

Roll No.....

Time allowed : 3 hours

Maximum marks : 100

Total number of questions : 6

Total number of printed pages : 4

NOTE : Answer **ALL** Questions.

1. Read the following case :

The liberalisation process initiated by the Government of India during the early 1990s witnessed the entry of several private players in the Indian banking sector. ABC Bank (ABCB) was one of the earliest private sector banks incorporated on 30th October, 2004, in Hyderabad promoted by Joy, Jatin and Chandan. Joy, a development banker, was employed with the Asian Development Bank, Manila; Jatin was Chairman of Vysya Bank for 10 years and Chandan was a former bank executive. Apart from these three promoters, the Global Finance Corporation (GFC) and the Global Bank for Development (GBD) were other major shareholders. ABCB offered an array of products and services in retail, wholesale, corporate, treasury and investment banking for non-resident Indians, apart from depository and advisory services. The bank specialised in lending to software, energy, telecom, textiles, pharmaceuticals and jewellery sectors.

Within three years of operations, the total business exceeded ₹43.02 billion, making it one of the fastest growing private sector banks in India. It was also the first among Indian banks to raise Tier-II capital from multilateral institutions. In five years, ABCB's deposits were worth ₹40 billion, out of which 70% were from retail investors. Its presence in the states of Maharashtra, Andhra Pradesh, Karnataka and Tamil Nadu was significant, with more than 70% of branches in seven major cities and four metros. By July, 2014, the bank had grown to 104 branches in 34 cities, 275 ATMs and 1,400 employees. It had more than a million depositors with deposits worth ₹65 billion. The loans disbursed were to the tune of ₹35 billion.

Despite all the sound state of affairs, ABCB collapsed in the year 2014-15 and the collapse resulted on account of many mistakes committed by the bank's management including lack of financial supervision, weak corporate governance coupled with indulgence of promoters and management in financing collusion with the borrowers. RBI's probe into ABCB's accounts revealed a significant erosion of the bank's net worth and huge number of NPAs. Moreover, ABCB's attempts to strengthen its capital base through investments from overseas failed due to regulatory problems, resulting in total collapse of the bank.

The major factors that led to the fall of ABCB included disbursement of loans of ₹1.4 billion to Carl, a leading stockbroker at the Bombay Stock Exchange (BSE). Carl used the money to purchase ABCB's shares from the BSE and the National Stock Exchange (NSE). ABCB's share trading volumes, usually in thousands, shot up during June and July, 2010 to millions. Its share price shot up from ₹65 to ₹114 between October, 2010 and January, 2011. The

Securities and Exchange Board of India (SEBI) later confirmed that ABCB's stock price increased because of price manipulation. After the price increase, Carl sold the shares and reaped huge profits. Later, in 2011, investigation reports on the securities scam revealed that Carl had received insider information. In December, 2012, SEBI imposed a ban on the promoters of ABCB, Carl and his associates from dealing in ABCB shares until completion of investigation into the bank's capital market activities.

RBI charged ABCB with several financial irregularities and lack of transparency in its banking operations. It had not followed SEBI guidelines which capped a bank's direct exposure to capital markets at five per cent of total advances of the bank. Since 2009, ABCB had given loans worth ₹17 billion to many stock brokers against shares as security. When the stock market witnessed a major fall in the aftermath of the securities scam in 2011, loans given by ABCB against the security of shares turned into bad debts, taking a toll on the bank's financial position.

In late 2010 and early 2011, ABCB gave loans of over ₹8 billion to corporate and stock market related entities. For the fiscal 2010-11, ABCB had a total of 55 major corporate NPA accounts; highest NPA accounts in trading (15); broking accounts (11); followed by accounts in food processing, textiles and petrochemicals. Other NPA accounts were from distillery, agriculture, gems and jewellery and media companies. In the last quarter of fiscal 2010-11, ABCB reported a fall of 164% in profit after tax (PAT) because of ₹900 million provisioning for NPAs.

ABCB's exposure to the capital market in the fiscal ending 2010-11 was around 24% of total advances; which came down to 14% by March, 2012 and around 5% for the fiscal ending March, 2013. Though the exposure to capital markets had been brought down gradually by ABCB, the damage had already been done as most advances turned into NPAs due to the downtrend of the stock market after the securities scam. ABCB had to write-off ₹2.52 billion towards NPAs for the financial year 2011-12, after securing RBI approval to utilise reserves of ₹2.0195 billion. Still, there was under-provisioning in the books. Much of ABCB's NPAs were due to the loans given to Carl of ₹2.8 billion, a telecom company linked to Carl of ₹2.5 billion and a media company of ₹2.5 billion. As on 31st March, 2013, ABCB reported gross NPAs of ₹9.158 billion while total provisioning for the period was at ₹2.68 billion and the bank's net NPAs for the period stood at 19.7% of its advances.

