Press Release

Yes Bank's early revival critical for banking sector stability

Impact on private sector banks' funding profile likely over the medium term

- The moratorium on Yes Bank by RBI and the prompt release of a draft scheme for reconstruction involving a strategic investor like SBI is a step in the right direction. It is likely to revive the stakeholders' confidence in the bank and limit the exit of depositors and borrower clients.
- However, an early completion of the resolution process and an immediate infusion of equity infusion will be critical to prevent any significant damage to the business and the liability franchise of the bank.
- Acuité expects a longer term impact of the crisis in Yes Bank on the Indian private banking sector. Given the higher perceived risks by depositors, the sustainability of a healthy deposit franchise in private sector and small finance banks may be a major challenge. This may impede the growth of smaller private sector banks in the near to medium term. Also, the heightened corporate governance concerns of the investors will also make it difficult particularly for smaller banks to raise capital both through equity or bonds.
- The asset quality concerns in the banking sector continue to be reinforced through this crisis. While the reported gross NPAs of Yes Bank stood at Rs. 17,134 Cr as on Sept-2019, Acuité estimates that the underlying stress in the bank's portfolio is far deeper at Rs. 55,000 Cr.
- Acuité believes that the permanent and full write down of AT1 bonds of Yes Bank as envisaged in the reconstruction scheme will substantially add to the risk perception on these hybrid instruments and limit their issuances only by large public and private sector banks. In our estimates, investors i.e. mostly domestic mutual funds and banks would lose both principal and interest payable on AT1 bonds amounting to Rs. 10,800 Cr of Yes Bank.

RBI has imposed a moratorium on Yes Bank and has also released a draft scheme for its reconstruction on March 5-6, 2020. This was a necessary intervention by the banking regulator to address the steadily increasing concerns on the bank's capital position and importantly, to protect the interests of the depositors of Yes Bank whose outstanding deposits stood at Rs. 2.09 Lakh Cr as on Sept 30, 2019. While the bank's ability to raise equity capital up to a reported amount of USD 2.0 billion was under doubt, the concerns on its asset quality has been rising steadily. Clearly, the likely acquisition of up to 49% shareholding in Yes Bank through an equity infusion of around Rs. 2,450 Cr by SBI and perhaps other public sector institutions will provide comfort to the depositors regarding the safety of their money.

RBI made an announcement on March 5, 2020 under Section 45 of the Banking Regulation Act, 1949 to put the operations of Yes Bank under moratorium for nearly a month up to April 3, 2020 which imply significant restrictions on withdrawals of any form of deposits beyond Rs. 50,000 and a temporary cessation of any fresh disbursements to its clients towards loans or investments. The regulator has promptly backed up the moratorium with a draft reconstruction plan for the bank which envisage among other things (i) new strategic investor (likely to be SBI) to take a 49% stake in the bank at a price not less than Rs. 10 per share on a face value of Rs. 2 (ii) the constitution of a new board of directors where the investor bank will have 2 nominee directors in the board and RBI may additionally appoint other directors (iii) the investor bank will continue to hold a minimum stake of 26% in the bank for a period of 3 years (iv) appointment of a former DMD and CFO of SBI as an administrator to manage the bank through the moratorium period (v) a permanent write down of the Additional Tier-1 Capital (AT1) of the bank raised through perpetual bonds that have inherent risk absorption characteristics under Basel III norms. With such a revival plan in place that is set to be tightly monitored by RBI, all the stakeholders of the banks and particularly, the depositors are expected to remain confident on the continuity and sustainability of the bank's operations.

Yes Bank has been one of the fastest growing private sector banks in India with outstanding advances of Rs. 2.42 Lakh Cr and deposits of Rs. 2.28 Lakh Cr as on March 31, 2019. The bank witnessed a high and sustained growth in its advances over the 5 year period 2014-19 with a CAGR of 34.1% which was also supported by a steady growth in its deposit base (CAGR – 25.1%) and an improving CASA ratio which stood at 33.1% as on March 2019. While the size of the bank continued to grow aggressively, the signs of a deterioration in asset quality were visible as early as March 2017 when its reported NPAs doubled to 1.52% from 0.76% in the previous year. Further, the significant divergence in asset categorisation and resultant NPA provisions pointed out in the risk based supervision (RBS) conducted by RBI in October 2017, triggered corporate governance concerns in the bank which only continued to grow as time progressed. Meanwhile, the bank reported fresh slippages of around Rs. 8,000 Cr in each of the years FY2018 and FY2019, leading to gross NPAs of 3.22% as on March 2019. With increasing concerns on the underlying weakness in its asset quality, the bank reported a sharp surge in GNPAs that reached Rs. 17,134 Cr or 7.39% of the bank's book in the first half of the current year. Expectedly, the market capitalization of the bank came down sharply and stands at around Rs. 4,000 Cr as on date as compared to a reported networth of Rs. 27,790 Cr as on Sept 30, 2019.

