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YES BANK, NO BANK-COLLAPSE OF YES BANK

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Abstract

An economic collapse is often combated with a several waves of interventions and fiscal measures. For example, banks may close to curb withdrawals, new capital controls may be enforced, billions could be pumped into the economy through the banking system, and entire currencies may be revalued or even replaced. The reasons for such failures are quite transparent. In essence, the sloppy regulatory oversights, weak supervision, absence of accountability, susceptibility to misuse by prominent figures and the ineptitude to learn from past mistakes keep adding to the woes of the financial system. The case is discussing in detail about Banking crisis is not a new development in the Indian financial history; the failures in the past didn't have severe implications due to the relatively small size of the banks. The banking slumps date back to the 1900s when the Indian banking sector was rapidly soaring up. The overwhelming entrepreneurial growth saw the prominent banks granting large loans to influential business tycoons. The same problems of overextended balance sheets, accounting frauds saw the mushrooming banks head to a sad fate. India's central bank, despite being in constant touch with the management of Yes Bank in finding a solution for improving the balance sheet and liquidity, couldn't determine the impending disaster. The case takes a look at the way in which the collapse of major private player Yes Bank (India's fifth largest private sector bank) has also come under the RBI action for mounting bad loans. The bank indicated they are likely to be successful and gave false hopes assuring the situation was under control. It struggled to acquire serious investors ready to infuse their capital. Besides, it witnessed a regular outflow of liquidity that further deteriorated their financial position.

Keywords: *RBI, Yes bank, Bad debts, Bank crisis, Accountability, banking system, economic collapse, Non-Performing Asset*

ISSUES

The case is structured to achieve the following objectives

- ***i)*** *Understand the* **Prompt Corrective Action framework.**
- ***ii)*** ***Analyse the strategies***to carry out **governance reforms** in the financial sector.

iii) Analysethe impact of Yes Bank Crisis reflects badly on **RBI**

iv) Discuss and debate about commercial banks and shadow banking institutions to implement **prudential norms in events of providing loans.**

iv) ***Suggestions in*** order to save Yes Bank from collapsing and to preserve people's trust in the Indian banking system, RBI has taken several measures.

QUESTIONS FOR DISCUSSION

1. The Yes Bank Crisis - A Brief Timeline
2. Why Yes bank collapsed?
3. What Is The Current Status?
4. What Has Gotten The Bank Into A Jam?
5. Why was Yes Bank Destined To Fail?
6. What happens now?
7. How will the crisis at Yes Bank and RBI action impact its corporate clients and employees now?
8. What happens in the event of a merger with another bank?
9. RBI's draft Yes Bank reconstruction scheme

1. Introduction

Yes Bank Limited is an Indian public bank headquarteredin Mumbai, India[5] and was founded by Rana Kapoor and Ashok Kapur in 2004. It offers wide range of banking and financial products for corporate and retail customers through retail banking and asset management services. On 5 March 2020 in an attempt to avoid the collapse of the bank, which had an excessive amount of bad loans, the Reserve Bank of India (RBI) took control of it. RBI later reconstructed the board and named Prashant Kumar former Chief financial officer of SBI as new MD & CEO at Yes Bank.

YES BANK, NO BANK.

Within months of a **small cooperative bank fallout in India**, major private player Yes Bank (India's fifth largest private sector bank) has also come under the RBI action for mounting bad loans. In order to save Yes Bank from collapsing and to preserve people's trust in the Indian banking system, RBI has taken several measures.

What steps RBI has taken?

First, the Reserve Bank of India has taken over the YES Bank management.

It has imposed a moratorium whose cash withdrawal limit has been capped at Rs 50,000.

The RBI used the instrument of moral suasion on the SBI to acquire the Yes bank.

- **Moral Suasion** – is a qualitative control method of the **RBI.**
- **Moral Suasion** means the use of compulsion or informal suggestion by the **RBI** on Commercial banks for the condition of Credit Policy.

The RBI announced a draft 'Scheme of Reconstruction' that entails the State Bank of India (SBI) investing capital to acquire a 49% stake in the restructured private lender.

The Yes Bank Crisis - A Brief Timeline

1. **2003** - Rana Kapoor and Ashok Kapur start Yes Bank.
2. **2008** - Ashok Kapur dies during the 26/11 Mumbai terrorist attacks of 2008.
3. **2008 - 2017**: Rana Kapoor begins giving loans to poorly performing companies in exchange for taking loan fees upfront, and using that money to run the bank.
4. **2018** - RBI kicks Rana Kapoor out of the CEO position of Yes Bank.

During that time, Yes Bank also loses a lot of money.

