The Yes Bank Crisis

This article is based on **Banking on bailouts: On Yes Bank crisis**, **Yes bank, no bank**. It talks about the collapse of Yes 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.

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.

- 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.**

Drishti Mains Question

Reflect on the underlying problems in India's financial sector.