भारतीय रिज़र्व बैंक
RESERVE BANK OF INDIA
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कार्यपालक निदेशक
Executive Director

DOR.MON.LC-08/12-28-207/2024-2025 December 27, 2024

ORDER

Cancellation of licence issued to carry on banking business in India under Section 22 read with Section 56 of the Banking Regulation Act, 1949 - The Vaishali Shahari Vikas Co-operative Bank Ltd., Hajipur, Dist. Vaishali.

The Vaishali Shahari Vikas Co-operative Bank Ltd., Hajipur, Dist. Vaishali (hereinafter referred to as 'the bank') was registered as a co-operative society on June 15, 1988 under the provision of the Bihar and Orissa Co-operative Societies Act, 1935 (Bihar and Orissa Act VI of 1935) and was granted a licence by the Reserve Bank of India (hereinafter referred to as 'RBI') on June 17, 1997 to conduct banking business in India under Section 22 read with Section 56 of the Banking Regulation Act, 1949 (hereinafter referred to as 'the BR Act'). The bank being a "co-operative bank", as defined under Section 5(cci) read with Section 56 of the BR Act, is bound to comply with the provisions of the BR Act and Directions, guidelines etc. issued thereunder by RBI from time to time.

2. Brief history of supervisory action taken under Supervisory Action Framework (SAF):

The bank was placed under SAF with effect from on December 13, 2013 due to breach of two major trigger points i.e., losses for two consecutive financial years and high GNPA. The bank had exited from SAF in the year 2017 vide RBI letter dated December 18, 2017.

3. Imposition of All Inclusive Directions (AID):

The statutory inspection of the bank as on March 31, 2022, carried out by RBI, revealed significant deterioration in its financial position with CRAR at (-)60.31%

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against the minimum regulatory requirement of 9%, net worth at ₹(-)4576.84 lakh, and deposit erosion to the extent of 50.04%. Further, large scale fictitious and suspicious activities of the bank with apparent involvement of the board, CEO and staff of the bank, and possibility of siphoning of money by staff were observed during the said statutory inspection. Accordingly, RBI placed the bank under All Inclusive Directions (AID) under Section 35A read with Section 56 of the BR Act for a period of six months from the close of business on June 14, 2023, vide Directive No. DoS(Patna). Co-op.Bk./ No.S50/04.01.009/2023-24 dated June 13, 2023. The same have been extended from time to time and are currently valid up to close of business on March 14, 2025.

4. Supersession of the Board and appointment of an Administrator:

The statutory inspection of the bank as on March 31, 2022 carried out by RBI and subsequent follow-up done by RBI conclusively established that the Board of Directors (BoD) of the bank failed in discharging its responsibilities and taking appropriate action to arrest and improve the deteriorating financial position of the bank. The BoD also failed in its duties to establish good corporate governance and compliance culture in the bank. Further, non-compliance to various supervisory instructions issued by RBI reflected the continued inability of the BoD to protect the depositors' interest. Therefore, in compliance with Section 36AAA of the BR Act, RBI consulted the Registrar of Co-operative Societies (RCS), Government of Bihar vide its letter dated June 26, 2023 sought their comments on supersession of BoD of the bank. The RCS, vide letter dated July 12, 2023, recommended that RBI may take appropriate action to supersede the BoD of the bank and appoint an Administrator. Accordingly, RBI vide order dated July 24, 2023 superseded the Board of Directors of the bank and appointed an administrator for a period of one year. The tenure of the administrator has been currently extended till January 23, 2025 vide RBI directive dated October 18, 2024.

5. Major Financial Parameters and comparative Financial Position of the bank:

5.1 The assessed key financial parameters of the bank as on March 31, 2022 along with audited financials as on March 31, 2021 and March 31, 2023 are as follows:

(Amount in ₹ lakh)

Sl No	Particulars	March 31, 2021 (Audited)	March 31, 2022 (Assessed)	March 31, 2023 (Audited)#	March 31, 2024 (Audited)
1.	Net Worth	569.24	(-)4576.84	-	(-)7162.35
2.	CRAR (%)	14.53	(-)60.31	17.60	(-)1327.09
3.	Net Profit /Loss(-)	100.73	(-)5468.77	(-)27.28	(-)244.30
4.	Deposits	7702.79	9145.54	9990.66	3655.03
5.	Deposit erosion (%)	0	50.04	-	100
6.	Advances	4583.72	7173.51	9147.44	7906.68
7.	C-D ratio (%)	59.50	78.43	91.55	216.32
8.	Gross NPA (Amount)	0.59	4792.27	1302.44	7761.62
9.	Gross NPA (%)	0.01	66.81	14.24	98.17
10.	Net NPA (Amount)	0	4792.27	1172.20	130.97
11.	Net NPA (%)	0	66.81	13	47.45

Statutory auditor of the bank has given qualified opinion in the bank's audit report for FY 2022-23 and has submitted that the financials of the bank as on March 31, 2023 do not provide true and fair view in conformity with the accounting principles generally accepted in India.