An analysis conducted by Acuité Ratings on the reported capital position of Yes Bank and its underlying asset quality (based on realistic assumptions) indicates that a predominant part of not only its common equity but also Tier-1 capital is set to be eroded [please refer to Table-1 for the broad calculations]. Acuité estimates that on an aggregate, around Rs. 55,000 Cr of advances and investments of Yes Bank i.e. roughly 20% have a significant element of stress and will need to be provided for. Clearly, an intervention from RBI had become necessary to facilitate a fresh infusion of capital and a restoration of stakeholders' confidence in the bank.

Acuité believes that a quick resolution of the crisis in Yes Bank and an early end of moratorium is critical for not only limiting the impact on the latter's business but also for sustaining confidence in the Indian private sector banks in general. In the short term, the customers and the depositors of the bank will be impacted due to the disruptions in the operations of the bank. Yes Bank had a steadily improving deposit franchise with Rs. 64,500 Cr i.e. 30.8% CASA (albeit reduced from last year) as on Sept, 2019 and an increasing granularity with retail term deposits comprising 29.5% of its total term or Non-CASA deposits. However, the announcement of the moratorium and the permission to withdraw up to Rs. 50,000 may lead to some exit of the small depositors in the near term, thereby reversing the granularity to an extent. Further, there is also a risk to the asset franchise of the bank as a significant proportion of its customers – retail, MSME and corporate may move their transactions to other banks to minimise the disruptions in their operations. It may be noted that the MSME portfolio of the bank stood at Rs. 41,100 Cr as on Sept, 2019 and a significant proportion of such customers have either sole banking arrangement or a high dependence on the bank for its regular working capital needs. Therefore, a rapid revival of the bank through the entry of the strategic investor and a healthy level of equity infusion will be the key to its longer term sustainability.

The crisis in Yes Bank will also have longer term implications for the private sector and the small finance banks in the country. Except for the established and the large 3-4 private sector banks, the others may face increasing challenges in deposit mobilisation. It has already been observed that many small finance banks (SFBs) are facing growth constraints due to their inability to grow their deposit franchise. Many of the smaller private sector banks pay 1%-2% higher interest on their savings or term deposits to attract depositors. The developments in Yes Bank are likely to aggravate such liability challenges in private sector banks. Furthermore, the corporate governance concerns in the banking system continue to get reinforced by such events and this is likely to impact fresh capital raising by banks from the equity market. This has further implications for the growth trajectory of the private sector banks who have witnessed a significant improvement in their market share vis-à-vis public sector banks.

The impact of the moratorium will also be seen in the bond markets. Both public and private sector banks have raised a significant amount of Basel III bonds – that qualify either as Tier-1 and Tier-2 Capital depending on the instrument characteristics. While Tier-2 Capital has limited risks till the liquidation of a bank, the Tier-1 Capital (also called Innovative Perpetual debt Instruments or IPDI or AT1) have substantial loss absorption characteristics under Basel III norms. The draft scheme of reconstruction has envisaged a full and permanent write-down of such AT1 bonds and therefore, strongly validates the inherent risk in these hybrid instruments. This is for the first time in the history of the Indian Banking sector that a bank's AT1 bonds is being written down at the 'point of non-viability' (PONV) i.e. the investors have to take a hit on both principal and the balance interest payments. With the outstanding AT1 bonds for Yes Bank estimated at Rs. 10,800 Cr, the investors mainly comprising mutual funds and banks' treasuries will witness a major impact on their portfolio. In the opinion of Acuité, this will limit the market for AT1 bonds in India only to issuances by a few large public sector banks and further, the pricing will see increased differential with that of Tier-2 bonds to reflect the equity like risks.

Table-1: Yes Bank: Capital, Asset Quality Position

Rs. Cr	**30-09-2019**	**31-03-2020**
Risk Weighted Assets (RWA)	310000	
Common Equity (CET 1)	8.7%	
CET 1- Rs Cr	26970	
Tier -1 Capital (T1) (inclusive of AT1 bonds)	11.5%	
T1- Rs Cr (A)	35650	
Gross NPA	17134	
Net NPA	9757	
Outstanding Provisions	7377	
Provisioning Cover	43%	
Average Recovery Level		40%
Balance Provisioning/WO Required		17%
Balance Provisioning/WO Required on Existing NPAs (B)		**2903**
Residual Corporate Portfolio		
BB & Below	31400	
BBB	65287	
Average Recovery Level: <=BB Portfolio	64%	
Balance Provisions: <=BB Portfolio (C)		**11304**
Average Recovery Level: BBB Portfolio	82%	
Balance Provisions: BBB Portfolio (D)		**11752**
Additional Provisions/WO s Required (B+C+D)		25959
Proportion of T1 Capital Write Off Required*		73%
Projected Stress Asset Levels*		55560

* Broad estimates made based on latest data available and on recovery assumptions

About Acuité Ratings & Research Limited:

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