarter the bank's CET 1 (Common Equity

Tier-1) ratio and Tier-I ratio has slipped to a precarious 5.9 per cent (as against regulatory requirement of 7.375 per cent) and 6.1 per cent (8.875 per cent) respectively.

The bank will soon have to come knocking on LIC's door to infuse more capital.

LIC, which acquired a controlling 51 per cent stake in IDBI Bank, has already seen its investment erode by more than half — the insurer had been allotted shares in the bank at a price of 60-61 per share; the stock price has plunged to ☐27 since then.

The latest June quarter numbers suggest that the worst is not over for IDBI Bank, with bad loan provisioning continuing to eat into its capital. The stock has fallen by 9 per cent today

The question is: how long can LIC, the knight in shining armour, come to the rescue of the ailing bank?

Not a pretty picture

IDBI Bank, which has been reporting losses for the past four fiscal years, reported another loss in this quarter. The bank's bad loans have grown by more than four times over the past five years, leading to huge losses. Bad loan provisioning in the June quarter remained elevated at Rs 7009 crore, leading to a loss of Rs 3801 crore for the quarter. The bad loans for the bank is a huge Rs 51,658 crore (against market cap of just Rs 19,000 crore!), forming 29 per cent of the bank's loans (up from 27 per cent in March quarter).

In the June quarter, fresh slippages shot up to Rs 3,486 crore from Rs 1,781 crore in the March quarter.

The bank's SMA book (special mention accounts where payments are overdue by 1-90 days) has risen too. From Rs 7,343 crore in the March quarter, the SMA book has gone upto Rs 10,272 crore, implying persisting stress in the bank's books, which can continue to keep slippages and bad loan provisioning elevated in the coming quarters.

This essentially implies that there is more stress on the bank's capital, and hence there is a need for more capital infusion in the current fiscal.

The bank's capital ratio has weakened in the June quarter, despite the fall in its risk-weighted assets (RWAs). The RBI assigns different 'risk weights' to different types of loans based on the risk — higher the risk of defaults, higher the risk-weight. Capital ratios for banks are determined with RWA as denominator and hence a decrease in RWAs should ease up capital.

But for IDBI Bank, despite its risk-weighted assets falling by 7 per cent in the June quarter (from March quarter), capital ratios have slipped, owing to losses.

This is a cause for concern, as it indicates that the bank is unable to check its bad loans, despite bringing down its risky exposures. As such, the bank's weak core performance is worrisome. IDBI Bank's loans shrunk by 6 per cent in the June quarter, with its corporate book declining by 14 per cent, while retail loans growing by a meagre 4 per cent. The bank's net interest income fell by 11 per cent.

PCA status

The RBI had initiated Prompt Corrective Action (PCA) on banks in 2017, owing to its high net NPAs and negative return on assets (ROA). The PCA framework deems banks as risky if they slip below certain norms on three parameters — capital ratios, asset quality, leverage and profitability. It has three risk threshold levels (1 being the lowest and 3 the highest) based on where a bank stands on these ratios.

As of June quarter, IDBI Bank continues to fall within the three risk threshold levels across various parameters. Continued restrictions on credit and other activities, is likely to keep the bank's core earnings under pressure. If slippages continue to rise, losses could persist and eat into the bank's capital.

Non-core investments

The bank has been offloading some of its own non-core investments, to fund its losses. In FY18, the bank had sold its entire 30 per cent stake in

NSDL e-governance Infrastructure (NEGIL). The bank had also sold some of its stake in NSDL (National Securities Depository Ltd). It holds 26 per cent stake in NSDL as of March 2019.

IDBI Bank has other non-core investments as well — IDBI Federal Life Insurance (48 per cent) and IDBI AMC (66.7 per cent) — among the key ones.

After 3 per cent fall in premium (first-year preimum) in FY19, IDBI Federal Life Insurance reported a decline of 15 per cent in premium in the June quarter, according to data put out by IRDAI. Its share amongst private players is under 1 per cent. IDBI AMC also ranks low among the fund houses in terms of assets under management (AUM). Weak market share may weigh on the valuation of these businesses.

Hence while offloading some of its non-core investments can help, IDBI Bank will still have to largely rely on LIC to for its capital needs.

Press Release from Communist Party of India

Government's Decision to Merge Banks - Retrograde and Unwarranted

The National Secretariat of the Communist Party of India issued the following statement on August 31, 2019:

Finance Minister has announced that 10 major public sector banks will be merged into 4 Banks to make them big banks so that these big banks will help the Indian economy.

This decision is totally unwarranted and announced at an inappropriate time. When the country's economy is in shambles, Banks have a very important role to play in boosting the economy. This is the top priority today. Accordingly, Government announced various measures in their attempt to revive the economy from the slide down. But unfortunately, the whole attention is now being diverted from revival of the economy to merger of Banks. This is a deliberate attempt to shift from real issues facing the economy.

