

Financial



Changing Rules Changing Lives

THE ANATOMY OF INDIA'S BIGGEST FINANCIAL SCAM

The Yes Bank Fiasco

Rana Kapoor, 62, entered into a criminal conspiracy with Kapil Wadhawan, DHFL promoter for round tripping of funds where loans from Yes Bank to DHFL landed in companies owned by daughters of Rana Kapoor, DoIT Urban Ventures (India) Pvt Ltd, officials had said.

The Yes Bank Fiasco

Shares of Yes Bank, which traded at 404 rupees at its peak in August 2019, fell to a record low of 5.65 rupees on Friday, with the stock plunging nearly 85%. The fall wiped out 79.43 billion rupees (\$1.08 billion) from Yes Bank's market value.

Here's a look at the events leading up to the Reserve Bank of India's move:

- Sept. 19, 2018 - RBI refuses to give Chief Executive Officer Rana Kapoor an extension to his term - Kapoor to step down by end of January 2019
- Nov. 27 - Moody's cuts bank's foreign currency issuer rating; changes outlook to 'negative' from 'stable' citing concerns over corporate governance

The Yes Bank Fiasco

- Jan. 24, 2019 - Yes Bank hires the head of Deutsche Bank India Ravneet Gill as its new CEO
- Feb. 13 - Yes Bank says RBI observed no divergences from central bank norms in the bank's asset classification and provisioning
- April 8 - Pressed for capital, Yes Bank says it will consider raising funds by issuing shares and debt securities

The Yes Bank Fiasco

- April 26 - Rising levels of bad loans trigger Yes Bank's first-ever quarterly loss; Macquarie Research double-downgrades stock to 'underperform', stock tanks 30% on next trading day
- May 14 - RBI appoints ex-central bank Deputy Governor R. Gandhi as additional director to Yes Bank's board - a rare move signaling an increased level of scrutiny on the lender
- July 17 - Yes Bank reports 91% drop in first-quarter profit, as provisions surge and asset quality deteriorates sharply; gross bad loan ratio stood at 5.01%

The Yes Bank Fiasco

- Sept. 10 - Yes Bank CEO Gill says lender is close to securing a deal to sell a minority stake to a global technology company to help boost its capital
- Oct. 3 - CEO Gill says bank is in talks with private equity firms, strategic investors and family offices to raise additional capital
- Oct. 31 - Yes Bank gets binding investment offer of \$1.2 billion from global investor, sends stock 39% higher

The Yes Bank Fiasco

- Nov. 1 - Yes Bank reports bigger-than-expected loss for the second quarter, as bad loan ratio deteriorates to 7.39% and provisions swell to 13.36 billion rupees
- Nov. 29 - Yes Bank says it aims to raise up to \$2 billion in a massive issue of new shares to institutional investors and family offices; says it is in talks to sell shares worth \$1.2 billion to Canadian investor Erwin Singh Braich and Hong Kong-based SPGP Holdings, which he backs
- Jan. 10, 2020 - Yes Bank rejects Braich's investment, says will launch a \$1.4 billion share sale, after a board member's resignation casts more doubt on the lender's future

The Yes Bank Fiasco

- Feb. 12 - The lender says it will delay disclosing its October-December earnings by at least a month, and that it was in talks with potential investors for a cash infusion
- Feb. 12 - Bank says it received non-binding expressions of interest from JC Flowers, Tilden Park Capital Management, OHA (UK) and Silver Point Capital.
- March 5 - India places Yes Bank under moratorium, with RBI taking over from its board for 30 days and imposing limits on withdrawals to protect depositors

Issues and Probe against DHFL

DHFL stopped payment of bonds and defaulted. This made stock to fall over 97% and Government intervention into the case. Even as efforts to draft a resolution plan were underway in August 2019 by banks to restructure DHFL debt into equity, a few bond holders of the company moved to the debt recovery tribunal that may impact the resolution.

The company meanwhile offered to repay all investors in full with due process of inter-creditor-agreement. In October 2019, the Enforcement directorate conducted raids at several places of DHFL offices and promoter residences and found links of money laundering activity in loans given to firms closely linked to the promoters of the company.

The DHFL Story Contd

- This way the private assets acquired by the Wadhawans and their associates by using the funds from these dubious loans are completely ring-fenced from any recovery process that may be initiated by authorities under the SARFAESI Act or Insolvency and Bankruptcy Code of India.
- Thus, the only losers in the process would be the public sector banks, such as State Bank of India and Bank of Baroda, with an exposure of over Rs. 11,000 crore and Rs. 4,000 crore, respectively, foreign banks and shareholders from among the public or investors of DHFL.

