

# **NEEDED BIFURCATIONS FOR HAVING ROBUST PROCESS OF LEGISLATION, SUPERVISORY AND FRAMEWORK FOR FINANCIAL INSTITUTIONS, AUDITORS AND BORROWERS**

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## **ABSTRACT**

The article mainly emphasizes on the bifurcations, measures and methods for protecting and safeguarding the hard earned savings of the centric depositors and insurance to protect their investment and savings by expressing concern and accountability upon any default in banking sector. Further the piece discusses on the situation of the present age of the banking that has been deteriorated, reasons for such aftermaths articulated as demotion in operating performances, dismay in long term ratings, substantial fall in recovering dues from the big borrowers etc. The major part of the dialogue covers the much highlighted recent failure of the Yes Bank and how it had hit the functioning segment of banking authorities to maximum also how the very much critical financial standoff had amply occurred the financial as well as money lending institutions financial collapse, crisis and declining in the banking industry. The reasons of such unprecedented situation had been discussed in detailed in the further part of the article. Further the article discusses the structure and working of the Reserve Bank of India (RBI) had also been explained for better understanding of the role in holding, monitoring and functioning the financial sector. Further also it is being elaborated as to how the fourth largest private bank of India graced this financial failure in a row to be considered as a matter of serious concern of second thoughts. Also, in further content the role of Hon'ble Supreme Court is being as how it came forward for protecting the rights and interest of the depositors. At, last but not the least it is being discussed that how weaker mechanism of the banking segment needs to be strengthened, how it is essential that both RBI as well as government must act as a very supervising anatomy and legislate some indestructible and stringent provisions more specifically in Banking regulations Act, 1949 for combating fallouts and scams.

**Keywords:** Bifurcations, centric depositors and insurance, institutions financial collapse, starved financial sector, yes bank case, banking business and trade, boosting the economy.

## **INTRODUCTION**

Banking segment have been one of the most trusted end financial institution pertinently for centric depositors alike middle class and lower middle segment those meant to deposit their hard earned savings and income, keeping their vital trust and interest upon the bank and its workers, ensuring to protect their investment and savings by expressing concern and accountability upon any default in maneuver with banks to be resolved pro rata, assuring to prevent the depositors and investors from facing any complication while accessing the benefits from bank in return of their savings or investments. Furthermore, the situation erstwhile is not same at present age of the banking sector, though had been deteriorated, further the reasons for such aftermaths articulated as demotion in operating performances, dismay in long term ratings, substantial fall in recovering dues from the big borrowers, failure in catch hold of the corporate houses manipulating depositors monies, lethargy in checking financial status quo of the entities, and committing the modus in granting loans without mortgaging adequate collateral, etc., articulated as reasons for banks collapses or fallouts.

## **FALLOUT OF BANKS AND ITS IMPACT ON THE BANKING SECTOR AND OTHER INTERRELATE SEGMENTS**

In the scam-hit banking industry, on 05 March, 2020, the much highlighted recent failure of the Yes Bank had hit the functioning segment of banking authorities to maximum, the very much critical financial standoff had amply occurred the financial as well as money lending institutions, as the reasons of this unprecedent situation being no check in the financial health of the borrowers during the tenure of the loans granted by bank to the debtors including corporate houses, businesses, companies, non-banking financial corporation's etc., intended for gaining high rate of interest on the loans, which later classified as Non-performing assets (NPA's) when the borrowers to whom the loans were extended were unable to pay the Easy monthly installments (EMI's) within the stipulated timing, considered as one of the major reason of the collapse of the bank and further accumulative other factors were elaborated ahead. The shortcomings and difficulties that could not be resorted with the banks reflects that the borrowers to whom the loans had been granted being entities like IL&FS, Jet Airways, CG Power etc. have faceoff negative progress in recent years, diluted or framed under money laundering cadre, etc.

The scope and commencement of granting loans to the borrowers in case discussed herein is enormously intended for gaining higher rate of interest on loans, which later on one after the

other classified as NPA's, the frame soon came into the attention of the Enforcement Directorate, which later grabbed the Yes bank for generating money through undetermined resources and then laundered the amount. Later, it came into the upfront when it was figured out after making enquiries that Yes Bank had disbursed the loans which later they had corroborated. Soon, thereafter bank loans variations, deviations and provisions reported Non-performing assets. According the Securities and Exchange Board of India, banks are now required to disclose deviations and differences in the asset classification and to act immediately upon receipt of RBI's final Risk Assessment Report (RAR).

