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“A Lender’s fall from Diamonds to Dust” “Yes Bank”

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Abstract

The Yes bank board has been superseded by the RBI and the private lender has become the target of a forced bailout, given the huge bad debt level in its corporate and real estate portfolios. India’s central bank took control country’s fifth largest private sector lender Yes bank on 05 March 2020 and imposed limits on withdrawals, spreading confusion and fear among account holders. Shares of Yes bank which was traded at Rs 404 at its peak in August 2019, fell to a record low of Rs 5.65 on Friday March 6th, with the stock plunging nearly 85%. The fall wiped out 79.43 billion rupees from Yes bank’s market value.

Keywords: Bailout, private lender, Stock Plunging

Introduction

Yes Bank is a script that fits the bill for a super-hit Hollywood movie with a difference that all ends bad in loans. The Yes Bank story began in 1999 when three successful bankers came together to float a non-banking financial company. They were Ashok Kapur, the former country head of the ABN Amro Bank, Harkirat Singh, the former country-head of the Deutsche Bank, and third partner Rana Kapoor, and former corporate finance head of the ANZ Grindlays Bank. The three Indian promoters had 25 per cent share in the non-banking financial corporation while the rest 75 per cent were with the Rabo Bank of the Netherlands. It became the Yes Bank in 2003. It was also the same year when Harkirat Singh quit the Yes Bank over issues pertaining to influence exerted by Rabo Bank in appointment of CEO and executive chairman and it was now left to Kapoor and Kapur, who were already related since their wives were sisters. Yes Bank acquired license in 2004 and went to stock exchange with IPO (initial public offer) in 2005.

Yes Bank^[2] Ltd is engaged in providing a range of banking and financial services. The Bank operates in four segments: Treasury Corporate/Wholesale Banking Retail Banking and Other Banking Operations. The Treasury segment includes investments all financial markets activities undertaken on behalf of the Bank's customers trading maintenance of reserve requirements and resource mobilization from other Banks and financial institutions. The Corporate/Wholesale Banking segment includes lending deposit taking and other services offered to corporate customers. The Retail Banking segment includes lending deposit taking and other services offered to retail customers. The Other Banking Operations segment includes para banking activities such as third-party product distribution and merchant banking.

Methodology

In this case study we will see how the yes bank rose to new heights and fell from that point.

Rise^[3]

Responsibilities were clearly divided with Ashok Kapur being the chairman and Rana Kapoor, its CEO, with the job of running the bank on a day to day basis. The two men, as different as chalk and cheese, managed the relationship well.

In December 2005 the Bank bagged Corporate Dossier award from Economic Times. In the year 2006 the Bank received Financial Express Awards for India's Best Banks. In April 2007 they made a tie-up with the Agriculture Insurance Company of India (AIC). The Bank was ranked as the No 1 Emerging Markets Sustainable Bank of the Year-Asia at the FT/IFC Washington Sustainable Banking Awards 2008 in London. The Bank was ranked as the No 1

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Bank in the Business Today-KPMG Best Banks Annual Survey 2008. During the year 2008-09 the Bank opened 50 new branches and 18 new off-site ATMs. During the year 2009-10 the Bank opened 33 new branches. They opened 64 Branches during the year 2010-11. As of March 31 2011 they operated 214 branches across 164 cities in India and approximately 250 automated teller machines (ATMs). At the beginning of Financial Year 2010-11 the Bank embarked on an ambitious journey into the next phase of growth and launched YES BANK - VERSION 2.0 Building the Best Quality Bank of the World in India. Version 2.0 is clearly the most stimulating phase in the life cycle of YES BANK with a vision of establishing 750 branches 3000 ATMs 12000 employees Rs 125000 Cr. Deposit base Rs 100000 Cr. Loan book and a Rs 150000 Cr. Balance Sheet size by 2015. On 18 September 2013 Yes Bank announced that it has successfully closed equivalent to USD 255 million by way of Dual Currency Multi-tenor Syndicated Foreign Currency Loan Facility. The facility has a maturity of 1 and 2 years with majority commitments coming in the 2 year tenure bucket. The loan has been widely distributed with commitments from 11 banks representing 8 countries across US Europe Middle East Asia and Australia.