5. **2019**: CEO change - Ravneet Gill. Things go well for a while until RBI slaps Yes Bank with non-compliance, violating money transfer norms and PPI norms.
6. **July 2019:** Rana Kapoor takes a loan against his entire stake in the market and then sells it, and then in a few months, sells some of it to the open market.
7. **Nov 2019- Jan 2020:** Yes Bank finds a private investor in Hong Kong, however, the deal doesn't go through. The bank continues to incur a big loss.
8. **March 2020:** RBI and government take matters in their own hands. The RBI also asks SBI (State Bank of India) to form a consortium and buy a stake in Yes Bank.

Why Yes bank collapsed?

Domino effect of IL&FS crisis: Yes Bank illustrates the widening damage from **India's shadow banking crisis**, which has left the Bank with a growing pile of bad loans.

- Yes Bank's total exposure to Infrastructure Leasing & Financial Services(IL&FS) and Dewan Housing Finance Corp (DHFL) was 11.5% as of September 2019.

Rising NPA's: Apart from these, Yes Bank suffered a dramatic doubling in gross non-performing assets over the April-September 2019 to ₹17,134 crores.

- Due to this, Yes Bank was unable to raise capital to shore up its balance sheet.

Vicious cycle: Decline in the financial position of Yes Bank has triggered invocation of bond covenants by investors (redeeming of bonds), and withdrawal of deposits.

- The bank was facing regular outflow of liquidity. It means that the bank was witnessing withdrawal of deposits from customers.

Governance issues: The bank has also experienced serious governance issues and practices in recent years which have led to a steady decline of the bank.

- For instance, the bank under-reported NPAs to the tune of Rs 3,277 crore in 2018-19.

Effect of Yes bank Crisis

This revived the theory of **India's Lehman Moment.**

- The government took over IL&FS in 2018 in an effort to reassure creditors after the defaults. Also, in 2019, the RBI seized control of another struggling shadow lender, Dewan Housing Finance Corp., to initiate bankruptcy proceedings.
- The Yes Bank crisis could trigger a domino effect that could lead to the collapse of various other financial institution.

India's Lehman Moment

The IL&FS default spooked the markets and raised fears of a Lehman-like crisis, referring to the collapse of the US investment bank Lehman Brothers in 2008-09.

The event rocked global stock markets and led to the biggest financial crash (Global financial crisis) since the Great Depression 1929.

What Is The Current Status?

1. Shares of Yes Bank surged more than 25%.
2. Yes Bank has become Rs. 2 per share bank.
3. State Bank of India (SBI), agreed to do a viability assessment and buy a stake in troubled Yes Bank.
4. The Reserve Bank of India (RBI) on March 3 imposed a month-long moratorium and restricted certain business transactions.

What Has Gotten The Bank Into A Jam?

Just a couple of years ago, Yes Bank was a 'big deal' in the banking industry. Everyone expected the bank to become one of the largest private banks in India. Investors, customers - everyone was happy, and the man leading the bank, the CEO - Rana Kapoor started considering himself the wolf of "Dalal Street". That is until RBI refused to let him continue being the CEO.

The company's stock price plummeted. Investors were clueless as to why Rana was being ousted. Yes Bank's stocks started shrinking and on 21st September 2018, and the private bank lost Rs. 22,000 Crores in a single day of trading.

That's when rumours and skeletons started tumbling down the closet. There were speculations that the company was underreporting bad loans. In order to improve the situation, a new CEO was appointed along with a change in management. But despite optimistic assessments, Yes Bank was destined to lose.

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Why was Yes Bank Destined To Fail?

1. **Decline In The Financial Position:** The financial position of Yes Bank has been on a constant decline over the last few years. The private bank was struggling to raise capital and improve potential loan losses and downgrades. This invoked bond covenants by investors, and withdrawal of deposits. The bank was making huge losses and inadequate profits since the last four quarters.
2. **Government Issues:** The bank has always seemed to be in the bad books of the government and RBI. For example, the bank continued to under-report its NPAs (Non-performing Assets) which turned out to be INR 3,277 crore in 2018-19. This made RBI dispatch R. Gandhi, former Deputy Governor of RBI, to board the bank.
3. **False Promises:** Every time RBI tried to probe the bank, management tried to indicate that they are in talks with various investors and are close to cracking a deal. In reality, the bank was not able to propose a concrete proposal to investors. Hence, no investors were ready to put in the money required to survive and grow.
4. **Non-serious Investors:** The bank tried to engage with few PE (Private Equity) firms in order to infuse capital as per the filing in the stock exchange. "These investors did hold discussions with senior officials of the Reserve Bank but for various reasons eventually did not infuse any capital," says RBI. This shows that the investors were not serious enough to put capital in the bank.
5. **No Market-led Revival:** The RBI did say that a market-led revival would be

a better option as compared to regulatory restructuring. RBI made all type of efforts to facilitate such a process and gave enough opportunity to the bank management to come up with a credible revival plan, which they were not able to materialize.