5.2 The financial position of the bank as assessed by RBI as on March 31, 2022 and as audited on March 31, 2024 was highly precarious and revival of the bank does not appear to be feasible.

i. The bank's net worth has deteriorated from ₹569.24 lakh as audited on March 31, 2021 to ₹(-)4576.84 lakh as assessed on March 31, 2022 and ₹(-)7162.35 lakh as audited on March 31, 2024 implying that the bank did not have adequate assets to meet its liabilities. Consequently, deposit erosion stood at 50.04% as on March 31, 2022 and 100% as on March 31, 2024. Thus, the bank had failed to comply with Section 22(3)(a) read with Section 56 of the BR Act and was not in a position to pay its present or future depositors in full as their claims accrue.

ii. The bank's CRAR has deteriorated from 14.53% as audited on March 31, 2021 to (-)60.31% as assessed on March 31, 2022 and (-)1327.09% as audited on March 31, 2024 against the minimum regulatory requirement of 9%. As such, the bank had failed to comply with the requirements of minimum paid-up capital and reserves prescribed under Section 11(1) read with Section 56 of the BR Act and minimum regulatory CRAR of 9% prescribed by RBI in para 4 (iii) of Master Circular DCBR.BPD. (PCB). MC.No.10/09.18.201/2015-16 dated July 1, 2015 on Prudential Norms on Capital Adequacy-UCBs and updated vide para 4 of Master Circular DOR.CAP.REC.5/09.18.201/2024-25 dated April 01, 2024.

iii. The gross NPAs (GNPA) of the bank which stood at ₹0.59 lakh (0.01%) as audited on March 31, 2021, deteriorated to ₹4792.27 lakh (66.81%) as assessed on March 31, 2022 and further to ₹7761.62 lakh (98.17%) as audited on March 31, 2024. The net NPA (NNPA) of the bank, which was NIL as audited on March 31, 2021, deteriorated to ₹4792.27 lakh (66.81%) as assessed on March 31, 2022 and to ₹130.97 lakh (47.45%) as audited on March 31, 2024. The bank had incurred net loss in FY 2021-22, FY 2022-23 and FY 2023-24.

6. Major Findings of Inspection Report of FY 2021-22:

The major findings/ irregularities observed in the functioning of the bank during statutory inspection with reference to its position as on Mach 31, 2022 were as follows:

Concentration risk

i. The bank's loan portfolio primarily consisted of Loan against Warehouse Receipts forming 61.18% (₹4388 lakh), Cash Credit Accounts forming 11.43% (₹820 lakh) and Loan against Other Deposits at 8.04% (₹577 lakh) signifying high Concentration Risk.

Instance of fraud and divergence

ii. The bank had opened 44 cash credit (CC) accounts just before the balance sheet dates, i.e., March 28, 2022 and March 29, 2022, amounting to ₹413 lakh and the inspections of such large number of accounts were also conducted on the same day by the branch manager which was apparently implausible. No monthly/ quarterly stock statements / drawing power computations were available. Post sanction inspection follow ups of the accounts were not found conducted thus violating para 4.7.1 of the RBI Master Circular on Management of Advances of UCBs dated July 1, 2015.

iii. The bank had submitted that credit data was uploaded in all four Credit Information Companies (CICs), however, 176 loans examined were not reflected in the report of CRIF High Mark CIC. Non-submission of information to CICs was a violation of para 5.1 of the RBI Master Circular on Management of Advances of UCBs dated July 1, 2015.

iv. In CC accounts, the net worth computations of the borrowers were overstated and not matching with the declared income in the account opening forms while no other documents like ITR on income assessment were available.

v. The business appraisals of the borrowers were done by the bank based on the self-prepared balance sheet, income statement and stock statement, and had similar values in all loan accounts. Project Report was prepared with estimates for March 2022 and March 2023 without any base document.

vi. The verification of LIC policies kept with the bank (around 137) against which loans /CC accounts were sanctioned, revealed that 106 out of 137 policies were fake.

vii. Several sale deeds pertaining to housing loans, expired FD receipts were lying with the bank despite closure of related loans.