Fall ^[1]

The Yes Bank started making slow and steady progress in the initial years. But it received a big shock in 2008. Ashok Kapur, then chairman, was at the Trident Hotel on 26 November 2008 when 10 Pakistani terrorists attacked Mumbai. The Trident Hotel was one of the targets of the 26/11 terror attack. Ashok Kapur died in the terrorist attack that Thursday night. This changed the way Yes Bank would go about its business under the new leader Rana Kapoor. Ashok Kapur seemed to have fancied Rana Kapoor. This stems from the fact that he is said to have got his wife, Madhu Kapur's sister Bindu get married to Rana Kapoor. This marriage made Ashok Kapur and Rana Kapoor not only business partners but also relatives. These ties came under scrutiny soon.

Battle for supremacy in the Yes Bank ensued. This props up from the failed attempts by Madhu Kapur in 2009 and again in 2011 to get her daughter Shagun on the board of directors. The moves were scuttled apparently by Rana Kapoor, now in full control of the Yes Bank. During this period, Madhu Kapur's name from major promoters was also removed in the Yes Bank's communiqués.

In 2012, Rana Kapoor published a history of the Yes Bank but it had no reference to Ashok Kapur. The dispute settled finally in 2015 with Kapurs getting the seats on the board of directors. The period of internal fight was also the phase when the Yes Bank went aggressive with lending. A Business Today report says that of around Rs 35,000 crore of stressed loans, most of the lending's were done in post-2008 period.

The Yes Bank gave loans to companies which were struggling in their businesses. These companies included the Anil Ambani Group of Companies, the Essel Group, the Dewan Housing Finance Corporation Ltd (DHFL) and Infrastructure Leasing and Financial Services (IL & FS). Of these DHFL and IL&FS) have collapsed and taken over by the government for restructuring.

By the time dispute between Kapoor and Kapurs settled, the

steel frame of the Yes Bank had begun creaking. Global major financial services firm, the UBS in a report dated 7 July 2015, said the Yes Bank had the strongest growth in loans to potentially stressed companies.

The report read, we believe Yes Bank is most vulnerable to a prolonged weak credit cycle and consensus may not be ready for a sharp increase in the company's credit costs. The UBS downgraded Yes Bank's stock to a sell meaning it advised the investors to sell their stocks as the company was heading to doom. Instead of plugging the loopholes, Rana Kapoor-headed bank moved the Securities and Exchange Board of India (SEBI) against the UBS. Following the collapse of IL&FS in 2018, the Yes Bank practically had no means to recover. But the issue with the bank was that it was not ready to admit its problems and underreported its stressed loans instead.

With the intervention of the Reserve Bank of India, it is now known, that the Yes Bank has been passing through a tumultuous period for long. In August 2018, the RBI asked the then chief executive Rana Kapoor to quit the bank by January 31, 2019 when it emerged that he could be the real problem of banking governance and source of bad loan practices.

After a brief intermediary period, the RBI appointed Ravneet Gill as the chief executive of the Yes Bank, the fourth largest private sector bank before its collapse. Ravneet Gill later disclosed that there had been large under-reported stressed assets in the Yes Bank. As a result, the Yes Bank reported its maiden loss in March 2019 quarter.

The Yes Bank has been trying to raise capital to infuse fresh lease of life in the bank. It initially planned to attract \$2 billion (approximately Rs 15,000 crore) in the current fiscal. But later its board rejected a \$1.2 billion (approximately Rs 9,000 crore) investment in the bank by Canadian investor SPGP Group/ Erwin Singh Braich. The bank's asset size stood at Rs 3.71 lakh crore at the end of June 2019. Promoters of Yes Bank - Madhu Kapur, Yes Capital (India) Pvt. Ltd and Mags Finvest -- hold 8.33 per cent stake in the crisis-ridden bank, as per data available on the stock exchanges.

The bank's co-founder Rana Kapoor sold his entire stake in the bank in November 2019, when the Yes Bank had turned completely unbankable. Rana Kapoor is now in the custody of the Enforcement Directorate (ED) on charges of money laundering in connection with a case, registered by the CBI, in the Yes Bank scam.

The case is about an alleged bribe of Rs 600 crore by the DHFL Rana Kapoor family on a quid pro quo basis for Yes Bank's investment of Rs 3,700 crore in scam-hit DHFL. More skeletons are expected to tumble out of the closets of the Yes Bank and Rana Kapoor's world of banking

Analysis & findings

Reasons for the fall

1. Aggressively ambitious ^[3]

Rana Kapoor is a bit of an oddball in banking circles. In a business often marked by some level of conservatism, he brought in an aggression that was unprecedented. Private sector banks, barring the occasional binge, choose to tread on the right side of caution. Of course, lending to sectors such as power came a cropper when coal licenses were cancelled and that landed many of them in a soup. Bruised,

they slowly limped back to normalcy.