The huge financial collapse, crisis and declining in the banking industry significantly was a reason tragic shirk of Yes Bank being fourth largest private bank in India, as within the timeline of past three four years there had been many instances which self-explained that the cash starved financial sector have proved to be a fallout failure for the reasons that the expressed negligence of the supervisory of public interest and their income savings. Despite, having implementations of enforcement action framework and complying guidelines ensuring and committing regulatory supervision; resolving corporate governance issues; appropriate action for any lapses or discrepancies found in audits while inspecting balance sheets, etc., as per Banking Regulation Act, 1949, and other enactment within the legal framework itself been legislated by the Central Government that despite such laws and rules the alleged lethargy and mishandling, keeps the government as well as the supervisory on their toes.

### **EXPLANATION OF RESERVE BANK OF INDIA'S STRUCTURE AND FRAMEWORK AND THE FACTORS THAT NEEDS TO BE CHECKED BY RESERVE BANK OF INDIA WHILE GRANTING LOANS**

Since the fallouts of the banking sector had disclosed the inattentive and remiss framework of the authorities for the causes of the loopholes in the action framework. Henceforth it is necessary to make the legislation more core though for understanding the same. The Reserve Bank of India's structure and framework has been explained herein for better understanding of the role in holding, monitoring and functioning the financial sector as playing a vital part in strengthening the bank, auditors and corporate governance which are must:

#### **➤ Board of Financial supervision**

The RBI performs the supervisory function under the guidance of the Board for Financial Supervision (BFS). The Board was constituted in November 1994 as a committee of the

Central Board of Directors of the Reserve Bank of India under the Reserve Bank of India (Board for Financial Supervision) Regulations, 1994. The constitution and legal framework of the Reserved Bank of India revolves and carbs around:

➤ **Main key Functions**

Some of the ingenuities taken by Board for Financial Supervision include:

1. Boosting the statutory audit process of banks
2. Widening auditors role in supervisory;
3. Establishment of the internal defenses within supervised institutions such as internal control and audit functions, management control and risk control systems etc.;
4. Supervision regarding fraud risk management framework in banks;
5. Establishment of enforcement framework in respect of banks etc.

It is now a better understood significance from the above understanding that at which cornerstone the RBI as well as the government had been lethargic, negligent and over lookers and had even after “facing huge crisis and criticism on major supervision lapses in cases like Punjab National Bank (PNB) and Punjab and Maharashtra Cooperative Bank (PMC)”<sup>1</sup> and in recent had established another example of Yes Bank had not changed their process functioning and working mechanism in a much wider and manner which is an issue of serious concern. Henceforth, the accumulated factors that were to be pertinently checked by the RBI as well as the government but were ignored were elaborated hereunder:

- (i) Granting loans to the corporate houses, businesses , companies, non-banking financial corporations, etc, are with the clear agenda for gaining high rate of interest on loans, which soon turned into incremental bad-loans, as the borrowers later were unable to pay the EMI's and loans within the stipulated timing, which later classified as Non-performing assets;
- (ii) “Increase in divergence in the bank loans and provisions reported Non-performing assets”, “resulting in difference in assessment”;
- (iii) RBI's shortcoming as a supervision authority as well as its supervision lapses

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<sup>1</sup> <https://www.moneycontrol.com/news/business/companies/yes-banks-financial-failure-is-first-for-a-new-age-private-bank-was-rbi-late-in-acting-5008051.html>

(iv) The “Corporate Governance issues gradually eroded the investor trust in the Bank”;

(v) “Outflow of liquidity”.

### **REASONS ELABORATED HEREIN UNDER OF THE CRISIS WITH THE BANKS AND THE RBI’S ROLE IN CONTROLLING IT**

The said reasons of which the crisis occurred with the fourth largest private bank of India as elaborated above further graced this financial failure in a row to be considered as a matter of serious concern of second thoughts.

Further, firstly as far as the doubt of the loan which were granted to the corporate houses, businesses, companies, non-banking financial corporations, etc., are with the clear agenda for gaining high rate of interest on loans, which soon turned into incremental bad-loans, as the borrowers later were unable to pay the EMI’s and loans within the stipulated timing, which later classified as Non-performing assets, the experts of the banking segment believe that with intent to generate the high-interest rate, whereas the bank lended the money to the corporate on easier norms without checking the financial condition of the companies.

