EXPLAINER

THE FAILURE OF INDIA'S YES BANK POSES UNCOMFORTABLE QUESTIONS

Yes Bank, which was established in 2004, was once considered a rising star in India's banking industry. However, saddled with bad debts and experiencing a corporate governance failure, the private bank needed to be bailed out by the Reserve Bank of India (RBI) earlier this year. A closer look at the debacle reveals lessons that the sector would do well to heed.

1 WHAT LED TO THE EXTRAORDINARY RBI INTERVENTION IN YES BANK?

According to Krishnava Dutt, managing partner of Argus Partners, governance issues had been plaguing Yes Bank for some time, and these ranged from disputes between the two promoter families to misstatement on the quality of assets. "Aggressive lending may have also added to the stress the bank was facing," he says, adding that a much-needed management change was brought in by RBI in 2019 with the appointment of Ravneet Gill as MD & CEO. "The new management was tasked with the mission to save the bank by finding eligible investors. Various investors showed interest but ultimately none fructified."

However, with the bank "slipping fast into ICU," the RBI had no other option but to step in by invoking section 45 of the Banking Regulation Act, says Dutt. "Section 45 is invoked under exceptional circumstances and gives the RBI the power to apply to the central government for suspension of business by a banking company and to prepare schemes of reconstitution or amalgamation," says Dutt. "The circumstances were truly exceptional and had the RBI not stepped in, Yes Bank in all probability would be staring at bankruptcy – causing significant loss to millions of depositors and investors."

2 WHAT LESSONS DOES THE YES BANK SAGA HAVE FOR INDIA'S BANKING INDUSTRY GOING FORWARD?

Dutt believes that good corporate governance, including credit discipline, is the most important factor for sustainable growth in the banking and financial services space. "Whilst the RBI regulations do create mandatory frameworks within which the bank is required to conduct its business, it is the inherent conflict of interest in the business of banking which needs to be addressed," he notes. "The management remuneration is linked to the profit of the bank. The profit of the bank depends primarily on disbursement or funds deployed. This leads to innovative financial engineering and 'structured solutions' which oftentimes are nothing but 'evergreening.'"

To ensure credit discipline, institutions - other than scheduled commercial banks which have already such regime - may put in place conflict management and risk management policies which are more specific, says Dutt. For example, the risk/compliance team can be completely separated from reporting lines to the MD/CEO and report directly to the board with their remuneration also not being linked to the profitability of the bank. "Although Yes Bank has a significant wholesale book, it must be noted that the narrative that retail banking is inherently risk-free may also not be true," says Dutt. "Credit discipline must be imbedded in the DNA of the institution irrespective of the character or quality of its asset book."

3 WHAT KIND OF REFORMS ARE NEEDED TO ENSURE ANOTHER YES BANK DOES NOT HAPPEN?

Dutt says that while regulators and enforcement agencies have historically viewed "evergreening" as antithetical to good corporate governance, this view may not necessarily be shared by all the lenders. "Most financial scams for banks or financial institutions revolve around the real quality of the assets versus what is disclosed. Section 447 of the Companies Act also brings 'evergreening' within the ambit of 'fraud', as is seen in the case of IL&FS," he notes. "The dichotomy between 'bad business decision' and 'fraud' has largely seen the judiciary tending towards the latter. Thus, an issue that begs a question – does restructuring an account necessarily need to attract regulatory provisioning or whether a more open targeted disclosure regime with appropriate approvals for provisioning with respect to restructuring may be explored."

He adds that serious government and regulatory intervention is needed for building a far more active and robust corporate bond market. "A mature corporate bond market (with appropriate disclosure mechanisms) may eventually, albeit not absolutely, reduce the dependence of corporates on banks for debt capital other than for working capital requirement," says Dutt. Finally, far more use of technology especially by RBI in its supervisory role is an essential requirement. "This shall aid RBI in identifying issues and providing directions for corrective or preemptive actions," he concludes.