RBI's annual financial inspection (AFI) showed that the networth had been further eroded and capital adequacy ratio (CAR) had also turned negative. For the financial year 2012-13, ABCB recorded loss of ₹2.720 billion with gross NPAs at ₹9.17 billion, accounting for 28% of the bank's total advances. High NPAs were a primary reason for ABCB's poor performance as it had lent indiscriminately to stockbrokers, diamond traders and exporters, without following RBI norms.

In the wake of these financial irregularities, RBI placed ABCB under monthly monitoring and its operations relating to advances, premature withdrawal of deposits, declaration of dividend and capital market exposure were restricted. The statutory auditors of the bank were also asked to be changed. The central bank further advised ABCB to infuse fresh capital to prevent the networth from remaining negative and restore its CAR to a minimum of nine per cent. The bank was advised to explore all possible options for infusion of capital through domestic sources or through merger with another bank.

All these factors resulted in the imposition of moratorium by RBI and on 24th July, 2014, the Government of India imposed a moratorium on the bank on the grounds of 'wrong financial disclosures'. The moratorium was for three months from close of business on 24th July, 2014 till 23rd October, 2014. RBI said that the moratorium was imposed in public interest and to protect the interests of depositors. All operations of ABCB were frozen and it was ordered not to give loans without RBI permission. It was allowed only to make payments for day-to-day operations or for meeting obligations entered into before the order.

On 26th July, 2014, RBI announced that ABCB would be merged with the Northern Bank of Commerce (NBC). As per the scheme, NBC took over all the assets and liabilities of ABCB on its books. It acquired all 104 branches of ABCB, 275 ATMs, a workforce of 1,400 employees and one million customers at an estimated merger cost of ₹8 billion. NBC's total business volume was expected to reach ₹65 billion and the total branch network to cross 1,100. All corporate accounts including salary accounts were transferred to NBC. The entire amount of paid-up equity capital of ABCB was adjusted towards its liabilities. There was no share swap between ABCB and NBC, which meant that ABCB's shareholders were the ultimate losers, as they did not get any shares of NBC.

Though the interests of ABCB's depositors were protected, its shareholders lost their total investments in the bank overnight.

ABCB's collapse raised doubts on the credibility of private sector banks in India. Before ABCB, two other private sector banks, namely, Bank of XYZ and the EFG Bank had collapsed in 2010 and 2012 respectively. Analysts said that ABCB's customers should have been more aware about protecting their interests as the bank catered primarily to educated, city-based customers who were expected to be more knowledgeable and prudent. When ABCB's weak financial position was made public, they should have understood that their deposits in the bank were unsafe. However, they seemed to have been carried away by the bank's higher rate of interest. The entire issue served as a lesson for small investors to exercise more diligence while choosing a private sector bank.

In the backdrop of this case, answer the following questions :

- (a) Describe the basis on which RBI would have granted licence to ABCB to set-up the bank. How far ABCB has not been able to comply with these requirements ?

(10 marks)

- (b) Analyse the reasons that led to the fall of ABCB, duly supported by facts and specific data.
(10 marks)
- (c) State the norms for exposure to capital market as enumerated by RBI. How far has ABCB followed such norms ?
(10 marks)
- (d) Examine the role of RBI and SEBI as regulating authorities in the collapse of ABCB. Also give your suggestions to ensure non-recurrence of such debacle.
(20 marks)
2. (a) NPA management is the most important responsibility of bankers. Explain how a banker can reduce the probability of an advance turning into NPA.
(15 marks)
- (b) Explain how information technology has changed the face of banking in India.
(15 marks)
3. Banks are required to freeze the accounts of customers on the orders of the government/enforcement authorities. During the currency of such orders, a term deposit gets matured. What procedure should be followed by the bank in such cases ? Explain.
(5 marks)
4. What do you understand by cheque truncation system (CTS) ?
(5 marks)
5. State the role of RBI as a banker to the government.
(5 marks)
6. Explain the following terms with reference to electronic banking and IT activities in the banks :
- (i) SWIFT
 - (ii) CHIPS
 - (iii) NEFT
 - (iv) RTGS
 - (v) DWH/EDW.

(1 mark each)