By contrast, here was a man more than happy to entertain people at home with drinks and dinner or take them to Mumbai’s racecourse or sponsor golf tournaments. He liked the limelight and could never seem to have enough of it. His rivals in the banking industry wickedly call him the ‘lender of the last resort’. That title is not entirely misplaced. In fact, it has sadly done him in. Friends are distancing themselves and Yes Bank, the institution Kapoor co-founded, is out of his grasp. Not only has he lost his job but the shares he holds in the entity are no more than 0.8% of the bank’s equity.

Those who have known him say the real Rana Kapoor is aggressive (abusive as well, they add gently), hyperactive and will do anything to get a deal. Equally, he knows how to get his pound of flesh and it is said very few can match his ability to get back the money he has lent. Be it folks as

dodgy as Deccan Chronicle Holdings or the Vijay Mallya-promoted Kingfisher Airlines, every rupee lent came back. It left many a lender, which included large public sector banks, an embarrassed lot, as the fate of their money remained unknown. Besides, it gave Kapoor the confidence to lend larger sums to borrowers and that lack of judgment cost him dearly. Clearly, aggression worked only when the going was good.

2. High risk exposure to several hard pressed companies^[3]

Never letting go of a borrower was Kapoor’s way of doing business. But most on that list have defaulted at will, leading to Yes Bank’s current position (*See: Leveraged to the hilt*). Even the relatively good borrowers express a sense of surprise on how easy it was for them to get money.

Leveraged to the hilt								
<i>Yes Bank has high-risk exposure to several hard-pressed companies including ADAG, DHFL and Essar Shipping</i>								
Borrower	Yes Bank	IndusInd Bank	Bank of Baroda	SBI	Axis Bank	ICICI Bank	Kotak Mahindra Bank	HDFC Bank
ADAG (Finance)	28.5*	6	21.2	6.9	6.4	3		4.6
Cox & Kings	13.4		1.8	6.2	2.1			
CG Power	5.2			26.3	3.6			
DHFL	37	15.3	55.8	88	2.8	9.6	3.7	6.8
Essar Shipping	5			5.2				
McLeod Russel	13.5	3.5			4	10.1		1.2
Sintex Industries				16				
Total high risk	102.6	24.8	78.8	148.7	18.9	22.7	3.7	12.6
As % of FY19 reported net worth	38.10%	9.30%	15.50%	6.70%	2.80%	2.10%	0.90%	0.90%

Note: Overall exposure to ADAG is ₹130 billion; Source: Jefferies; Figures in ₹ billion

One large infrastructure group needed ₹20 billion for a project expansion. It had fallen on bad times with its traditional lenders turning tight-fisted. Not only was the loan sanctioned in just two to three meetings, there was no talk of wanting to see the project in the current form. A senior official at the group remembers Kapoor as being the “most unconventional banker”, who had no interest in prolonged discussion. The rate of interest was higher at 15-16% compared to the 13% others charged, apart from the now well-established upfront fee of 2-3%.

A standard joke in banking circles is about how Kapoor would never compromise on fee income, Yes Bank’s mainstay for at least six years. If there was pressure on that building up towards the end of each quarter, a call would go out to a borrower informing him that an additional loan has been sanctioned. In most cases, the businessman would not need the loan but a sanction letter would be sent anyway, and he would have to send it back signed. “The fee did come but one never knew if the loan ever went out,” quips the private sector banker quoted earlier. Consequently, fee income upwards of ₹3 billion was reported every quarter.

3. Power centralization^[3]

This was Kapoor’s bank and he would run it the way he wanted to. Former Yes Bank officials say there were no

power centers, since it was him deciding everything. “It was very normal for Rana to fire a relationship manager by sending him a text message,” says one person in the know. While disbursing a loan, it was Kapoor who would sit with the businessman and thrash out the smallest detail. “It was a power trip for him to deal with the promoters directly. The team only had to disburse the amount,” says the source, adding that it was odd that he would involve himself even in smaller deals. This approach works when you are a small Organisation. With size, the lender needs to evolve and change. Yes Bank didn’t.

He ruled over the board with an iron fist and that came to light when a bitter battle ensued between the Kapur and Kapoor families. This was after Kapur passed away and his wife wanted to nominate her daughter Shagun on the board of Yes Bank. This was not going through and the Kapur family alleged that Kapoor had absolute control over the board. This turned out to be a long battle ending only early this year, when Shagun was finally accommodated.

