

POLITICS OF ETHICS- POOR CORPORATE GOVERNANCE AT PMC BANK

Dr. Lakshmi Mohan

Professor & Director, Institute for Technology and Management, Navi Mumbai, Maharashtra, India

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INTRODUCTION

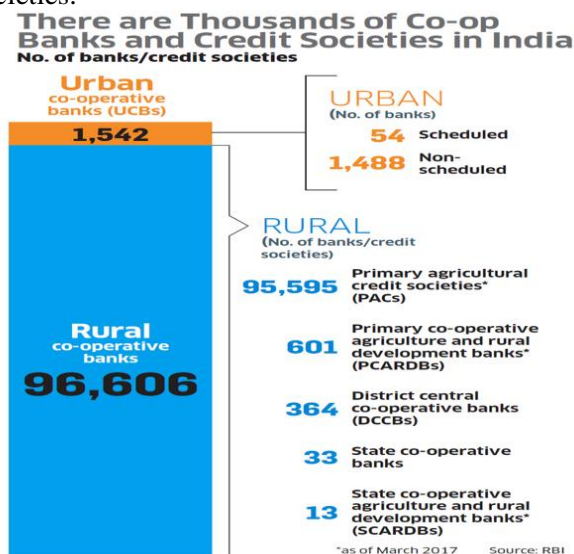
A bank of repute ran to shame! Banker -politician nexus, lack of corporate governance and slack watchdogs brought the doom of Punjab and Maharashtra Co-operative Bank (PMC Bank). Rs.11,617 crores as on 31st March 2019 in deposits was no joke, which only showed the trust public had on the bank. Unfortunately, it could be termed a multi crore loot where the bank lent Rs.6200 crores as loans to just one client, a real estate firm named Housing Development and Infrastructure Limited (HDIL), which ironically was already facing bankruptcy proceedings.[¹]

While investigations were on, the Reserve Bank of India (RBI) laid operational restrictions. Depositors were left uneasy and in despair with restrictions on withdrawing their own hard-earned money as RBI imposed that only Rs 10,000 could be drawn by any customer for a period of six months.[²] Later , on 13th October 2019, ET came with the news that the withdrawal cap was raised to Rs 25000. [³] The PMC Bank authorities and HDIL promoters were booked for the gross crime but that did not assure safety of the depositors’ money. Lending 6200 crore to HDIL was a shocking 70 percent of the bank’s loan book.[⁴] Lending ethics and defaulted recovery in cases like Loha Ispat, Winsome Diamonds, Spanco, Kingfisher etc. branded a few Indian banks as “sitting ducks”. The PMC Bank was barred from granting and renewing loans and advances, making any investments and accepting fresh deposits.[²]

BACKGROUND

History of Cooperative Banks

The cooperative banks in India originated in the late 19th century as an alternative to the treacherous money lenders. These banks started operating with passing of Cooperative Society’s Act in 1904 and by 2019 accounted for around 9% of loans and advances in India. They catered predominantly to first time borrowers and formed important part of the eco system. While they countered risk by charging higher rates of interest to loans, the interest rate on deposits were made attractive. Cooperative Banks have dual regulators, the state government and the RBI. Further Central Bank supervises along with monitoring by Registrar of Co-operative Societies.



Source: [16], RBI

PMC Bank’s Legacy: PMC Bank was considered a matured 36-year old cooperative bank regulated by RBI. The bank was registered under the Cooperative Societies Act. In the year 2000, though being the youngest bank, it was conferred with **Scheduled Status** by the Reserve Bank of India.

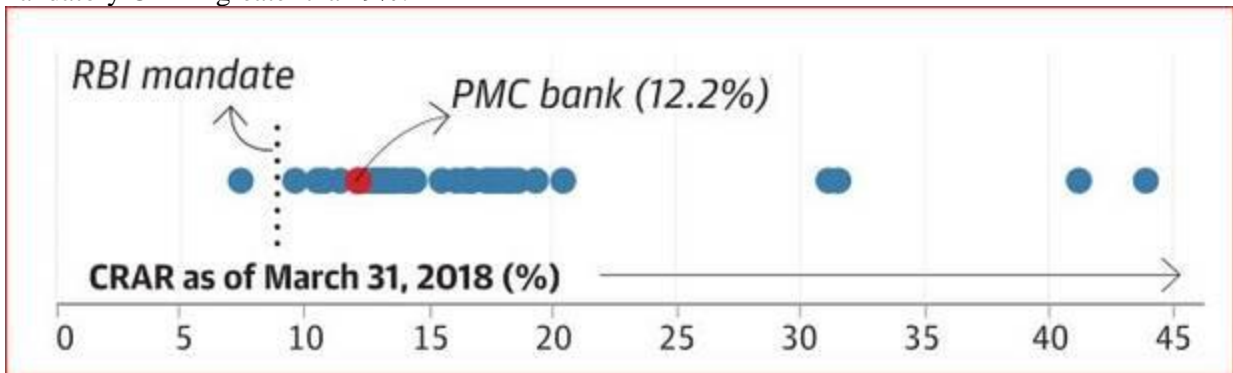
Further the Bank was conferred multi state status from 2004 by the Central Registrar , thus paving way for it to enter the national platform. The bank boasted of 137 branches spread across seven states with about 100 of them in Maharashtra and the rest in Delhi, Karnataka ,Goa, Gujarat ,Andhra Pradesh and Madhya Pradesh. The Bank stood among top 10 co-operative banks of the country. The Bank was accoladed with several laurels for work ethics, great service to depositors, for lowest dispute ratio and as the best urban cooperative bank. The Bank took pride in employing 70 percent women employees and for various incentives provided towards upliftment of women. The largest urban co-operative bank came under RBI radar from 2001, ever since the Ketan Parekh’s stock market scam linked to the Madhavpura Mercantile Co-operative Bank debacle came to light. [5&6]