viii. The bank had opened and operated fictitious accounts violating para 10(a) of the RBI Master Direction on Know Your Customer (KYC) (updated as on April 01, 2021). Transactions in these accounts were being conducted without following Customer Due Diligence (CDD) procedures, thus violating para 10(d) of the Master Direction ibid, and customer identification process was completely manipulated, thus violating para 13 of the RBI Master Direction on Know Your Customer (KYC). Further, it sanctioned loans against fake LIC policies and also passed fictitious accounting entries while overstating the cash holdings. Accordingly, the total erosion in the bank with the given evidences was arrived at ₹5573 lakh [cash shortage (₹635 lakh), 44 fictitious cash credit accounts (₹413 lakh), 47 fictitious loans against fake LIC policies (₹577 lakh), 86 fictitious term loans (₹3802 lakh) and income reversal (₹146 lakh)] as on March 31, 2022 bringing down the assessed net worth of the bank to negative at (-)₹4577 lakh, thus violating Section 11(1) read with Section 56 of the BR Act, 1949. The assessed CRAR of the bank turned negative to (-)60.31% as against 18.04% reported by the bank as on date of inspection. The assessed deposit erosion of the bank as on March 31, 2022 stood at 50.04%. The assessed Net Profit for FY 2021-22 stood at ₹(-)5469 lakh as against ₹104 lakh reported by the bank. The divergence in assessed and reported CRAR and net profit was mainly due to erosion of ₹5573 lakh from Tier I capital on account of additional provision required for understatement of NPAs, interest capitalized on NPA accounts and overstatement of other assets.

Governance and oversight

ix. Despite cash shortage of ₹635 lakh observed during inspection in the three branches of the bank, the bank had failed to submit Fraud Monitoring Return (FMR)-I or DO Letter to RBI. The Board had tried to conceal the cash shortage by stating that the amount was remitted to Head Office (HO), though only the voucher was passed. Further, to adjust the shortfall identified during inspection, cash withdrawals were shown beyond the banking hours. Accordingly, the bank violated para 3.3 of the RBI Master Circular on Classification and Reporting of Frauds dated July 1, 2015.

x. The BoD. even though had admitted the fraud towards extending loans against fake LIC policies, violated paras 3.3 and 7.1 of the RBI Master Circular on Classification and Reporting of Frauds dated July 1, 2015 by not reporting in FMR-1 and not filing FIR.

xi. The BoD's efforts to safeguard the Chief Executive Officer (CEO) of the bank and reluctance to file FIR against the staff/persons involved in the fraud indicated perceptible connivance of the Board in the matter.

xii. There was no evidence of due deliberation/questioning by the Loan Committee / Board on large value sanctions. Though the sanctioning power was vested with the Loan Committee, the sanction was not obtained from them, instead, the loans were put up for monitoring after sanctioning and disbursal in Core Banking Solutions (CBS). Neither any objection/observation of the Loan Committee towards the same nor any observation of the Board in the matter was observed in the minutes, thus violating para 4.6 of the RBI Master Circular - Management of Advances by UCBs dated July 1, 2015.

xiii. Powers were centralized with CEO of the bank who was taking each and every decision of the bank, be it a long-term decision or a day to day decision. The transactions in the CEO's personal accounts were not consistent with his income. The statement (December 1, 2021 to December 9, 2022) revealed transactions to an extent of ₹2900 lakh (including capital market transactions) which was not consistent with his annual salary of ₹16 lakh as CEO of the bank.

xiv. The bank had sanctioned cash credit and loans against fake LIC policies and increased its assets in the Balance Sheet. Further, capital deduction, interest income, fee income etc., were being booked under such fictitious loan accounts. In view of the large level of fictitious loans sanctioned and capital as well as income shown out of such loans, the loans as well as income out of these loans were considered as erosion. Accordingly, income of the bank was eroded, and accumulated losses were assessed at ₹5379 lakh.

xv. The Statutory Audit as well as Internal / Concurrent Audit for FY 2021-22, had failed to ensure that the balance sheet and profit and loss account reflect the true and fair position of the bank, as large level of cash shortage, loans against fake LIC policies, cash credit against securities of fake LIC policies and other fictitious accounting entries were observed in the bank. The Statutory Auditor, however, had qualified in the balance sheet of FY 2022-23 that once again a shortfall of ₹447 lakh was observed by them in the bank, indicating the continuous fictitious accounting by the bank.

Liquidity Risk

xvi. The total liquid assets as submitted by the bank in the form of Cash in Hand, Balance with other Banks, SLR Securities and Deposits with other Banks stood at ₹2007 lakh. However, after adjusting towards the erosion, the bank defaulted in CRR/SLR, and thus violated Sections 18 and 24 read with Section 56 of the BR Act. It further indicated that the bank did not have enough liquidity to meet its current liability in adequate manner.

Operational Risk

xvii. Violations in KYC: a) PAN card copies of the customers were not clear and the signatures were not visible, wherever visible, the signatures were not matching with that of available copies of PAN Card, (b) the mobile numbers given in the KYC forms and those in the CBS did not match, (c) the Aadhaar was not verified with UIDAI, (d) current accounts were opened in the name of individuals without obtaining any KYC documents related to the business being run by the borrowers thus violating Para 28 of the RBI Master Direction on Know Your Customer (KYC) (Updated as on April 01, 2021), (e) loans were given to the borrowers for storage of turmeric whose business line was completely different, (f) the authorisation from the warehouse was not available for signatures in the warehouse receipts and covering note to the bank, (g) The signatures of the borrowers in the warehouse receipts and that of PAN did not match, (h) higher threshold limits were fixed without any valid documents.

xviii. There were no evidence of physical cash receipt or payment in the branches towards all the cash transactions in the CBS. Third party cheques were being passed by the bank towards cash payments without any presence of the third party. The bank held accounts for the entities which are under action from Law Enforcement agencies, without any specific approval by the government authorities.

xix. The bank had current accounts in 11 banks, the rationale for maintaining such large number of current accounts was not provided by the bank.

