

PERSONALITY TEST PROGRAMME 2019 (Current Affairs Interview Issues)

YES BANK CRISIS

Introduction

Yes Bank has reported a dramatic rise in gross non-performing assets. RBI has undertaken a series of measures to control the situation.

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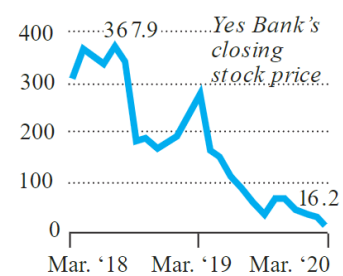
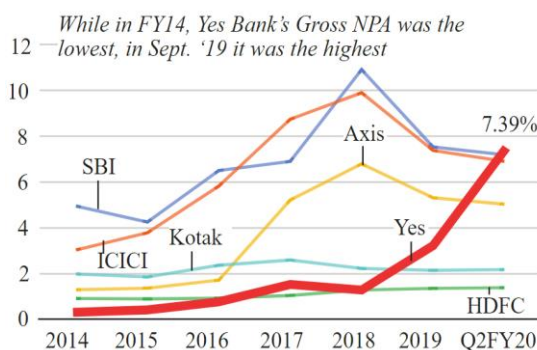
- Chief Economic Advisor while commenting on the health of banking sector in India has said that Indian banks are very well capitalized. He said that while international norm for capital to risk weighted assets ratio (CRAR) is 8% but RBI has mandated a CRAR of 9% for Indian banks. Against this limit, Indian banks maintain an average of 14.3% CRAR.

Crisis as it unfolded

- 10 years after the initial liberalisation of banking sector in 1993, Yes Bank was given banking license. It was doing good in its first decade and reported NPAs of just 0.31% in 2014.
- From 2014-2019, its total advances rose by 334% the highest rise among comparable banks in the period.
- It was found that the Bank had been indulging in high-risk lending without adequate risk-mitigating measures. RBI also found large divergence between NPAs notified by the bank and its own estimates. **Gross NPAs** zoomed to 7.39% at the end of Sept 2019 and since then jumped to **around 19%**.
- The loan spree & high NPA meant poor profitability, which is evident from Yes Bank's sinking Return on Assets (RoA) ratio (RoA=net income/ total assets). For instance, Yes Bank's RoA in FY19 was 0.52, in FY18 it was 1.78.
- So, RBI refused to extend the term of then CEO Rana Kapoor and he stepped down in Jan 2019. RBI also appointed a former deputy governor of the RBI on the board of bank.
- In the meantime, the bank was facing **regular outflow of liquidity**. While bad loans piled up, **Yes Bank did not make enough provisions in its profits**. Its Provision Coverage Ratio in FY19 was 43.1%, the lowest among comparable banks. RBI says a PCR of >70% is desirable.
 - The **provision coverage ratio (PCR)** gives an indication of the provision made against bad loans from the profit generated. Higher the PCR, lower is the unexposed part of the bad debts.