4. Trying to Change the rules of regulation^[3]

While all this was going on, the Reserve Bank of India (RBI) was starting to look at the books of banks a lot more closely. The worry was that non-performing assets (NPAs) were difficult to monitor, since banks always had a way to

beat the system. The method was simple and banks would quietly move around NPAs between themselves when they realised that a loan was close to the danger zone. This is essentially Bank A selling a bad loan (an asset) to Bank B, and promising to buy it back at the same price later. It adds no value but makes the books look good, giving investors and regulators a false assurance. The absence of technology to monitor this was fully exploited by these banks and the result was that NPAs were always under reported.

Yes Bank had said it was producing less than 1% of bad loans, when its corporate exposure was a high 65%. In an interview with CNBC-TV 18 in April 2016, Kapoor, who was then at his peak, was asked how he managed to do this, when rivals were well in the double digits. To this, he grandly said the solution was in building, what he termed, a three-eyed principle — with relationship managers, product managers and risk managers, all looking at a relationship from all angles. “That makes sure that when you have a problem, the red flag surfaces early enough,” stated Kapoor.

Red flags had begun to go up at the central bank, which had started to tighten the loophole by storing details in its central database, called Central Repository of Information on Large Credits (CRILC). This was in 2016. Banks now needed to submit quarterly reports on all its borrowers with an exposure of ₹50 million or more (fund-based and non-fund based). This was apart from having to segregate borrowers as special mention accounts (SMAs) to determine if they could go delinquent.

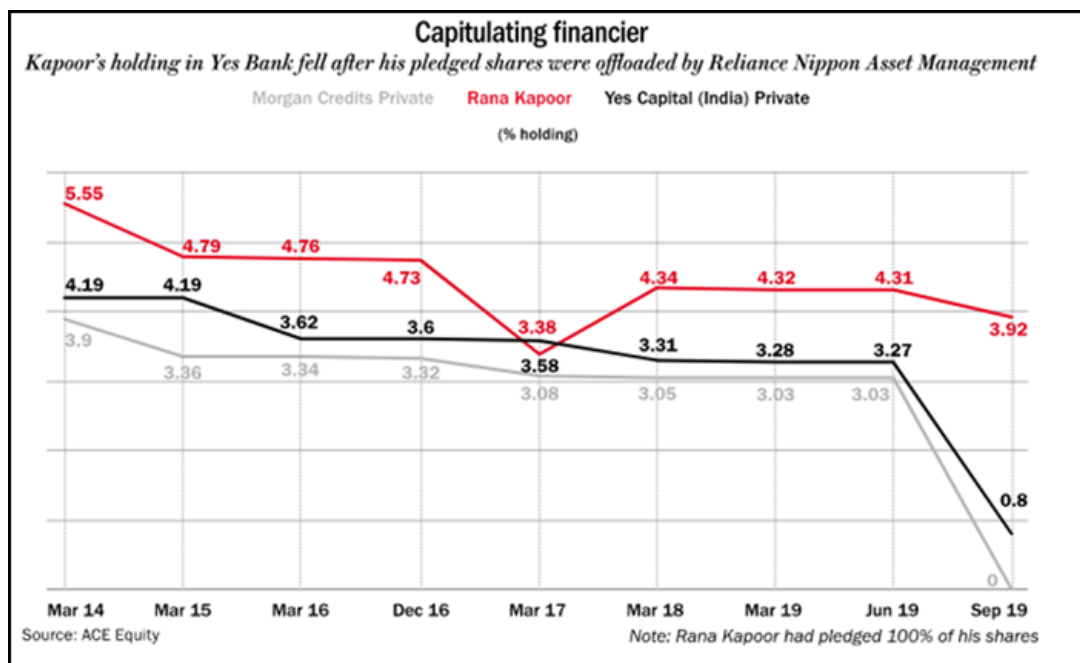
This kind of scrutiny is what led to the risk assessment report (RAR), which was more stringent than the conventional asset quality review. A former Yes Bank official says that reports on industrial groups and their high debt levels were now out. “Suddenly, there was more information available to the RBI. Historically, the regulator was good in laying down the rules but did not impress on execution. The current scenario allowed for a higher level of probing,” he says.

