Moratorium and Restructuring
YES Bank (2020)

Background and context

YES Bank, an Indian public bank, was founded by Rana Kapoor and Ashok Kapur in 2004. It was listed on the Bombay Stock Exchange in 2005. Over the next decade, it became India's fourth largest private lender by assets. It offered a wide range of banking and financial products for corporate, SME and retail customers. YES Bank operated its investment banking, merchant banking and brokerage businesses through YES Securities, and its mutual fund business through YES Asset Management (India) Ltd, both wholly owned subsidiaries of YES Bank. Headquartered in Mumbai, it had a pan-India presence across all 28 states and nine Union Territories in India, with a network of 1,130 branches. The period from mid-2018 to 2019 saw a significant shift in YES Bank's ownership from institutional to retail investors. As at 2019, retail investors collectively held 48% (June 2018: 9%) in YES Bank, while mutual funds and foreign institutional investors held 5.1% and 15.2% respectively (June 2018: 11.6% and 42.5%).

Several events led to the failure of YES Bank, including aggressive growth, a depositor run, lack of fresh capital and default of a bond coupon payment. YES Bank had experienced a crisis of management and governance, including allegations of money laundering against its founder, Rana Kapoor. In late 2018, the Reserve Bank of India (RBI) refused YES Bank's requests to renew the term of Rana Kapoor, who was replaced in March 2019 by Ravneet Gill, a banker with 30 years of experience from Deutsche Bank tasked with reviving YES Bank.

Over a five-year period, the loan book of YES Bank grew rapidly from INR550 billion ($8.7 billion) in 2014 to INR1.3 trillion ($20.3 billion) in 2017, and then accelerated substantially by more than 80% to INR2.4 trillion ($33.6 billion) in 2019. 62% of YES Bank's loan portfolio was to corporates (industry average: 40%). Such financing was extended to financially stressed borrowers such as

Reliance Communications, Essel Group, Vodafone Idea and Jet Airways in the engineering, steel, construction and power sectors. In addition, more than INR400 billion ($5.6 billion) had been provided to India's troubled shadow banks, property developers and power generators. All these loans were made against collaterals such as personal guarantees by tycoons, that were tough to value or seize. In the process, YES Bank had collected high one-time fees on top of interest rates for granting loans to risker borrowers. It also offered generous interest rates of up to 7% on its savings account.

Resolution actions

Moratorium

On 5 March 2020, the RBI placed YES Bank under moratorium for a period of 30 days pursuant to sections 45 and 35A of the Banking Regulation Act 1949,[58] owing to the steady decline of its financial position. Despite rounds of discussions with investors, YES Bank was unable to raise capital and failed to address potential loan losses and resultant downgrades. This triggered investors to invoke bond covenants and the withdrawal of deposits. In recent years, YES Bank also suffered serious governance issues and practices. There had been regular outflows of liquidity from YES Bank. The RBI had undertaken efforts to facilitate a market led revival of YES Bank as a preferred option over regulatory restructuring. Despite being provided with adequate opportunities, YES Bank's management had failed to draw up a credible restructuring plan.

The moratorium involved two areas. Firstly, capping depositor withdrawals and payment to creditors to a maximum of INR50,000 ($680) except for medical treatment, costs of higher education, obligatory expenses for marriage or other ceremonies, and expenses for any other unavoidable emergency. Even in these cases, payments were not to exceed INR500,000 ($6,800) or actual depositor balances, whichever was less. Secondly, prohibitions on the granting or renewing of any loan or advance, making investments, incurring any liability or agreement to disburse payment (whether in discharge of its liabilities and obligations, or for the transfer / disposal of any properties or assets). However, exceptions were provided for expenditures necessary to carry on the bank's day-to-day administration and the payment of premiums payable to India's Deposit Insurance and Credit Guarantee Corporation (DICGC).

> ***The resolution (of YES Bank) will be done very swiftly, it will be done very fast. 30 days which we have given is our outer limit. You will see a very swift action from RBI***
>
> Shaktikanta Das, Governor of the Reserve Bank of India

Expenditures were not to exceed the average monthly expenditure on account of the item, for the six months preceding 5 March 2020.