Secondly, increase in divergence in the bank loans and provisions reported Non-performing assets, resulting in difference in assessment, the RBI identified major divergence in the reported NPA’s numbers and the actual bad loan figures due to which the financial ratios deteriorated. Divergence in provision issues was a major problem faced by bank.

Thirdly, firmly audit lapses resulting in errors in bank’s financial statement, wrong clarifications and information given by the auditors had been one of the major reasons for most of all was that even in the frame of bank failures, also indicates a serious risk of the health of the banking system and in a hard situation which duly shifts the onus upon the auditors of banks which in Yes bank case is BSR and Co. who had been the statutory auditor. Further, the Central Bank will now specifically look at whether the auditors had issued any intimation over past one year. At, times for committing fraud the assesses i.e., the bank in case herein use advantage of e-filing at the time of submission of accounts and Balance sheets and Income tax returns, involves their auditor company by giving them unscrupulous offers by violating the law and its provisions for which the auditor agree, misconducting their

audits, lapses resulting in errors in financial statement etc., with prolix, oppressive and determined intentions above all with per incuriam ignore the due process of law even not taking the vigilance and supervision being under RBI body and an important pillar, where even the dishonest corporate houses and businesses for doing fraudulent are also involved, making depositors the easiest target.

Fourthly and a major drawback is RBI's shortcoming as a supervision authority as well as its supervision lapses as the supervisory committee being established with the agenda having the primary role to supervise the Banks, Consortiums, Money Lending Institutions instead in many past instances and at present committed defaults, thereby when "In parallel with SEBI, RBI has also ratcheted up its supervision on auditors in the banking sector. In June 2018, RBI issued a graded enforcement action framework to enable appropriate action by the RBI in respect of the bank's statutory auditors for any lapses observed in conducting a bank's statutory audit."<sup>2</sup> Where the Reserve Bank of India default in its supervision framework has a serious worries to the security of the hard earned money and income of the depositors. The serious discrepancies in the statutory audits occurred, whilst at the time of "preparation of accounts, journal and ledger, balance sheet income, tax returns and their audits due to non-compliance of Section 29, 30 and 31 of the Banking Regulation Act, 1949, where in the said act under Section 29 it had discussed about preparation of accounts and balance sheet, under Section 30 it is being explained the process of auditing of balance sheet and profit and loss, whereas Section 31 discusses how returns to be submitted. Perhaps at most of the times such law is not complied as per the process given under the said section of the said act."<sup>3</sup>

Fifthly, the corporate governance issues gradually eroded the trust in the bank. The bank witnessed issues related to the corporate governance is a concern of serious in nature for private sector lender and deteriorating practice. Sixthly, the outflow of liquidity faced by banks had been a technical issue, in such situation the bank witness withdrawal of deposits from depositors that being a pertinent reason the RBI capped the withdrawal limit.

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<sup>2</sup> [http://www.mca.gov.in/Ministry/pdf/2018\\_CommitteeExperts\\_Report\\_08112018.pdf](http://www.mca.gov.in/Ministry/pdf/2018_CommitteeExperts_Report_08112018.pdf)

<sup>3</sup> Universal's, New Delhi, India, The Banking Regulation Act, 1949



## **ROLE OF HON'BLE SUPREME COURT IN PROTECTING THE RIGHTS AND INTEREST OF THE INVESTORS**

The rights and interests of the investors and depositors were to be the highest priority as they are the assets who wheel the financial institutions, though for protecting the same the Hon'ble Supreme Court had came forward couple of times in ensuring the RBI to keep vigilance and to recover the amounts from big borrowers who are in obligation to pay dues:

The Hon'ble Supreme Court being top ,highest and well-built anatomy of the judiciary having original, appellate and advisory jurisdiction had in past years as well as in present given some of the well methodized, well explained and law indorsed judgments and in depth discussed banking provisio case laws with per curiam keeping in view the rights and interests of the investors and depositors, actual flooring have serialized and planned the working of Banking sector in a bona-fide and germane way since after such vigilance and surveillance and even after such high level of directions given to the supervisory as well as to Banking Companies more specifically to private banking companies for mechanism adoption, despite of such directions the alleged derelictions by the banks led to the third such crash.