7. Major Findings of Forensic Audit Report of the bank:

As mandated by RBI, the Administrator of the bank had appointed auditors to carry out the Forensic Audit of the bank for the review period from November 27, 2020 to November 15, 2023. The findings of the Forensic Audit Report dated February 28, 2024 submitted by auditors were on the similar lines of the findings of Inspection Report of FY 2021-22. The additional major findings of Forensic Audit report were as follow:

Observations on the bank's lending policy

i. The lending policy of the bank was revised and approved in BoD meeting dated April 30, 2021 and various key dilutions in lending terms including KYC compliance were carried out in the said policy.

ii. The bank had increased the limit for loans and advances against public deposits from 'up to 65%' to 'up to 70%' and against the reserve fund and paid-up share capital from 'not more than 60%' to 'not more than 90%'.

iii. Earlier, loan proposals from customers having CIBIL score less than 640 was barred but in new policy the power to accept/reject was vested with Loan Committee of the Board.

iv. A new clause was introduced in the lending policy "No CIBIL shall be mandatory for Warehouse loans and where 100% liquid security is available."

v. In earlier policy, branch was guided to start review process at least 3 months in advance for loans above ₹10 lakhs and in other cases 2 months in advance. This clause was removed from the new lending policy.

vi. A new clause was inserted in the lending policy that no exposure limit shall be applicable for loan against FDR/National Saving Certificates (NSC)/ Kisan Vikas Patra (KVP)/LIC policy and other liquid security.

vii. As per old policy, for loans against FDR/LIC etc, if borrower fails to pay 3 monthly instalments on time, the collateral would be liquidated but the same was removed in new lending policy.

viii. The aforementioned changes in the lending policy resulted in lack of controls in sanctioning, monitoring and disbursement.

Observations on sanction and monitoring of account

ix. Hajipur Branch and Loan Committee of Head office sanctioned loans against security of LIC policy and warehouse receipts totalling to ₹7773 lakh taking benefit from relaxations/amendments done in Lending policy.

x. As per lending policy, the branches were to ensure the disbursement of the loan/advances through saving/current account of the beneficiary or issuance of pay order favouring the suppliers/borrowers themselves. Despite this, almost all loans were allowed to be withdrawn as cash at one go itself, even share capital, loan processing fees etc. was paid from loan amount only.

xi. Accounts were not marked sub-standard on account of non-service of EMI, non-submission of stock statements, inadequate credits, etc. as per RBI Income Recognition and Asset Classification (IRAC) norms.

Observation on Loan against warehouse receipt

xii. There were 88 loan accounts against warehouse receipts totalling ₹3925 lakh which were sanctioned more than once in past before classifying the accounts as loss assets. It became clearly evident that new loan was sanctioned within few days of closure of previous loan, in most cases the loan was closed by depositing cash and new loan was disbursed in cash too. Comments on creditworthiness of borrowers depositing such huge amounts in loan were not found on records.

xiii. In few cases nominees/relatives of borrowers also had availed fund-based facilities from the bank. Credit worthiness of such nominees/relatives of borrowers was not investigated by the bank.

Observation on Concurrent Audit Report

xiv. The reporting of the internal Audit/concurrent system was not adequate to cover the areas as guided by RBI Master Circular on Inspection & Audit Systems in Primary (Urban) Cooperative Banks vide RBI/2015-16/3 DCBR.CO.BPD.(PCB).MC.No. 3/12.05.001/2015-16 dated July 1, 2015.

8. Issuance of Show Cause Notice (SCN) for cancellation of banking licence:

In view of the precarious financial position of the bank as on March 31, 2022, other major irregularities revealed in the inspection findings as on March 31, 2022 and lack of any progress in revival or on merger front, a Show Cause Notice (SCN) dated April 04, 2024 was issued to the bank by RBI calling upon the bank to show cause as to why the banking licence granted to the bank to commence and carry-on banking business should not be cancelled.

9. The bank's reply to SCN and RBI's comments thereon

9.1 The bank vide letter dated April 15, 2024, has furnished its reply to SCN for cancellation of banking licence. In the reply, the bank has not denied any of the violations and non-compliances mentioned in SCN. In fact, it has admitted that the state of affairs of the bank was detrimental to the interest of the depositors due to acts of omission and commission by previous management. However, the bank has stated that after imposition of AID, it has made every effort to ensure compliance culture for restricting any further deterioration in the financial health. It has stated that, tenable action plan has been prepared for revival of the bank and that it has proceeded with multidimensional activities for safeguarding the bank's interest.