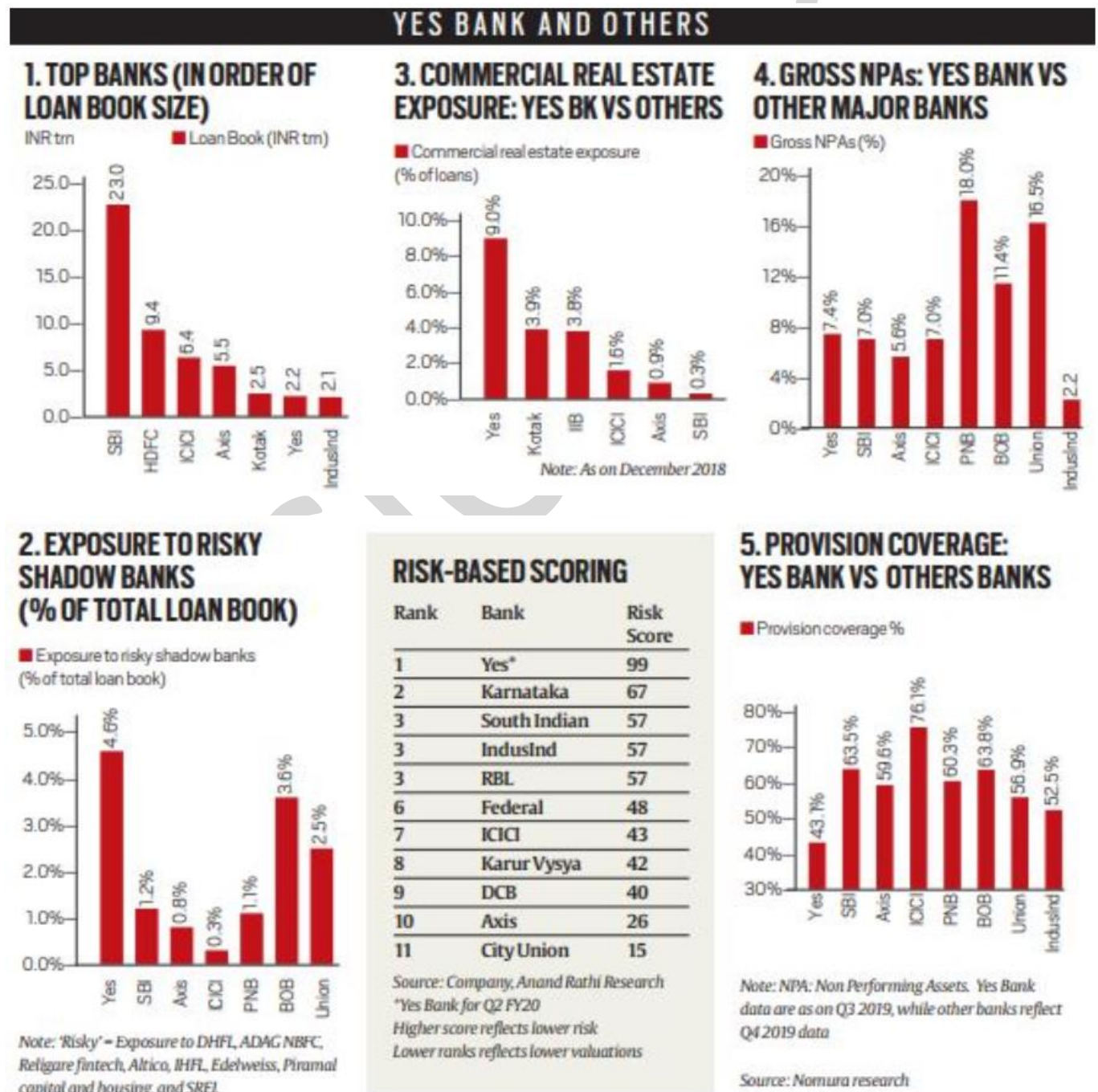
Reasons of poor health of the Bank

- Corporate Governance lapses:** it involves under-reporting of NPAs by at least Rs 3,277 crore in 2018-19, complains about kickbacks for loans, dysfunctional board etc.
- Absence of risk management practises:** reckless lending even to stressed companies including the Anil Ambani-led Reliance group, Dewan Housing Finance Corporation Ltd (DHFL) and IL&FS by earlier CEO.
- Slowdown of economy:** inability of companies to pay back affected profitability of bank (twin-balance sheet problem). According to an estimate, as much as 25% of all Yes Bank loans were extended to NBFCs, real estate firms, and the construction sector.
- Outflow of liquidity:** it means that depositors started taking back their deposits while bad loans were rising. From Sept 2019 to March 2020, 34% drop in the bank's deposit base was noticed.
- Other reasons:** poor external auditing standard, low supervisory competence, lack of political will and corrupt nexus between politicians, promoters and bankers.



- In this scenario, **RBI started pushing it to raise more capital** in the hope of finding a market-led revival rather than a regulatory restructuring.
- **New CEO, who was appointed in March 2019**, made several unsuccessful attempts to raise capital in the last few months to improve the health of the bank in the light of potential non-performing assets.
- These failings resulted in **downgrades by credit rating agencies**, which in turn made capital raising even more difficult leading to a **vicious cycle** that further worsened its financials. Hence, the bank's **stock price fell steadily** in the past year.
- The **tipping point came when one of the bank's independent directors and chairman of the board's audit committee resigned** from the board in January citing governance issues. Moreover, **3rd quarter's report that was to be released in Feb was delayed by at least 1 month** as the bank said that it was in talks with potential investors for a cash infusion.
- Only when RBI found that no credible investor was coming forward that could stem a steady decline in Yes Bank's financial position, it decided to recommend the moratorium.