Secondly, Bank themselves are facing a major challenge to recover the huge bad loans. Corporates are deliberately cheating the banks. Due to this, the Banks are made to show losses though all the public sector banks are earning gross profit. Hence taking tough measures to recover bad loans is the main job before the Banks and the Government. But the proposed move to merge Banks will shift the attention of the banks to issues connected with merger and bad loan recovery will take the back seat.

Thirdly, in the previous merger of Banks with SBI, we have seen that 7000 branches were closed down. Same will happen now also. When Government talks of Jan Dhan Yojana to take banking to every India, closure of branches due to mergers will take banking services away from common people. Hence this is a retrograde move.

Government claims that merger will make our Banks big. India does not need big banks. Globally big banks were found to be very risky as it happened in USA. We need our public sector banks to effectively serve the people and we do not need such big banks which will only help the big corporates.

Hence merge of banks is unwarranted and is not in our country's interest. Government should reconsider its decision. The CPI extends its support to the agitation of the Bank employees and their unions.

FinMin allows PSBs to create Chief General Manager posts

K R Srivats New Delhi | September 04, 2019

For the posts of CGM, the qualifying PSB have been allowed to consider GMs with minimum two years experience.

New flexibility to be available for public sector banks with total business of over Rs 10 lakh crore

Public sector banks (PSBs) can now create Chief General Manager (CGM) posts as per their business needs. The Department of Financial Services (DFS) in the Finance Ministry granted the flexibility to all nationalised banks.

Banking industry experts see this development as part of PSB Governance reforms undertaken by the Government and empowerment of Bank Boards.

CGM posts (in a fresh scale termed as scale VIII) can be created (with Board approval) in nationalised banks that have total business of Rs 10 lakh crore or higher, sources said. Such CGMs will act as an administrative and functional layer between the existing levels of General Manager and Executive Director.

The number of CGM posts created should not exceed the ratio of 1:4 between the total number of posts of CGM and GM. For the posts of CGM, the qualifying PSB have been allowed to consider GMs with minimum two years experience. However, this norm could be relaxed up to 50 per cent with the approval of bank's Board, sources added.

The eligible candidates should have at least two years residual service, the Finance Ministry has said.

Wave of bank mergers may sink fresh hiring

G Naga Sridhar Hyderabad September 04, 2019 businessline

The PSU bank merger is expected to impact the recruitment of clerks, in particular.

'Dip in recruitment, a natural offshoot of rationalisation'

Even as Finance Minister Nirmala Sitharaman assured the unions last week that the mega merger of 10 public sector banks into four entities will not lead to job losses, it looks likely that the sector will see a tapering of fresh hiring.

The Centre had announced last week that Punjab National Bank, Canara Bank, the Union Bank of India, Indian Bank, the United Bank of India, Allahabad Bank, Syndicate Bank, Corporation Bank, the Oriental Bank of Commerce and Andhra Bank would be merged to create four big lenders

— Punjab National Bank (PNB), Canara Bank, the Union Bank of India and Indian Bank.

Per IBPS (Institute of Banking Personnel Selection) data, these banks have been major recruiters over the years, which will change now.

“Reduction in fresh recruitment will be a natural consequence of any merger as rationalisation of branches and staff will have to be worked out to optimise resources,’’ a senior PNB official told ***Business Line*** on the condition of anonymity.

Fewer openings

According to CS Vepa, former director of the National School of Banking and the present Director of Vepa Academy, recruitment notifications expected to come up this year may feature fewer openings.

“Already, over the years, there has been a steady decline in recruitment conducted by the IBPS for its member-banks. The number of clerical vacancies has come down progressively to 7,275 last year from 19,243 in 2016, while (the number of) probationary officer posts dropped to 4,336 this year from 16,722 in 2016 per IBPS data,’’ he said.

The hiring of clerks is more likely to be impacted as so far no notification has come up.

When asked about human resource management at SBI when its associate banks were merged with it in 2017, a top executive said: “There was rationalisation of branches and optimisation of staff across the country.’’

The SBI example

The staff of SBI before and after the merger also confirm a likely dip in hiring.

In FY17 (before the merger), 13,097 had joined SBI against the retirement of 11,264. But in FY18, the fresh addition was only 3,211 even as 18,973 retired. As of March 2019, the total number of employees decreased to 2,57,252 from 2,64,041 the previous year.

The bank had also said earlier that achieving optimal manpower by leveraging data and technology would be its focus.

As a majority of applicants for bank jobs in the country are engineering graduates, this is likely to the impact the overall job market scenario.

“**The Finance Minister says there will no job loss due to the merger. But the real issue for us is the creation of new jobs, which will be hit**,'' said Challa Gangadhar, an engineer who is preparing for the bank exams.

Jump in bank frauds: Risk control systems need urgent strengthening

September 04, 2019, EDITORIAL, BUSINESSLINE

Rather than attempt piecemeal fixes to individual cases, the RBI must undertake system-level interventions to improve risk management at PSBs

More than a year after Punjab National Bank admitted to the mega-fraud perpetrated by diamantaire Nirav Modi, the furore over corporate borrowers gaming gaps in Indian banks' lending systems appears to have died down. But data on bank frauds disclosed in the RBI's latest annual report reveal that the Nirav Modi affair was not an isolated instance of a rogue borrower making away with bank funds using Letters of Undertaking.