## **ROBUST PROCESS OF LEGISLATION, SUPERVISORY AND FRAMEWORK FOR FINANCIAL INSTITUTIONS, AUDITORS AND BORROWERS ARE DISCUSSED HERE AFTER**

Problems faced by the investors and depositors on dereliction in adherence of functioning by banks and they being easy targeted before or after any difficulty on crisis during fallout of financial institutions, as well the mechanism adoption for having robust process of legislation, supervisory and framework for financial institutions, auditors and borrowers are discussed here after:

The financial institutions for easily defrauding the customers have now and then voluntarily adopted a practice of laundering of the investment of the investors and depositors or by other ways which is a grave offence under the law, as a medium of lending the loans to big business man and corporate houses, lead to corruptive steps by the chairman, founders, directors, executives, officers as well as the employees of the Bank, borrowers, auditors etc., had never been new or a shocking revelation even in recent age as well as in old times as the innocent customers who get their account open for saving their investments are when the bank associate approach and by their means convince the customers for opening their bank

account in their respective bank, with the agenda to run and operate their banking business and trade in fasten process by making irrelevant commitments, which should be stopped.

As, most of the times the fraud executed by undue means gets hidden by bank from government and supervisory. In recent times as most of the process of requirements of a customer are done through digitization, which had actually been a major hassle for the depositors after the failure of the banks one after the other as in the Yes bank case the “customers faced difficulties as most cash dispensing machines ran dry and withdrawals as bank branches were possible thru the old and much slower token system, thereby resulting in long queues. Depositors also faced trouble because internet banking services don’t work.”

That the cash reserves limit should be increase from the limit which is at present for putting shield on such crisis faced by the investors and depositors, also there should be extension of vigilance and the administered acts should be more stringent, whereas the enforcement actions framework must be fastened for the banks and for curbing any fallouts due to fraudulent activities played by the banks, even for containing such activities. Though for curbing out the complications in Yes bank scenario “the scheme of reconstruction has been proposed u/s 45 of Banking Regulation Act, 1949 which gives RBI enormous power to deal worth a bank superseding any norms of the market regulations.”<sup>4</sup> For the cash starved bank. “In its draft ‘Yes Bank Ltd. Reconstruction scheme, 2020, RBI said the strategic investor will have 49% stake and it cannot reduce holding below 26% before three years from the date of capital infusion, SBI board has already given in principal approval to explore investment opportunity in Yes Bank, as per the scheme full repayment of all deposits, dilution of equity, and write-off of Rs 10,800 crore of additional tier one (AT-1) bonds.”<sup>5</sup> The said mechanism of a draft reconstruction that had been adopted along with other measures at a later stage whereas in a bid to reassure depositors and markets a moratorium of 30 days had been imposed the resolution should have been executed much earlier.

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<sup>4</sup> <https://timesofindia.indiatimes.com/business/india-business/yes-bank-crisis-ed-questioning-founder-rana-kapoor-customers-scramble-for-cash/articleshow/74528636.cms>

<sup>5</sup> <https://timesofindia.indiatimes.com/business/india-business/sbi-set-to-acquire-49-in-yes-bank-even-as-ed-raids-promoter-kapoor/articleshow/74520493.cms>



## CONCLUSION

The scheme and measure taken are less than sufficient as the more need for RBI as well as the government at present and in future as of Yes bank case study had been discussed and the factors of fallout were elaborated and the schedules passed, the big worry is of weaker mechanism that expeditiously needs to be strengthened and the establishment of a new regulator for stabilizing the banking methods and system is not necessary. Furthermore the RBI as well as government must act as a very supervising anatomy for combating such fallouts, and scams. Also, must legislate some indestructible and stringent provisions more specifically in Banking regulations Act, 1949 and other administered acts for a robust process of legislation which would not only affirm and uphold the pre clinch of such scams but will also aid and influence in boasting the economy of the nationwide at large, and may even be an accelerating boost in gearing up in stabilization of the economy and will also be a fence or carve in securing and protecting the interest and hard earned money of the depositors and investors much of lower middle class and middle class sector, who deposit their money in the banks trusting upon the mechanism and the system at the earliest needed to be more stout, for detecting and getting rid of such frauds and a transparency, colossal supervision and a better vigilance of banks and consortiums is required at expedite.



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