Comparison of financial health of Yes Bank with other banks



Regulatory concerns raised

- **Lack of asset quality recognition and lethargic response of RBI:** Yes Bank ended up at a resolution stage without crossing threshold of PCA, which is a kind of tailor-made solution to address weakness at banks at the pre-emptive stage itself. This is **despite the fact that the central bank had in recent years flagged several concerns**, including a divergence between the reported and RBI's own findings on the bank's financials.
- **Decision to suspend normal business operations** could have been avoided along with a **cap on withdrawals which is a big disservice to depositors**. Future of a bank depends on its depositors. The moratorium, although temporary, could discourage the depositors from putting their trust in the bank.
 - RBI could have used its own prowess to show that investors money is safe and sentiment is high in banking sector.
- **No Market-led revival in sight:** Just 6-week time was given to some foreign investors who were exploring investments into Yes Bank. Also, because of no clear answers by the regulators on the pricing or taxation, they decided to walk away.
- **AT-1 bond holders:** concerns are being raised and it is said that it is for the first time that **AT-1 bonds are being written off ahead of equity**. This means Rs 10,800 crore of AT-1 bonds could turn into wastepaper which constituted over 40% of the bank's net worth of roughly Rs 27,000 crore.
 - AT1 bonds, also known as CoCo bonds (contingent convertible capital instruments), are **unsecured debt instruments that rank lower to the claims of all creditors and only senior to common equity**.
- **Systemic risk:** RBI failed to check the **rise of shadow banking sector** which gained momentum by recklessly borrowing the savings deposited in banks after demonetisation. **Cheap credit was made available to refinance the stuck real-estate and infrastructure projects** which is now turning into NPAs as seen in IL&FS, DHFL, PMC Bank and now Yes Bank.
 - Fitch Ratings has said that the latest developments spotlight the governance risks in India's banking sector overall.
- **Lack of effective framework for resolution of financial sector:** SBI, LIC were large shareholders of IL&FS but still they failed to prevent the fall of the institution. Similarly, Yes Bank's resolution should not merely be based on the premise that large shareholders will be able to keep a check on it.

Recent steps taken to handle the crisis

- On the advice of the Reserve Bank of India (RBI), the government has imposed a moratorium under **Section 45 of the Banking Regulation Act** for 30 days that puts a cap of Rs 50,000 on withdrawals by Yes Bank depositors with few exceptions. It will be withdrawn soon.
- Cabinet has approved the RBI's '**Yes Bank Ltd. Reconstruction Scheme, 2020**' under which State Bank of India (asked using the instrument of moral suasion) will pick up a maximum 49% stake and it cannot reduce holding to below 26% before three years from the date of capital infusion.
 - Some private sector banks like ICICI Bank, Axis bank etc. have also been roped in.
- Yes Bank will not be able to grant or renew any loan or advance, make any investment, incur any liability or agree to disburse any payment.
- All existing shareholders (except those holding not more than 100 shares) of Yes Bank have been barred from selling more than 25% of their current holding for 3 years.
- The RBI also superseded Yes Bank's Board of Directors and appointed former SBI Chief Financial Officer Prashant Kumar as its administrator.
- Temporary relief on maintaining cash reserve ratio (CRR) was provided along with liquidity support. RBI will continue to provide liquidity support once the moratorium is lifted to meet any deposit outflows if needed.

Comparison with PMC Bank crisis

Section 45 of Banking Regulation Act is not applicable to cooperative banks. So, similar kind of forceful action was not taken during PMC crisis.

Recently, an amendment has been purposed to the Act in order to strengthen cooperative banks and avoid PMC Bank like crisis in the future.

Lessons learnt from history

- **Merger of Global Trust Bank (GTB) with Oriental Bank of Commerce (OBC) in 2004:** failing private sector bank GTB was merged with well performing OBC which dented the profitability and growth of OBC itself as GTB's bad loans turned out to be way above what was revealed at the time of merger.
- **Satyam scandal case:** government kept the business running because of its viability by replacing the company's board by Company Law Board and appointing nominal directors. Satyam was eventually sold to Tech Mahindra. The current intervention of SBI is not a merger and its own balance sheet is not going to be liable for any future losses of the troubled bank.