What helped Kapil Wadhawan and Dheeraj Wadhawan to pull off the scam?

The position of power and influence they occupied as majority members in the Finance Committee of DHFL, which approves loans of Rs 200 crore and above to any entity.

They ensured that loans were granted to shell/pass-through entities and the money ultimately ended up in the companies owned or controlled by the Wadhawans.

DHFL - The Alleged/Proven Details

- The scam has been pulled off mainly by sanctioning and disbursing astronomical amounts in secured and unsecured loans to dubious shell/pass-through companies, related to DHFL's own primary stakeholders Kapil Wadhawan, Aruna Wadhawan and Dheeraj Wadhawan through their proxies and associates, which have in turn passed the money on to companies controlled by the Wadhawans.
- The money has been used to buy shares/equity and other private assets in India and abroad, including in countries like UK, Dubai, Sri Lanka and Mauritius.

Impact on Larger Financial System Of India

- As an industry practice, loans are advanced to companies and are secured by not only mortgaging the properties of the borrower company but also by personal guarantees of promoters of companies.
- By lending to shell/pass-through companies without due diligence, DHFL has ensured that the recovery of such dubious loans is impossible since the companies or their directors themselves do not own any assets.

DHFL - The Alleged/Proven Details

Debt recovery is an important metric on which ease of doing business is judged. Such scams, if not identified, resolved and persons responsible punished, will only damage India's prestige on the world stage.

In case the Government of India takes over DHFL, like IL&FS, without a thorough investigation into its affairs by investigating agencies such as CBI, SFIO(Serious Fraud Investigation Office) and Enforcement Directorate, then the Wadhawans who are principal beneficiaries of the scam will go scot free.

DHFL - The Alleged/Proven Details

DHFL, rebutted these allegations in a Hosted Investors / Analysts conference & clarified that ₹ 31,000 crore loans mentioned in the allegation comprise its Project Loan Portfolio. Also that these Advances commented by CobraPost should be ₹ 21,000 Crores and not ₹ 31,000 Crores as alleged. Post CobraPost allegations Rating agencies reaffirmed their High Safety Rating for Instruments issued by DHFL.

On 6 June 2019, The DHFL shares tanked 16% after the company defaulted on debt repayment. This was a five and a half year low. And has left investors wondering whether to stay in the game or not.

TIMELINE

A string of defaults at Infrastructure Leasing and Financial Services Ltd triggered widespread selling in non-banking finance sector in September.

[DHFL shares](#) were further hammered after investigative media outlet [Cobrapost](#) alleged mismanagement within the company's board and said it diverted funds to shell companies to buy assets.

Over three-fourths of the company's market-value has been wiped off since September 19 and DHFL is now valued at Rs 4,668 crore (\$662.69 million). In 2019 alone, the stock has lost 46.31 percent as of close on March 6.

TIMELINE

Feb 28: CRISIL downgrades co's commercial paper program and short-term deposit.

March 6: An auditor dismisses media allegation that DHFL created shell companies to divert funds, but says co's monitoring of loans was inadequate.

Care Ratings revises DHFL's long-term ratings, placing most of them on credit watch with developing implications

March 7: DHFL expresses concerns over the re-ratings, saying it is an "irrational" decision.

Here's how the saga unfolded this year :

Jan 29: Investigative media outlet Cobrapost alleges financial misappropriation by DHFL's controlling shareholders, saying publicly available data showed funds, including a large amount the firm secured from Indian state banks, were diverted to shell companies in India and abroad to buy assets.

Jan 30: DHFL says allegations by Cobrapost are 'unfounded and malicious', denies diverting funds via shell companies.

Ministry of Corporate Affairs will look into allegations of financial mismanagement against DHFL, sources tell Reuters

TIMELINE

Jan 31: Government sources confirm that investigations into allegations against DHFL have begun.

DHFL says it has not received any communication from the government in relation to an investigation.

Feb 4: Co says it will consider selling assets and some of its businesses to improve liquidity.

TIMELINE

Rating agencies CRISIL Ltd, CARE Ratings and Brickwork Ratings cut ratings on certain non-convertible debentures (NCDs) and debt instruments of DHFL.

The company says it had not delayed any payments to creditors and that it would approach CARE Ratings for a review.

Feb 11: DHFL gets notice from income tax department seeking information about certain accounts.

Feb 13: Chief Executive Officer Harshil Mehta resigns.