9.2 RBI has carefully considered the reply of the bank. RBI's comments vis-à-vis the reply of the bank in respect of observations in the SCN are as under:

i. <u>Loan Recovery:</u>

The bank, in its reply, has submitted that for recovery in fraud accounts, the first FIR was lodged for embezzled cash of ₹448 lakh, the second FIR was lodged in respect of 77 loan accounts (₹1411 lakh) pertaining to loan against the security of fake Life insurance policies and the third FIR was lodged reporting total fraud of ₹7902 lakh through 383 loan accounts and cash embezzlement of ₹448 lakh. The bank has further stated that, in this connection, FMR-I for ₹8666 lakh (₹8350 lakh and uncharged interest of ₹316 lakh) has already been submitted to RBI on November 28, 2023. The bank has stated that Demand and Legal notices were served to all the borrowers and letters have been issued to branches of LIC. The bank has further submitted that the award case in respect of 383 loan accounts amounting to ₹8666 lakh pertaining to loan against primary/ collateral security of LIC policy, loan against warehouse receipts and Joint Liability Group (JLG) loans has been filed on December 26, 2023 before RCS, Patna against the concerned officials of the bank. The bank has mentioned that, as per the decision taken in TAFCUB meeting held on January 10, 2024, efforts are being made for filing Individual Award cases before RCS and so far 47 cases have been filed before RCS, Patna in respect of loans against security of warehouse receipts pertaining to Hajipur Branch. The bank has stated that although achievement on recovery front is not on expected lines owing to faulty / fictitious loan underwriting, it is hopeful that once the legal recourse starts its action, this may result in good recovery. The bank has further submitted that its NPA portfolio was generated over a period by creating fictitious loan accounts by involvement of key persons in the bank, and as such, the recovery is dependent on the outcome of the efforts of law enforcing agencies.

RBI's comments: Serving demand and legal notices and filing award cases are standard procedures following fraud detection. Filing cases do not absolve the responsibility of the bank. However, these actions do not directly contribute to the recovery of NPAs or address the systemic issues that led to the bank's failure. The bank's almost entire loan portfolio turning into NPAs and the involvement of key persons of the bank in creating fictitious loan accounts make the prospect of recovery uncertain and dependent on law enforcement process. The bank has admitted that the prospect of recovery under a time bound manner is difficult to ascertain. The audited GNPA of the bank as on March 31, 2024 remained high at ₹7761.62 lakh (98.17%). The bank's record of NPA recovery has been very poor. The bank's NPA recovery stood at ₹182.63 lakh as of March 31, 2024, falling short of the ₹1500 lakh target indicated in the bank's action plan dated November 01, 2023. The recovery amount is meagre compared to the very high level of NPAs of the bank and is grossly inadequate to wipe out the accumulated losses, which stood at ₹8400.22 lakh as audited on March 31, 2024. As such, the efforts made by the bank on recovery front have been found to be insufficient for turnaround in the financial position of the bank

iii Action plan for revival:

The bank has submitted that it is facing constraints in the implementation of action plan for revival since 97.94% of the total loan portfolio is under NPA category besides cash embezzlement of ₹448 lakh. In this regard, the bank has informed that the FIR lodged with local police have been transferred to Economics Offence Wing of the State Government and the bank is complying with their requirements of supplying relevant papers / documents to the agency as per their requirements. The bank has submitted that recovery in the perpetrated fraud accounts and cash shortage is the main task of the bank which is dependent on the outcome of legal recourse. Further, the bank has stated that its revised action plan for revival dated January 16, 2024 was based on the liability of the bank excluding the term liability of DICGC of ₹5628.31 lakh and, in case of the inclusion of the DICGC liability, the revival plan could not be a viable one. The bank has further submitted that the rural/agricultural hinterland and demography of the area is the main obstruction for obtaining 100% full proof viable proposal for revival of the bank.

RBI's comments: The bank has admitted that the revival of the bank is completely dependent on the prospects of recovery and it is difficult to ensure that it is completed in a time bound manner. The bank has further admitted that in case of inclusion of the DICGC liability, the revival plan could not be a viable one. The bank cites the rural/agricultural demography as an obstacle to developing a viable revival plan. However, this does not absolve the bank of its responsibility to devise a comprehensive strategy that addresses the unique challenges of its operating environment. It may be noted that despite being given ample time and opportunities for its revival, the bank has failed to make sincere efforts on revival front or adequate capital infusion. In view of the above, the bank's revival seems highly unlikely.

iii. Merger Proposal:

The bank has submitted that it had discussion with certain persons handling the financial business/NBFCs for takeover/merger of the bank and a few of them desired to convert the bank into Small Finance Bank (SFB). However, the bank is yet to receive a concrete proposal. The bank submitted that it has explored the possibilities of merger but till date no financial institution has evinced any interest.