6. **Liquidity Outflow:** The bank was going through severe outflow of liquidity. Deposits are bread and butter of any bank. The bank was witnessing withdrawal of deposits from their customers.

6.**What happens now?**

Impact on employees: In similar cases, when there are distress mergers, the probability of the acquiring entity trying to cut cost or trim or overlapping functions. Hence there are charges that in Yes Bank's case, some employees might have to let go. But that's just a thought for now as the call is yet to be taken by the acquirer.

Impact on corporate customers: Companies that have a line of credit from Yes Bank or bank guarantees, may face problems. Hence, corporate clients and SMEs (small and medium enterprises) might seek alternate options to not have liquidity problems.

Impact on retail customers: RBI capped withdrawals within INR 50,000 per account limit till 3rd April 2020. This may impact a certain type of customers, like retirees, who have deposited their life savings in the bank and are withdrawing monthly payment interest. Normal banking transactions like fund transfer, cheque clearances and EMI debits will stay unaffected.

Deteriorating Financial Position

The financial position of Yes Bank has undergone a steady decline over the last few years because of its inability to raise capital to address potential loan losses and resultant downgrades, triggering invocation of bond covenants by investors, and withdrawal of deposits. The bank was making losses and inadequate profits in the last four quarters.

Governance Issues

The bank has also experienced serious governance issues and practices in recent years which have led to a steady decline of the bank. Take, for instance, the bank under-reported NPAs to the tune of Rs 3,277 crore in 2018-19. That was prompted RBI to dispatch R Gandhi, a former Deputy Governor, to the board of the bank.

False Assurance

The Reserve Bank says that it was in constant touch with the bank's management to find ways to strengthen its balance sheet and liquidity. It says that the bank management had indicated to the Reserve Bank that it was in talks with various investors and they were likely to be successful. But in reality, there was no concrete proposal from investors to put the kind of money that the bank required to survive and grow.

Non-serious Investors

The bank was engaged with a few private equity firms for exploring opportunities to infuse capital as per the filing in stock exchange in February this year. "These investors did hold discussions with senior officials of the Reserve Bank but for various reasons eventually did not infuse any capital," says RBI. Clearly, it shows that the investors are not serious enough to put the capital into the bank. In fact, the size of capital would have given the new investor (s) a large stake where RBI's permission is a must.

No Market-led revival in sight

The RBI says since a bank and market-led revival is a preferred option over a regulatory restructuring, it made all efforts to facilitate such a process and gave an adequate opportunity to the bank's management to draw up a credible revival plan, which did not materialize.

Outflow of liquidity

The bank was facing regular outflow of liquidity. It means that the bank was witnessing withdrawal of deposits from customers. In fact, the deposits are bread and butter of a bank. The bank had the deposit book of Rs 2.09 lakh crore at the end of September 2019.

How will the crisis at Yes Bank and RBI action impact its corporate clients and employees now?

Employees

It is too early to say. In the event of distress mergers, there is a possibility that the acquiring entity may seek to cut cost and look at trimming overlapping functions in the target bank. This may involve letting some employees go. But there is no need to panic at this stage as the call is yet to be taken by the acquirer.

Impact on ts corporate customers

More clarity is required from the new management. But senior bankers said those companies, which have a line of credit from Yes Bank or have bank guarantees, may face difficulties. Bankers told Moneycontrol that corporate clients and SMEs (small and medium enterprises) should seek alternate options to avoid liquidity problems.

“In a normal scnario, the bank has to honour its commitments on the guarantees that it has issued. Breaching this will permanently damage its reputation in the market. But in Yes Bank’s case, what will happen is a question,” said a former senior banker.

Impact on retail customers

RBI has capped withdrawals at Rs 50,000 per account till April 3. This will impact certain category of customers, for example retirees, who may have deposited their entire life savings in the bank and are drawing monthly interest payments.

Regular banking transactions are likely to remain unaffected including fund transfer, cheque clearances and EMI debits. But all cash outgoes will be within the Rs 50,000 limit.

Yes Bank: Salary account, EMI, fund redemption frozen? Here’s what you should do immediately

Will the withdrawal limit be raised?

In the case of Punjab and Maharashtra Cooperative Bank, the initial withdrawal limit was Rs 1,000. This was gradually increased to Rs 1 lakh. In the case of Yes Bank too, RBI may relax restrictions after a while when more clarity emerges on the bank’s future.

Will the deposit insurance scheme come into play?

The deposit insurance scheme ensures that a customer receives up to Rs 5 lakh from the Deposit Insurance and Credit Guarantee Corporation in the event of a total collapse of a bank. In Yes Bank’s case too, this provision will be triggered if all efforts to revive the bank fails. But bankers said it is highly unlikely that things will worsen to that stage.