In FY19, domestic banks reported frauds valued at Rs 71,543 crore, a **74 per cent jump** over the FY18 number of Rs 41,147 crore.

Public sector banks (PSBs) were the main victims, accounting for over 90 per cent of these frauds by value. Frauds relating to advances dominated in FY19 as against those involving off-balance sheet items in FY18. Given the inordinately long time that banks take to detect and report frauds, the spike in the FY19 numbers does not reflect recent developments.

But large-value frauds cropping up across different business verticals raise concerns that the RBI's regulatory fixes after the PNB scam do not address the root causes of bank fraud, which lie in governance and risk control lapses at PSBs. Details from past frauds hint at **three problem areas** with banks' lending practices that fraudsters have exploited.

One, lending decisions by bank employees at all levels — from the branch-level executive to the sanctioning authority in top management — ignoring obvious flaws in collateral or project contours suggest that many frauds are perpetrated with the active collusion of bank employees.

Yet, it is the **lower- or middle-level employees who often face the heat** for fraud, while **bank boards and lending committees face little scrutiny** for lax oversight. The fleeting tenures and poor compensation structures of top managers at PSBs actively abets negligence. This can only be fixed through pay structures that directly link their compensation to bank asset quality.

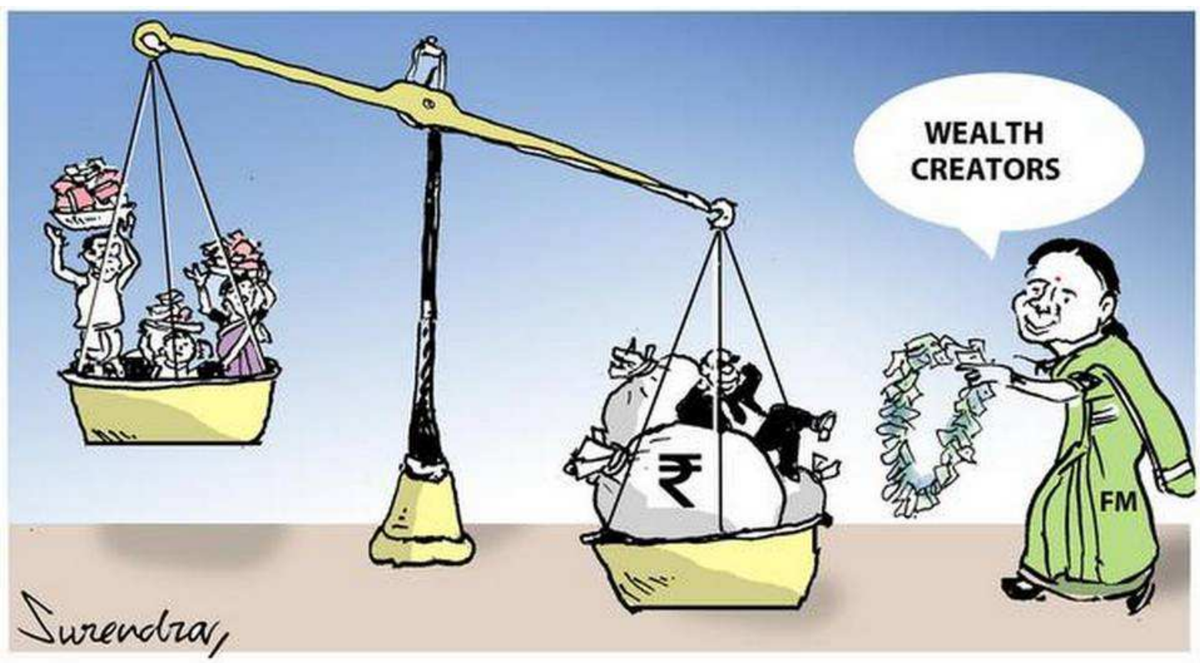
Two, long delays between the **occurrence of a fraud and its detection** (the average time taken by banks to report large frauds was 55 months) point to yawning gaps in banks' post-disbursement monitoring of funds. Here, whistle-blower protection laws may help bank insiders red-flag frauds at an early stage.

Three, the **window-dressing and misappropriation** that accompany large loan frauds cannot be perpetrated without the co-operation of statutory auditors or valuers who vet projects. It is therefore critical that they are brought to book when bank frauds surface.

Overall, rather than attempt piecemeal fixes to individual cases of fraud, the RBI needs to undertake system-level interventions to improve risk management at PSBs.

The PSBs also need to step up technology-related investments to effectively monitor end-use of their loans. Information sharing through a common credit registry, as mooted by the RBI, can help.

The Centre, if it is keen to ward off future bad loan build-ups at PSBs, needs to empower the RBI to effectively supervise PSBs and to allow an independent entity like the Bank Boards Bureau to fill key management positions.



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