RBI's comments: The bank has not submitted any concrete merger proposal to RBI till date. In view of non-receipt of any merger proposal for the bank, possibility of a feasible merger is highly unlikely in the foreseeable future.

Despite being given ample time, the bank has failed to make sincere efforts on the merger front.

iv. Action against fraudulent activities and staff accountability:

The bank has submitted that the Staff Accountability Committee formed to examine the staff accountability in all the concerned loan accounts submitted its report on October 30, 2023. The bank informed that based on the report, FIR has been lodged in which eight officials of the bank including CEO, Chairman and Branch Head of Hajipur and Lalganj Branches have been made accused for misappropriation of the bank's money.

RBI's comments: The formation of a Staff Accountability Committee and subsequent FIR against bank officials, including the CEO and Chairman, suggest deep-rooted governance issues in the bank. The BoD failed in its duties to establish good corporate governance and compliance culture in the bank. In view of the above, RBI, vide order dated July 24, 2023, superseded the BoD and appointed an Administrator. Though, action against fraudulent activities is obvious step post identification of the fraud, it does not necessarily contribute to NPA recovery and revival of the bank.

v. Miscellaneous:

The bank has submitted that the auditor of the bank has been advised to revise the statutory audit report for the FY 2022-23 in the light of financial anomalies pointed out by RBI in their Inspection/ Risk assessment Report as on March 31, 2022 and accordingly the interest income of ₹346.08 lakh booked in the FY 2022-23 was reversed. Consequently, there was further deterioration in the net worth of the bank to ₹(-)7108.41 lakh as on February 29, 2024 and the Gross NPA to ₹7758.46 lakh. The forensic auditor appointed by the bank to conduct forensic audit has completed their audit and their final report was submitted to RBI.

RBI's comments: The revision of the statutory audit report and reversal of interest income were mere corrective actions and do not demonstrate proactive measures to improve the bank's financial health. Further, the reversal of interest income highlights that the earlier management of the bank had adopted dubious accounting practices. In addition, the Forensic Audit Report has reiterated serious situation of the misgovernance in the bank.

9.3 Further, the bank has not furnished its comments on the major irregularities observed in the functioning of the bank as were highlighted in the SCN dated April 04, 2024. As such, the bank's reply to SCN is not considered to be satisfactory by RBI.

10. The bank's reply to the letter dated November 13, 2024 issued in continuation of SCN seeking comments on major observations of Forensic Audit report dated February 28, 2024 and RBI's comments thereon

10.1 The bank, vide RBI's letter dated November 13, 2024, was advised to furnish its comments on the major discrepancies pointed out in the Forensic Audit report. The bank vide letter dated November 23, 2024 has submitted its reply. In the reply, the bank has not denied any of the observations of Forensic Audit report mentioned in the letter. In fact, it has admitted the various irregularities pointed out in the Forensic Audit report.

10.2 RBI has carefully considered the reply of the bank. RBI's comments vis-à-vis the reply of the bank in respect of observations of the Forensic Audit report mentioned in the letter are as under:

i. Observations on the bank's lending policy:

   The bank has admitted that the lending policy was revised on April 30, 2021 with dilution in lending terms. The bank has stated that in the Board note, the changes were not properly explained/ justified and the same ultimately resulted in compromise of the bank's interest. The bank further stated that limit for loans and advances against public deposits was increased to enhance the C-D ratio, however, it was mis-utilised for increasing the quantum of loans in fraudulent accounts. The bank mentioned that the amendment pertaining to non-requirement of CIBIL score was undertaken to increase the loan portfolio in the chosen sector, however, it was mis-utilized resulting in increase in fictitious loan against LIC policy and warehouse receipts, and most of the loans were allowed against the same securities (viz. warehouse receipts and LIC policy) where CIBIL score was not mandatory. The bank has stated that clause related to liquidation of collateral pertaining to loans against FDR/ LIC was removed knowing the fact that as per policy the loan against fully covered securities will not be classified as NPA and the same resulted in delayed detection of fictitious loan accounts against LIC Policy.

RBI's comments: Serious deficiencies in underwriting practices, and due diligence were observed vis-à-vis its loan policy in the RBI Inspection report of the bank for the FY 2021-22. The RBI inspection report also made observations on disbursing loans against fake LIC policies. The bank has admitted that changes in the lending policy resulted in lack of control in sanction, disbursement and post disbursement monitoring of the entire loan portfolio of the bank leading to fraudulent activities and compromise of the bank's interest.

ii. Observation of sanction and monitoring of accounts

The bank has admitted that the changes in lending policy resulted in substantial growth in loans against LIC policies which were mostly fraudulent and a big increase in loans against warehouse receipts which were also fictitious. The bank has admitted that the loan amounts in all the cases were disbursed through saving/ current accounts of the borrowers instead of saving/current account of the beneficiary or issuance of pay order favoring the suppliers/borrowers. The bank has further stated that the amount so disbursed to their accounts were mostly withdrawn in one or two slots in cash through cheques and the gap in share capital amount, loan processing, documentation charges were also realized from the saving bank/current accounts of the borrowers after loan disbursement. Regarding loan accounts not being marked as substandard on non-service of EMI, the bank has commented that the system marks loan account as NPA as per 90 days overdue norm, but IRAC norms have not been followed in other parameters.