All that resulted in getting to the core of loan divergences or the difference between what the RBI thought was bad

compared to what the banks had been reporting. In the case of Yes Bank for FY16, the non-performing loans or gross NPAs were now assessed at ₹49.25 billion, while the official number reported was a much smaller ₹7.49 billion or a divergence of ₹41.76 billion! For the following fiscal, the divergence was a whopping ₹63.55 billion. Suddenly, the whole claim of having less than 1% as bad loans began to fall apart. Kapoor’s game was now up and he was sent packing.

The jury is still out on whether the decision was based only on the divergence issue. Ex-Yes Bank officials maintain the regulator had already been keeping a close watch on Yes, along with Dewan Housing Finance Corporation (DHFL) and India bulls Housing, for a while. “The bank was making money and reclaiming its loans but the fee model was making a lot of people uncomfortable,” one of them claims. Besides, the return of the incumbent government at the Centre is said to have complicated things just a little for Kapoor. It now transpires that its list of borrowers, such as DHFL, were quite close to the previous regime and that link is said to have gone down badly.

Earlier this year, following the elections, the government was starting to look closely at their books as well as those of India bulls, and Kapoor was asked for specific details on the nature of Yes Bank’s dealings with them. Nothing came out of that, but the regulator seems to have taken note of another transaction, where Kapoor, through promoter entities— Morgan Credit Private and Yes Capital India — borrowed ₹6.3 billion via unsecured NCDs from RNAM. They were eventually secured by the AMC recently and Kapoor’s pledged shares were sold off pushing the stock price to an all-time low (See: Capitulating financier). While there was time till next March to repay, the plummeting stock price might have forced the AMC’s hand. Not that the transaction was kosher to begin with — a listed AMC lending to the promoter of a bank, which in turn was the AMC’s parent’s biggest lender. The other puzzle is that the bank’s ex-CFO Rajat Monga has managed to extricate himself out of Yes Bank amidst the mayhem (See: The canary that did not sing).



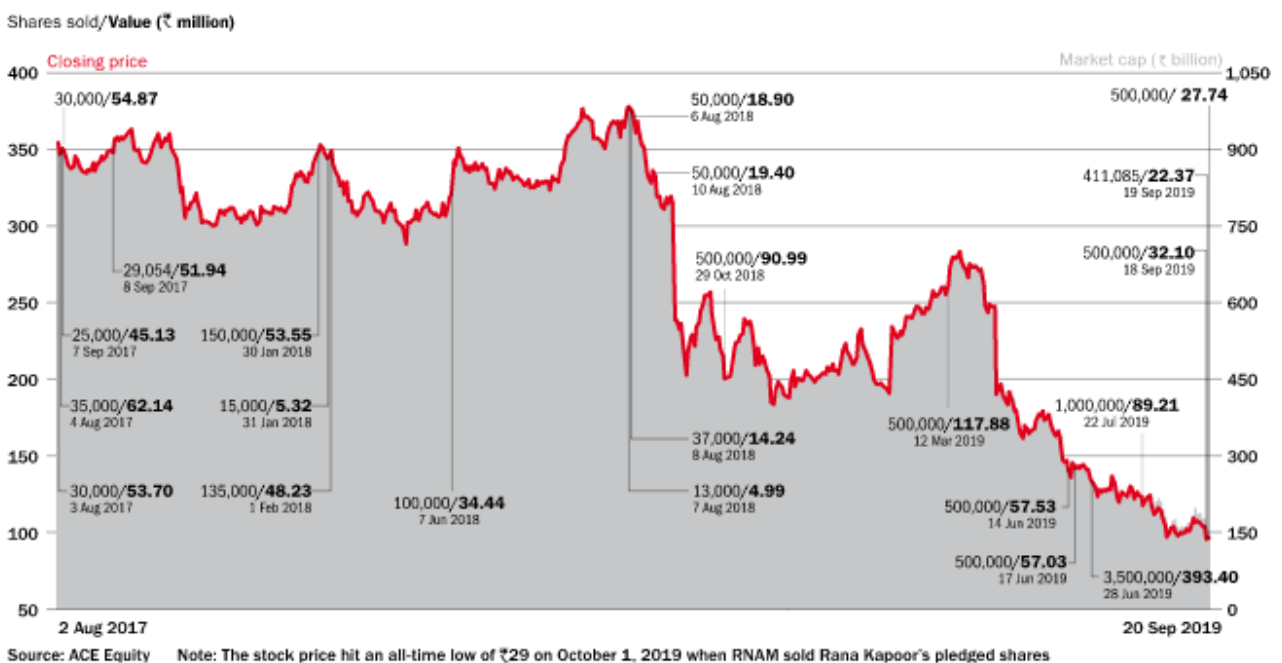
His continuous selling suggests that Monga realized that Kapoor was losing favour with the powers that be. “Rana is well-networked professionally but does not have too many friends. A lot of banks too were quite upset when he managed to get back the money from Deccan Chronicle and Kingfisher before they did,” says the former Yes Bank official.