The Yes Bank Crisis reflects badly on **RBI egregious on two counts:**

The unjustifiable delay: After being sluggish in identifying governance faultlines among IL&FS, DHFL, and now Yes Bank, RBI was slow to act.

Erosion of depositor faith: Even after RBI's takeover of Yes Bank, the news of limiting withdrawals at Rs 50,000, has led to long queues of people claiming their money back.

- Capping withdrawals for depositors for Punjab and Maharashtra Cooperative Bank was bad enough. Using the same principle for Yes Bank will only serve to erode the faith of depositors in private banks in general and the banking regulator in particular.
- The choice of SBI as the investor to effect the bailout reflects the **paucity of options the government.**
    - Owing to the recent announcement of the merger of banks, the majority of PSBs are in a transition period. After the merger, PSB will be reduced from 21 to 12.
    - Thus, the onus has fallen on India's largest bank (SBI) to play the role of a white knight (in economic terms it means a

firm that saves a weaker firm from economic crisis) for Yes bank.

- It will also have **adverse impacts on the Banking sector.**
  - One, people will gravitate towards public sector banks which are already reluctant to provide credit.
  - Two, private banks will be forced to offer higher deposit rates, keeping the cost of credit higher.
  - Thereby banks will not be able to cater the credit requirement which is a prerequisite to realise the dream of becoming a $5 trillion economy by 2024-2025.
- **Effect of Indian Economy:** Collapse of Yes Bank is highly undesirable, at a juncture when the growth in the Indian economy has dropped to 5%.

Way Forward

- Yes Bank crisis is not exactly new or unique and its problems with mounting bad loans reflect the underlying woes in the financial sector ranging from real estate to power and non-banking financial companies.
- Thus, Yes Bank crisis should be seen as a good opportunity for the various stakeholders:
  - For RBI to review its **Prompt Corrective Action framework.**
  - For the Government to carry out **governance reforms** in the financial sector.
  - For commercial banks and shadow banking institutions to implement **prudential norms in events of providing loans.**

What happens in the event of a merger with another bank?

This will be good news for Yes Bank's customers. Takeover by a bigger bank, like State Bank of India, will ensure that every penny of depositors' money in Yes Bank is safe and normalcy is restored. The acquiring bank will take care of the commitments of the acquired entity.

RBI's draft Yes Bank reconstruction scheme:

- All deposits with Yes Bank will continue in the same manner and with the same terms and conditions, completely unaffected by the scheme
- Authorised capital shall stand altered to ₹5,000 crore and number of equity shares will stand altered to ₹2400 crore of ₹2 each. The investor bank shall agree to invest in the equity of reconstructed Yes Bank to the extent that post infusion it holds 49% shareholding in the reconstructed bank at a price not less than ₹10 (face value of ₹2) and premium of ₹8.
- The investor bank shall not reduce its holding below 26% before completion of three years from the date of infusion of the capital into Yes Bank.
- From the appointed date, the office of the administrator of Yes Bank, appointed by the Reserve Bank, shall stand vacated, and a new board will be constituted.
- The investor bank shall have two nominee directors appointed on the board of the reconstructed Yes Bank.
- RBI may appoint additional directors on the board of Yes Bank. It will be open to the board of directors of Yes Bank to co-opt more directors.
- All the employees of reconstructed Yes Bank shall continue in its service with the same remuneration and on the same terms and conditions of service (T&C), including terms of determination of service and retirement, as were applicable to such employees immediately before the appointed date, at least for a period of one year.

- The board of directors of reconstructed Yes Bank will however, have the freedom to discontinue the services of the key managerial personnel (KMPs) at any point of time after following due procedure.
- The offices and branches of reconstructed Yes Bank bank shall continue to function in the same manner and at the same places they were functioning prior to the effective date, without in any way being affected by this scheme.
- RBI said it will be open to the reconstructed Yes Bank to open new offices and branches or close down existing offices or branches, in accordance with the extant policy of the central bank.

CONCLUSION

Requirement of a Rapid Resolution Scheme

The lenders must try to maintain a balance between corporate and retail lending. This will prove to be a big step in administering the bad loans.

To avoid collapse, the banks must voluntarily refrain from drawing out to one or a few large borrowers to minimize the chances of potential defaults.

To guarantee the consumers, taxpayers and borrowers don't suffer and pay for such collapses; the government should see that new bank licences are given to those emerging public or private sector banks which are coupled with a mechanism to exit in case things go sour.

Economic growth is indispensable, but to encourage this, the government shouldn't pressurize banks to overlend. Banks must not grow their loans faster than their deposits.

If these checks are implemented, and the government confirms stringent penalties for mishaps by auditors and rating agencies, India will be able to resolve and control a fair number of crises.