RBI's comments: Additional provision was suggested in RBI Inspection report of the bank for FY 2021-22 for understatement of NPAs in violation of IRAC norms. The bank has admitted the discrepancies related to sanction and monitoring of accounts mentioned in the Forensic Audit report.

iii. Observation on Loan against warehouse receipt

The bank has admitted that the loans against warehouse receipts were being disbursed in a rollover way. It further stated that on expiry of the tenure of loan, fresh loans were disbursed to the same borrowers and their earlier loan were closed through bulk cash deposits mostly in one or two slots. The bank has further admitted that lending to nominees/relatives of borrowers was made without any due diligence

RBI's comments: The bank has admitted the discrepancies related to loan against warehouse receipt mentioned in the Forensic Audit report.

10.3 Further, the bank has not furnished any comment on the observation of forensic audit report related to the bank's concurrent audit, wherein, it was stated that the reporting of internal audit/ concurrent system was not adequate to cover the areas as guided by RBI master circular on Inspection & Audit systems in Primary (urban) cooperative banks vide RBI/2015-16/3 DCBR.CO.BPD.(PCB).MC.No. 3/12.05.001/2015-16 dated July 1, 2015. As such, the bank has admitted all the major observations of Forensic Audit Report mentioned in the RBI letter dated November 13, 2024.

11. Action Plan for revival:

11.1 The bank, vide email dated November 01, 2023, submitted an action plan for revival, wherein, the bank proposed to recover minimum ₹1500 lakh from NPA loan borrowers by March 2024. Further, the bank proposed to mobilize fresh capital of ₹300 lakh from existing members and ₹200 lakh from prospective new members of the bank by February 2024. On examination of the action plan, the targeted recovery of ₹1500 lakh was found to be insufficient as against the bank's reported GNPA of ₹8140.72 lakh as on November 30, 2023. As against, the reported net worth of the bank stood at ₹(-)7098.45 lakh as on November 30, 2023, the bank's proposed total capital infusion of ₹500 lakh was insufficient. As such, the bank's action plan was found to be grossly inadequate for revival of the bank.

11.2 The bank, vide email dated January 16, 2024, submitted revised action plan for revival based on the proposal of representatives of its depositors. In the revised action plan, the bank proposed to infuse fresh capital of ₹750 lakh as equity shares and ₹750 lakh as preferential shares from the depositors of the bank. Further, the bank proposed that 25% of the applicant depositors' existing deposits of ₹3200 lakh i.e., ₹800 lakh of deposits, would be transferred to preferential shares account of the bank. The bank proposed that the amount of claim of ₹5628.31 lakh paid by DICGC would be repaid out of the recovery in fraud declared accounts with a guaranteed minimum annual instalment to the extent of 5% of claim amount i.e., ₹281.42 lakh starting from September 2025.

11.3 The bank's revised action plan for revival was duly examined by RBI. In this connection, it was observed that the DICGC, vide its letter dated September 26, 2023, has advised the bank that, in terms of Section 21(2) of the DICGC Act read with Regulation 22 of the DICGC General Regulations, 1961, the bank is liable to repay to the DICGC the claim amount paid in respect of the insured depositors and that the repayments may be made in five equal annual instalments, commencing from September 30, 2024. The DICGC has also advised the bank that Section 21(3) of the DICGC Act prohibits discharge of other classes of liabilities by the insured bank till such time repayment in full is made to the DICGC. In view of the same, the bank's proposal of repayment of guaranteed minimum annual instalment to the extent of 5% of DICGC claim amount i.e., ₹281.42 lakh starting from September 2025 was not acceptable. The bank's GNPA stood at ₹7785.95 lakh (97.69%) as on December 31, 2023 as reported by the bank. The bank's recovery stood at ₹146 lakh as of December 31, 2023, falling short of the ₹750 lakh target for December 31, 2023 indicated in the bank's previous action plan. As such the bank's record of NPA recovery has been very poor. As per the findings of Inspection Report of FY 2021-22, the bank was having 44 fictitious CC accounts with outstanding of ₹413 lakh, 47 fictitious loans against fake LIC policies of total ₹577 lakh and 86 fictitious term loans with outstanding of ₹3802 lakh. The prospects of time bound recovery from fraudulent NPA accounts remains uncertain. Therefore, the bank's proposal of repaying the DICGC liability of ₹5628.31 lakh from the recoveries in fraud declared accounts was found to be unrealistic. The bank's liability toward the DICGC continues to remain on the bank's balance sheet and the bank does not appear to be in a position to repay the DICGC liability. As against the bank's reported net worth as on December 31, 2023 which stood at ₹(-)6768.31 lakh, the proposed capital infusion of ₹2300 lakh was grossly insufficient. As such, the bank's revised action plan for revival was found to be inadequate, unrealistic, and therefore not credible for the bank's revival.