Financial Health, no alarming indicators of downfall till 31st March 2018

For about a year till the scam came out in the open in 2019, it was known that PMC bank was focusing on converting its poor performing branches profitable.

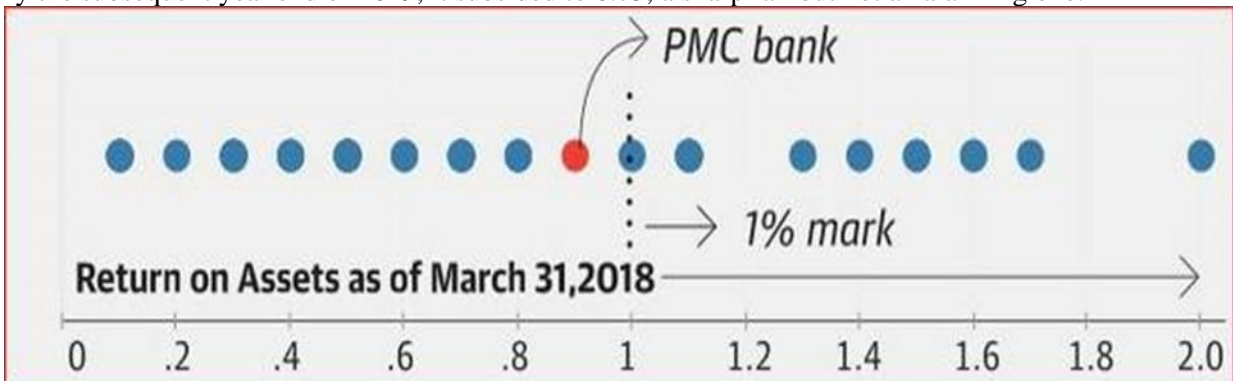
PMC Bank’s vital statistics failed to highlight the gravity of the situation until RBI imposed restrictions. Sharp observation of bad loans coupled with the shift from priority sector lending to a few borrowers from non-priority could have been taken as signals before the doom.

For any organization the capital position is a base indicator of its financial health, the capital -to-risk weighted assed ratio (CRAR) is a measure of the banks’ exposure to bad loans. Banks need to maintain mandatory CRAR greater than 9%.

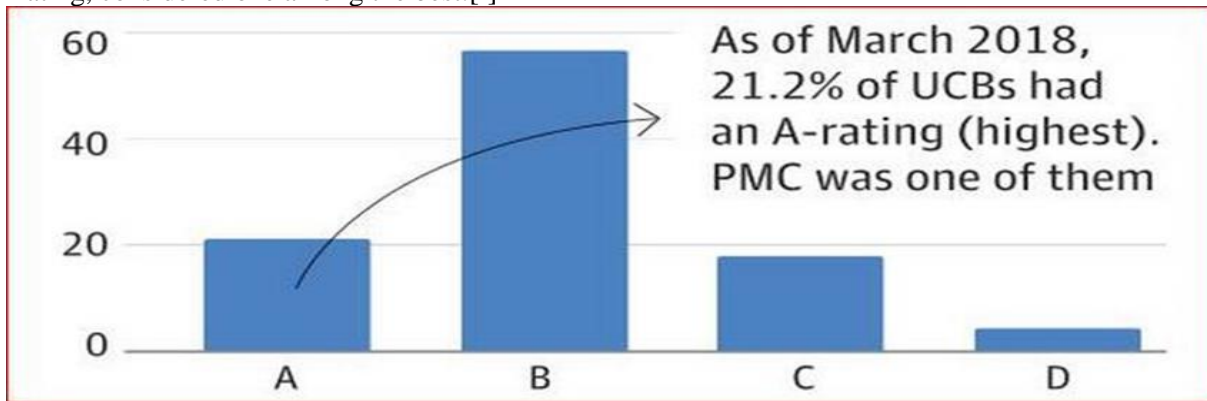


Profitability is measured based on Return on Assets i.e.: Net income by Total Assets. ROA of greater or equal to 1% is considered acceptable. It was found that PMC Bank had a ROA of 0.89% as on 31st March 2018 which seemed adequate.[7]

By the subsequent year end of 2019, it subsided to 0.75, a sharp fall but not an alarming one.