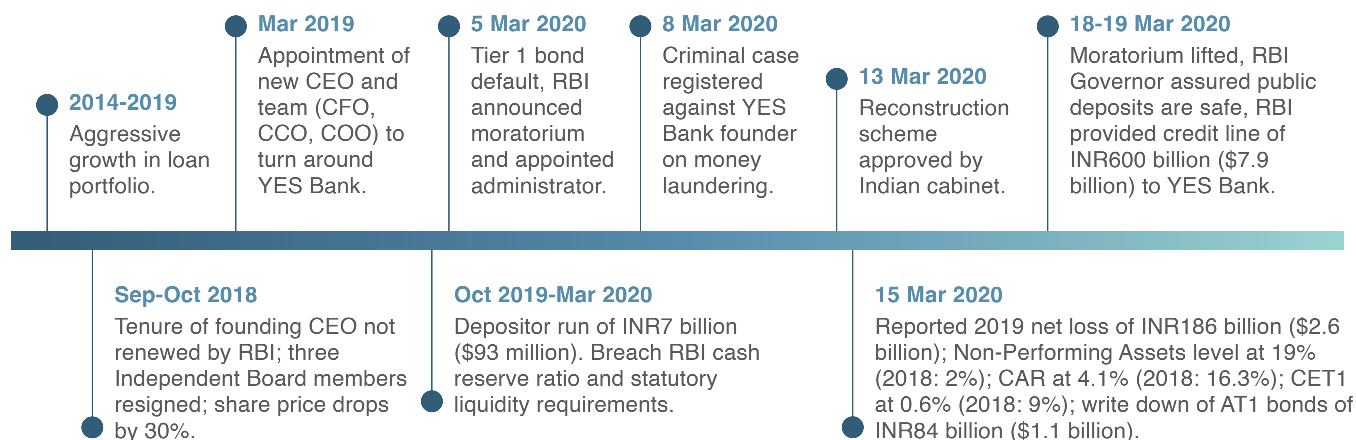
Shri Prashant Kumar – ex-Deputy Managing Director (MD) and Chief Financial Officer (CFO) of State Bank of India (SBI) – was appointed as YES Bank's administrator and subsequently, as MD and CEO on 26 March 2020.

The RBI continuously assured YES Bank depositors that their interests would be fully protected and there was no need to panic. The central bank also committed to a reconstruction scheme before the end of the 30-day moratorium to ease the hardship of depositors. Prior to lifting of the moratorium on 18 March 2020, the Governor of the RBI reiterated to stakeholders that the restructuring plan for YES Bank was credible and sustainable.

> ***I'm in continuous interaction with the RBI which has assured they will give a quick resolution. I want to assure every depositor that their money shall be safe. Their monies are safe***
>
> Nirmala Sitharaman, Minister of Finance

[58] On 26 June 2020, this Act was amended to enable RBI to reconstruct a weak bank without the prior requirement of imposing a moratorium on its depositors and creditors

Resolution of YES Bank – Timeline of Key Events



Reconstruction Scheme

On 13 March 2020, the Indian cabinet approved the Reconstruction Scheme (Scheme), which covered five main segments. First, SBI was to acquire a 48.2% equity stake in YES Bank for INR60.5 billion ($817 million) and could not reduce its shareholding to below 26% for the next three years. SBI is India's largest commercial bank (58% government-owned). Second, a consortium of seven new private FIs would take up 31% equity stake for INR39.5 billion ($533 million), with a lock-down period of three years on 75% of their investments. The FIs were ICICI Bank, Housing Development Finance Corporation, Axis Bank, Kotak Mahindra Bank, Federal Bank, Bandhan Bank, and IDFC First Bank. Besides the new investors, existing shareholders holding more than 100 shares were subjected to the three-year lock-in period. The Scheme resulted in dilution of ownership by existing shareholders, e.g. shares held by retail investors fell to 12.8% as at 31 March 2020 (end-2019: 48%). Third, YES Bank's authorised share capital was increased to cater for the new equity injection. Fourth was the appointment of new Board of Directors (BOD). Lastly, there would be no changes in YES Bank's offices or branches, and employees were to continue in their jobs with the same remuneration and terms and conditions of service.

In addition, INR84.15 billion ($1.1 billion) of YES Bank's AT1 bonds were written down fully to provide additional loss absorbing capital against its losses. This was the first time in India's banking sector that AT1 bonds were written down which negatively impacted capital markets. As investors turned risk averse, smaller and weaker lenders found it challenging to raise funds. The total outstanding AT1 debt in the Indian banking system was INR930 billion ($8.4 billion).[59] Of this amount, INR390 billion ($5.5 billion) was issued by private banks.

Nevertheless, the write down of AT1 bonds and new capital injection from the identified FIs raised YES Bank's proforma CET1 ratio and CAR to 7.6% and 13.6% (2019: 0.6% and 4.1%). The Scheme also resulted in credit rating upgrades (Moody's long-term issuer rating from Caa3 to Caa1) due to bailout of the bank's depositors and senior creditors, and lifting of the moratorium on its depositors and creditors.

YES Bank also received support from the RBI and raised funds. On 19 March 2020, a day after the moratorium was lifted, RBI extended a credit line of INR600 billion ($7.9 billion) to YES Bank. However, before accessing the credit line, YES Bank would have to use its immediate liquid assets. The provision of the credit line by the RBI was permitted as YES Bank was deemed to be illiquid but solvent after implementation of the Scheme and write down of the AT1 bonds. To further assure depositors, the Governor stated that RBI was ready to offer liquidity, if required. YES Bank also planned a certificate of deposits programme, to raise up to INR200 billion ($2.7 billion) from institutional investors. This was assigned an A2 rating by CRISIL Limited (the local arm of S&P Global) premised on continued extraordinary systemic support from key stakeholders, along with the sizeable ownership of YES Bank by SBI.