Feb 18: Co says no decision had been made about a stake sale yet.

Feb 27: ICRA cuts rating on the housing finance company's commercial papers.

What is the update as of now?

- Additionally the trail of the loan given by DHFL to Sunblink real estate in 2010 leads to gangster Iqbal Mirchi, who is supposed to be an accomplice of the fugitive Dawood Ibrahim.
- In exercise of the powers conferred under Section 45-IE (I) of the Reserve Bank of India Act, 1934, the Reserve Bank has today superseded the Board of Directors of Dewan Housing Finance Corporation Limited (DHFL) owing to governance concerns and defaults by DHFL in meeting various payment obligations

As of Today..

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RBI refers Dewan Housing Finance Limited to NCLT

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Mission Indradhanush

The government of India, in order to resolve the issues faced by the Public Sector Banks launched a 7 pronged plan called “Mission Indradhanush.

The Indradhanush for PSBs mission aims at revamping the functioning of the Public Sector Banks in order to enable them to compete with the Private Sector Banks.

It seeks to revive economic growth by means of reduction of political interference in the functioning of PSBs and improving credit.

Components of Mission Indradhanush

The 7 components of the Mission (symbolic of 7 colours of the rainbow) plan to address the challenges faced by the Public Sector Banks. The 7 components include:

- **Appointments:** Besides induction of talent from the Private Sector into the public banks, separation of the posts of Chief Executive Officer and the Managing Director, in order to check the excessive concentration of power and smooth functioning of the banks.

Components of Mission Indradhanush

- **Bank Boards Bureau:** The appointments Board of the Public Sector Banks would be replaced by the Bank Boards Bureau (BBB).
- Advice would be rendered to the banks in the matters of raising funds, mergers and acquisitions etc by the BBB. It would also hold the bad assets of the Public Sector Banks.
- The BBB separates the functioning of the PSBs from the government by acting as a middleman.

Components of Mission Indradhanush

- **Capitalisation:** Due to the high NPAs and the need to meet the provisions of the Basel III norms, capitalization of banks by inducing Rs. 70000 crore was planned.
- **De-stressing:** Solving issues arising in the infrastructure sector in order to check the stressed assets in the banks by strengthening the asset reconstruction companies. Development of a vibrant debt market for PSBs.
- **Empowerment:** Providing greater flexibility and autonomy to PSBs in hiring manpower.

Components of Mission Indradhanush

- **Framework of Accountability:** The assessment of the banks would be based on a few key performance indicators. It would be inclusive of
 1. *Quantitative Parameters* such as Non-Performing Assets Management, growth, diversification, return on capital, financial inclusion and
 2. *Qualitative Parameters* such as steps taken in improving asset quality, human resources initiatives etc.
- **Governance Reforms:** Banker's Retreat or the Gyan Sangam conferences between the bankers and the government officials for resolving the banking sector issues and deciding the future course of action.

ICA - Inter Creditor Agreement

To state it in simple words it is a big step taken by the key lenders of the country to tackle the menace of non-performing assets (NPA) or bad loans speedily which has breached Rs. 10 lakh crore mark on a more recent basis.

The problem of ever-increasing bad loans in the Indian banking system led to the introduction of the Sashakt resolution plan by the government that came up earlier this month.

The Sashakt plan besides other things demanded the establishment of an asset reconstruction company or asset management company for managing bad loans.

ICA - Intercreditor Agreement

The intercreditor agreement or ICA that is the direct result of the government's Sashakt resolution plan or report on bad bank drafted by the Sunil Mehta committee and will work as below:

Herein the lenders in the agreement will jointly appoint a lead lender who will function on behalf of the entire group.

The leading lender will then be required to put forth the resolution plan for the non-performing assets (NPAs) before the group and if it is given a go-ahead by two thirds of the lenders, the proposal will qualify to be taken up for resolution of the given account.

Responsibilities of lead lender

1. Submission of the NPA resolution plan before the overseeing committee. The oversight committee is expected to be created by Indian Banks' Association (IBA) in a month's time.
2. Each resolution plan has to comply with Reserve Bank of India norms, guidelines and applicable laws.
3. Taking decision in respect of the sustainable debt in relation to an NPA account
4. The pact allows the lead lender to implement the plan in 180 days.

ICA discussed

For the services rendered, lead lender will be offered a fee and is shielded from other liabilities.

First progress review under the inter-creditor agreement might be executed after three months of time.

It is to be noted that the inter-creditor agreement or pact will stand terminated in certain situations such as the direct intervention by the Reserve Bank of India.