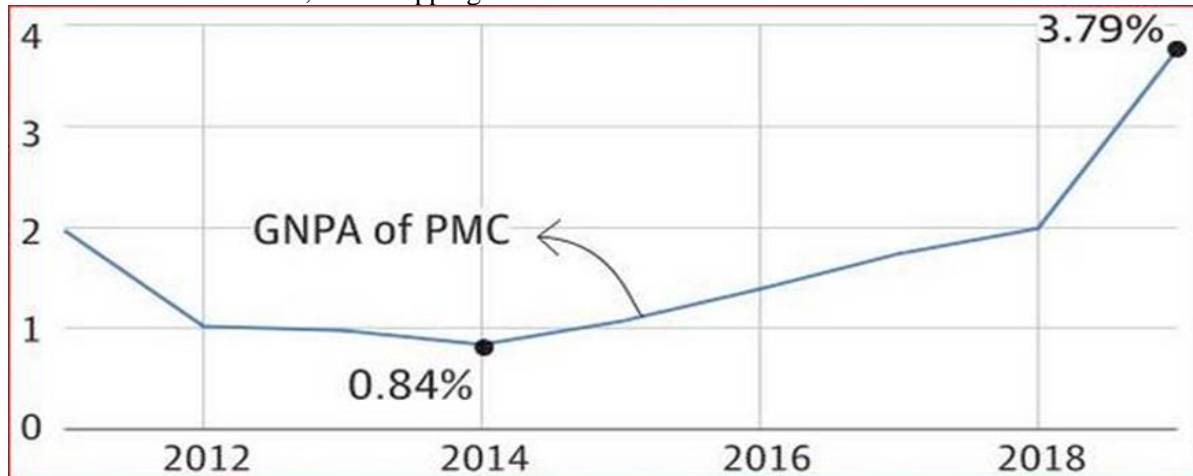


Another measure of financial robustness is calculated by Central Bank using a rating system which considers CRAR, net NPAs to total advances, ROAs, cost to income and liquid assets. PMC Bank had an A rating, considered one among the best.[7]

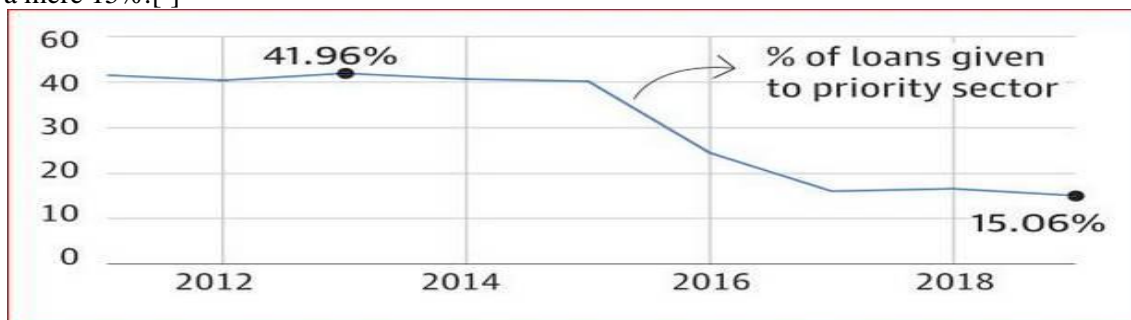


Deterioration of Financial Health by 31st March 2019

Non-Performing Assets are bad loans that banks may have to write-off and the Gross NPA rose to a sudden 3.79 % for the bank, thus dropping its ROA in 2019.



The lending portfolio had majorly the priority sectors like agriculture, education, housing and MSME, up to an extent of 40% till 2015. But later the scenario shifted from priority sector lending which by 2019 was a mere 15%.[7]



Breach of Trust- PMC Scam, out of the closet

- PMC Bank was a favorite for small savings and deposits, for its reputation specially in Mumbai where it had the largest chain of branches. On 23rd September 2019, RBI, based on whistle blower’s complaint, restricted the withdrawals of deposits when the regulator noticed huge withdrawals during the week. [8] The whistleblower’s complaint gave details of the deliberate underreporting of bad

loans by PMC bank, and its dealings with the dying HDIL prompting RBI to appoint an administrator for the next six months. There was massive withdrawal of funds which added to RBI's suspicion as withdrawals were crossing the prescribed threshold. RBI increased the withdrawal restriction to Rs.25000 from Rs 1000 and announced that 70 % of the account holders would be able to withdraw all their money.[⁹] It was unfortunate that PMC Bank misused money of the depositors to fund the affluent demands of HDIL's promoters Rakesh and Sarang Wadhwan, the father-son-duo. What was shocking was that the bank gave two thirds of its loan to HDIL whose creditworthiness was already at stake.