One incident in particular landed Kapoor in a spot. A sum of approximately ₹1.5 billion was lent to Gautam Thapar, Avantha Group’s chairman and the collateral was his

bungalow in South Delhi. The default on the loan meant that it went on the block and was picked up by Interglobe Aviation’s co-founder, Rahul Bhatia, at a price significantly more than what was quoted. Kapoor managed to quietly scuttle that sale and bought it for himself. A livid Bhatia wrote to the government complaining about the inappropriateness of the process and a government already uncomfortable with the running of Yes Bank began to push for Kapoor’s removal. The official line was still the NPA divergence.

The canary that did not sing

Former CFO Rajat Monga, who recently quit the bank, sold shares worth ₹1.36 billion over the past two years. He sold his final tranche of 500,000 shares on September 20



As the heat built up mid-last year, Kapoor was informally speaking to other banks for a potential deal. A conversation with one such entity broke down at the very first meeting. When this bank was keen on knowing the list of top 25 borrowers, Kapoor coolly produced it from his drawer. The banker is said to have been horrified at the quality of borrowers and made a hasty exit.

What spooked the banker was captured in a recent report by Jefferies, on stress exposure across major accounts. In the list of high risk borrowers, ICICI Bank and HDFC Bank have an exposure of ₹22.7 billion and ₹12 billion, respectively, with Axis Bank at ₹18.9 billion. Here, Kotak Mahindra Bank is the most conservative with ₹3.7 billion. By contrast, Yes Bank’s exposure is at over ₹102.6 billion, only second to SBI’s just under ₹150 billion. Within this, Yes Bank’s lending to Anil Ambani’s finance businesses stands at ₹28.5 billion, with Axis Bank, among its peers, having the largest exposure at ₹6.4 billion, with ICICI Bank and HDFC Bank together at ₹7.6 billion. The total exposure of Yes Bank to ADAG across its businesses is a stupefying ₹130 billion. Yes Bank’s exposure to Cox & Kings, again a high-risk borrower in Jefferies’ report, is ₹13.4 billion, with only Axis Bank among its peers having lent any money (₹2.1 billion). SBI from the state-owned segment has an exposure of ₹6.2 billion to this entity,

which is less than half of Yes Bank’s.

Kapoor responded to our long list of detailed queries with precious little. “Since I am no longer associated with Yes Bank, having been its founder, MD & CEO since inception in 2004 until January 2019, it is best you direct these questions to the current MD & CEO, Ravneet Gill and the communications team at Yes Bank,” he wrote.

Conclusion [4]

If large sections of the public tomorrow start believing their money in the banks is unsafe, it could end up creating a panic of immense proportions. India has not had a major financial system panic for decades thanks to nationalization and deft management by the RBI during past crises. Even the massive fraud at PNB in 2018 did not lead to mass withdrawals.

But private banks have become too big to fail. And with the growth of non-bank lenders, the explosion in financial market activity and the interconnectedness of everybody, the stage is set for mass convulsions, if things are not quickly brought under control.

Recap bonds for public sector banks should have been done in 2015, not in 2017, and the mergers could have been announced anytime in the past six years. This would have front-loaded the reforms and given banks enough time to

absorb the mergers and use the money to provide fully for the losses. A lot of market panic and losses could have been avoided.

Yes Bank is another classic example of delayed action. It was clear from last year that the bank is going to struggle to raise money. A quick rescue plan put together over the weekend with the markets closed could have made the government and the RBI look strong, nimble and purposeful. Instead, both are now fending off attacks and trying to take strong action in a bid to change the narrative.

The government now has a fantastic opportunity ahead of it in the next few years. Crashing oil prices could boost fiscal gains and wariness over supply chain concentration in China can drive FDI inflows to India. Structural reforms, low corporate tax and low interest rates can spur growth and drive the economy towards the \$5-trillion target by 2024. The opportunity should not be frittered away by lax regulation and delayed action in the banking and financial sector.

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