11.4 The bank has till date not submitted any merger proposal with a stronger bank.

12. DICGC Pay out:

The bank had insured deposits amounting to ₹6465.49 lakh as on June 14, 2023 i.e., the date of imposition of AID. As on December 05, 2024, under the provisions of Section 18A of the DICGC Act, 1961, DICGC has paid an amount of ₹5832.80 lakh to the insured depositors based on the valid claims received from the willing depositors of the bank. In terms of sub-section (5) of Section 18A of the DICGC Act, insured bank has become liable to the DICGC in respect of the amount paid by the DICGC.

However, the bank is not considered to be in a position to repay the said amount to the DICGC as is evident from its weak financial position.

13. Latest Financial position of the bank as on July 31, 2024:

As per the reported financials of the bank as on July 31, 2024, net worth and CRAR stood at ₹(-)7156.62 lakh and (-)1521.55% respectively with 100% deposit erosion. The reported GNPA and NNPA remained high at ₹7739.21 lakh (98.83%) and ₹108.56 lakh (54.14%) respectively. The reported accumulated loss of the bank as on July 31, 2024 stood at ₹(-)8394.13 lakh. As such, the financial position of the bank continues to remain highly precarious.

14. TAFCUB Recommendation:

The financial position of the bank along with latest developments was discussed in the 27th meeting of TAFCUB for the State of Bihar held on May 06, 2024. With regard to the bank, the forum recommended that in case the bank fails to submit any concrete revival / merger proposal or fails to give satisfactory reply to SCN, RBI may take action as deemed fit, including cancellation of licence.

15. Conclusion

It is evident from the foregoing that even though the bank was given ample time and opportunity for its revival, the bank's financials have continued to be precarious. It has also failed to adhere to various statutory provisions and RBI guidelines. Further, there is complete absence of any credible plan for revival or merger with any stronger bank. The bank's reply to the SCN is not found to be satisfactory to RBI for the reasons stated hereinabove. The efforts made by the bank are not sufficient to justify continuation of its operations, given that there is little scope of income generation when the reported gross NPA of the bank is as high as 98.17% as on March 31, 2024. There is no indication that the bank will be able to revive its business in near future. Thus, it is conclusively established that:

a) The bank is not satisfying the requirement of minimum capital and reserves as prescribed in Section 11(1) read with Section 56 of the BR Act and capital adequacy and earning prospects as stipulated in Section 22(3)(d) read with Section 56 of the BR Act and stipulated minimum regulatory CRAR requirement of 9%.

b) The bank is not in a position to pay its present and future depositors, thereby not complying with Section 22(3)(a) read with Section 56 of the BR Act.

c) The affairs of the bank were and are being conducted in a manner detrimental to the public interest and interest of the depositors and that the general character of the management of the bank is prejudicial to the interest of depositors as also public interest. Thus, the bank has not been complying with provisions of Sections 22(3)(b) and 22(3)(c) read with Section 56 of the BR Act. The depositor's interest is in peril with the bank.

d) The bank's efforts for revival have been far from adequate and its financials have remained precarious though the bank has been given ample time and opportunity. Thus, no public interest would be served by allowing the bank to continue to do the business of banking as envisaged in Section 22(3)(e) read with Section 56 of the BR Act. Rather in all likelihood, public interest would be further adversely affected if the bank is allowed to carry on its banking business any further.

16. Having regard to all these facts and circumstances, RBI is satisfied that allowing the bank to carry on banking business any further would be detrimental to the interest of its present and future depositors and therefore, the banking licence granted to the bank to conduct banking business in India needs to be cancelled. Accordingly, in exercise of the powers conferred on RBI under Section 22(4) read with Section 56 of the BR Act, the licence issued on June 17, 1997 to The Vaishali Shahari Vikas Co-operative Bank Ltd., Hajipur, Dist. Vaishali to commence and carry-on banking business in India, is hereby cancelled. This Order makes it obligatory on the part of the bank to stop conducting all business activities including the business of 'banking' within the meaning of Section 5(b) read with Section 56 of the BR Act and also acceptance and repayment of deposits with immediate effect.

17. A copy of this Order may be served on The Vaishali Shahari Vikas Co-operative Bank Ltd., Hajipur, Dist. Vaishali.

(R. Lakshmi Kanth Rao)
Executive Director