Way Forward

The overarching theme for government includes **restoring policy credibility, ensure depositor's and investor's confidence, improve corporate governance and accountability** of different stakeholders involved. Following steps need to be taken to ensure the same:

- RBI need to **review its PCA guideposts and revise them** to ensure that such a slipping under the radar does not recur.
- Government needs to **assure depositors that their money is safe by putting off the moratorium at the earliest.**
- The fear of default by the Bank is not going to go away until the Bank is able to find **market-led solution in the form of private investors.**
 - However, with creditors like Vodafone-Idea Ltd. which are at their brink of bankruptcy, this seems very challenging. If this doesn't happen, SBI may need to put more money in the Bank or go for merger in the future.
- Though its equity has eroded, Yes Bank has some underlying strengths like a **sound franchise, robust IT systems, skilled manpower and an extensive network of branches.** SBI should be able to harness these strengths and with proper pricing, its investment can become commercially attractive.
- **Need of more proactive role of regulators like RBI and SEBI:**
 - There is a **need of a watchdog for the financial sector outside of RBI** which is made accountable. Moreover, a full-fledged framework on the lines of Insolvency and Bankruptcy Code (IBC) is required for the resolution of financial sector firms.
 - SEBI needs to be empowered with **better surveillance and legal expertise** to be able to track **cases of insider trading**, and other **misdeeds in the markets**, and bring the culprits to book.
 - The government and RBI will have to be careful lest an impression is created that SBI is stepping in at their behest. If such a perception is created, questions of **interests of minority shareholders of SBI and other SEBI-related regulatory issues will crop up.**
- **Role of auditors and rating agencies:** they are rarely penalised for their mischievous acts. So, strict accountability and ethical guidelines are needed to be put in place. As pointed out in IL&FS crisis as well, the revenue model on which rating agencies work need to be changed and an independent and fair evaluation is the need of the hour.

Conclusion

Given the criticality of the financial intermediation sector in any economy, failure of a bank can have economy-wide ramifications, and a run on one bank can very quickly have a contagion effect. For this reason, RBI has identified SBI, ICICI and HDFC Bank as Domestic Systemically Important Banks (D-SIBs). Yes Bank is not a D-SIB but still has large deposits and asset base. So, government's alacrity in its smooth resolution is a welcome move.

The Budgetary sop of increasing deposit insurance up to Rs. 5 lakhs in the aftermath of the crisis at the Punjab and Maharashtra Cooperative (PMC) Bank is also likely to go well with depositor's sentiments.

Moreover, **it should not be seen as socialisation of private sector losses** as government action was needed for the sake of depositors and shareholders are anyway the biggest losers in this ordeal.

Summary

Introduction

RBI has taken various steps in order to contain the NPA and liquidity crisis in Yes Bank.

Major steps taken

- Imposing moratorium that puts a cap of Rs. 50000 on withdrawals.
- Buying of equity/shares by the likes of SBI, Axis bank, ICICI Bank etc. with SBI being the major investor.

Financial health of Yes Bank

- Gross NPAs have ballooned to around 19% as per latest quarterly report. Its Provision Coverage Ratio in FY19 was 43.1%, the lowest among comparable banks. RBI says a PCR of >70% is desirable.
- Profitability has been declining. Yes Bank's RoA in FY19 was 0.52, in FY18 it was 1.78.

Reasons of decline of the Bank

- **Corporate Governance lapses:** underreporting of NPAs, alleged kickbacks for loans etc.
- **Absence of risk management practises:** reckless lending even to stressed companies
- **Slowdown of economy:** inability of companies to pay back affected profitability of bank (twin-balance sheet problem).
- **Outflow of liquidity:** depositors started taking back their deposits while bad loans were rising.
- **Other reasons:** poor external auditing standard, low supervisory competence, lack of political will and corrupt nexus between politicians, promoters and bankers.

Regulatory concerns raised

- **Lack of asset quality recognition and lethargic response of RBI:** Yes Bank ended up at a resolution stage without crossing threshold of PCA
- **Decision to suspend normal business operations** could have been avoided along with a **cap on withdrawals**.
- **AT-1 bond holders:** it is being argued that claims of AT-1 bonds rank higher than common equity holders.
- **Systemic risk:** Fitch Ratings has said that the latest developments spotlight the governance risks in India's banking sector overall.
- **Lack of effective framework for resolution of financial sector**

Way Forward

- RBI need to **review its PCA guideposts and revise them** to ensure that such a slipping under the radar does not recur.
- Government needs to **assure depositors that their money is safe by putting off the moratorium at the earliest**.
- Underlying strengths like **robust IT systems, skilled manpower etc. of Yes Bank should be harnessed by SBI properly** for this investment to become commercially attractive.
- **Need of more proactive role of regulators like RBI and SEBI:** SEBI needs to be empowered with better surveillance and legal expertise. Moreover, a full-fledged framework on the lines of Insolvency and Bankruptcy Code (IBC) is required for the resolution of financial sector firms.
- **Role of auditors and rating agencies:** strict accountability and ethical guidelines are needed to be put in place.

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