[59] Source: ICRA Ltd (the local arm of Moody's Investors Service)

Key takeaways

YES Bank was rescued by strong and early interventions from the RBI, as well as direct support of equity injections from another state-owned bank and a consortium of seven privately owned FIs. Nevertheless, YES Bank's AT1 bonds were fully written down. For the first time in the history of India's banking sector, investors had to bear losses as part of YES Bank's restructuring scheme. Even though this jolted capital markets and a case was filed by an investor against the RBI in the Madras High Court, the RBI stood firm that the decision to write off YES Bank's AT1 bonds were in keeping with the regulations and disclosures in the information memorandum issued to govern such securities.

> ***It is clear that the AT1 bonds carry higher risk for which the interest rate is also on the higher side. Investors in such financial instruments are by nature savvy, with risk appetite and cognizant of the high reward-high risk principle***
>
> Reserve Bank of India

On 4 February 2020, the deposit insurance limit provided by DICGC was raised from INR1 lakh ($1,300) to INR5 lakh ($6,600). Once the order of moratorium is made by the Central Government under section 45(2) of Banking Regulation Act in respect of an insured bank and the said order of moratorium provides for restrictions on depositors of such bank from accessing their deposits, DICGC becomes liable under Section 18A of DICGC Act to pay deposit insurance to the depositors of that insured bank from the date of effect of such order. This was enabled by a bill[60] passed by the Indian parliament on 9 August 2021. In 2018, a proposal for a Financial Resolution and Deposit Insurance Bill fell through, owing to concerns about a bail-in clause.

> ***Going forward, we need the legislative backing to have some kind of a resolution corporation, which has to deal with resolution and revival of stressed financial firms***
>
> Shaktikanta Das,
> Governor of the Reserve Bank of India

As with the case of YES Bank, the growing complexities of resolving troubled or failed banks demonstrate the importance of instituting a resolution mechanism for FIs. This mechanism could prevent the failure of some FIs from affecting the entire system, and serves as a strong complementarity to adequate deposit insurance coverage. Both act in concert to promote public confidence in the financial system. In addition, resolution regimes and approaches need to be considered within the strategic context of policies on financial sector development and concomitant systemic risks. For instance, in October 2020, RBI issued a working paper which mooted possible ownership of banks by Indian conglomerates as well as licenses issued to well-run large Non-Bank Financial Companies (NBFCs), which could have implications on the resolution of FIs in India.

Prompt actions and decisions were taken to minimise disruptions in times of crisis. The RBI swiftly imposed a 30-day moratorium to stem the outflow of funds from YES Bank. Within the next 14 days, a reconstruction scheme was put together and approved by the Indian Cabinet, followed by lifting of the moratorium and further assurances by the RBI to support YES Bank. This was crucial to prevent further deterioration of the bank from the prevailing uncertainties of COVID-19, as well as the recent failures of Punjab & Maharashtra Cooperative Bank (PMC) and Dewan Housing Finance Corporation Ltd (DHFL) towards the end of 2019, which had impacted public confidence in the Indian financial system.

Different situations require different resolution responses. The moratorium and restructuring scheme were designed to ensure that YES Bank continued to be run professionally and independently without imposing burdens on its new shareholders. This differed from previous resolutions in India, when failed financial institutions were directly merged with state-owned FIs (e.g. Life Insurance Corporation of India took over 51% of IDBI Bank in 2019) or where the RBI initiated insolvency proceedings against DHFL.

In November 2020, the RBI also intervened to rescue a regional lender, Lakshmi Vilas Bank (LVB). The RBI imposed a withdrawal limit of INR25,000 ($336) and replaced the BOD of LVB. On 27 November 2020, LVB merged with the Indian unit of Singapore's DBS Bank (DBS India) (in 2018, DBS India had attempted to acquire a 50% stake in LVB). DBS India would inject INR25 billion ($336 million) into LVB and prior to the merger, LVB's Tier 2 bonds worth INR318 crore ($43 million) were completely written off.

As the crisis unfolded, there was also continuous public communications from the failed bank (YES Bank), the regulator (RBI) as well as main investor (SBI). The Governor of the RBI directly addressed YES Bank depositors to provide assurance that their deposits were safe and this message was echoed by the Finance Minister. Despite the long queues outside YES Bank branches for withdrawals, such assurances served to mitigate panic and were backed by timely actions to restore public confidence.

[60] Deposit Insurance and Credit Guarantee Corporation (Amendment) Bill, 2021