- PMCB's account holders assembled outside RBI office demanding assurance that their deposits were safe. They also demanded the revival of the bank for safety of their deposits. They created a five-member delegation of depositors to put before RBI Governor, their grievances for redressal.
- There was a concern for some banks over the letters of credit issued by PMC Bank, which they appealed to RBI for necessary action.
- About six senior officers of the bank, whopping 21,049 dummy accounts and a decade of misreporting led to the huge swindling, largest scam in the history of cooperative banks. [¹⁰]

Evaluation of PMC Bank fiasco:

- The controversy had many players, senior bank management, property developers and politicians, all whose credentials were at stake.
- Since 19th September 2019, it came to limelight that frenetic withdrawals were occurring, as high as 29% of the deposits. Joy Thomas, the MD of PMC Bank confessed to RBI that HDIL had borrowed to the tune of INR 6500 crore, 73% of its entire assets and four times the imposed regulatory cap.
- The Board of Directors in the bank were appointed through an election by the members, as in the case of co-operative banks, though it was forged and run unprofessionally.
- Though the financials of PMC Bank did not reveal financial lapses, there were serious under currents of scam. The annual report audited by Lakdawala and Co. showed in March 2019, profits to the tune of INR 99.69 Crores and 2.19% of nonperforming loans [¹¹] Unfortunately, neither the auditor nor regulators were aware of the fact that Wadhawan Group's exposure grew huge from INR 500 crore in 2006-07 to INR 6500 crore in 2019. Joy Thomas reasoned it by saying that the statutory auditors were only checking the incremental advances, ignoring the entire operations of all accounts as shown by the banker. RBI could not spot the misappropriation as dummy accounts matched the outstanding balances in the balance sheet.
- Further investigations revealed another borrower, The Abchal Group whose identity was password-protected. It was unfortunate that several ghost accounts burdened the bank with further INR 300 crore liability.[¹²]
- PMC during its initial phase of operations was on the verge of a collapse in 1986 on erosion of its net worth. The promoter of Wadhawan came to rescue by pumping INR 13 Lakhs and supported on another occasion by depositing INR 100 crore when the bank faced liquidity crunch. Joy Thomas said that 60% of the transactions were with HDIL and in those days the bank earned good profits. Wadhawan group started facing downslide ever since their slum rehabilitation project near Mumbai airport failed in 2012-13. According to Thomas's statement, the board was unaware of the scam, though it sounded unbelievable.[¹³]
- Around first week of October 2019, Joy Thomas MD of PMC Bank, Bank's former Chairman Waryam Singh and the Wadhawan brothers were arrested by the Economic Offences Wing (EOW) of Mumbai Police.

CONCLUSION

PMC Bank followed the ranks of failed co-operative banks due to mis governance. One still is left to wonder if that would be a lesson to change towards greater accountability. Dual supervision and other statutory provisions were blamed for the lapse in appropriate checks and balances. Waryam Singh was a

board member of HDIL while serving his term as Chairman with PMC Bank, a sheer misuse of corporate governance. The nexus of politicians, property owners and bankers formed a conspiracy that paralyzed the cooperative bank. It was unfortunate that 1.6 million depositors were left in the lurch. Will they get their hard-earned money back, only time would tell? Some banks will take a hit due to the letters of credit issued by PMCB. Whistle blowers were the saviors in revealing such scams, but ensuring their protection was very important. Sad state of affairs was that the crisis showed how watchdogs like bank auditors, the government and the RBI were not just napping but were unconscious! Twenty -one thousand and twenty -nine dummy accounts to keep non-performing assets hidden was no joke. It is sad to note that the Indian financial arena was akin to scams wherein private banks, public sector banks and cooperative banks were caught on the wrong foot. In comparison to year 2009, frauds detected increased about 45% by 2019. The financial embezzlement accounted to INR 71500 crores spanning across 6800 cases of fraud.[14]. The case leaves one with several questions like addressing depositors' woes, regulator's role in keeping check to avoid scams, role of banks in safeguarding people's money and ethical business, vital to society. It is intriguing to know why institutions like PMC were called banks but were left out of the regulations of mainstream banking.

PLEASE NOTE

This case study was compiled from published sources, and is intended to be used as a basis for class discussions. The matter gathered is not from primary source.

SOURCE

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