Corporate Governance Scandals in India's Banking and Financial Services Sector

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Abstract

In this chapter, we adopt a sector-specific approach to corporate scandals in one jurisdiction, namely India, to examine how corporate governance factors contributed to the scandals on the one hand and how the scandals have either resulted in governance reforms or merit further legal or regulatory transformations on the other. In doing so, we train our sights on the banking and financial services (BFS) in India. After highlighting the specific attributes in governance for BFS companies, including in the Indian context, we outline our aims for the chapter and briefly set out its roadmap. We explore three research questions. First, we consider whether and how poor corporate governance norms and practices contributed to the BFS scandals in India over the last decade. This is essentially the contribution question. Second, we explore the reforms, if any, that were introduced to the laws and regulations relating to corporate governance in the aftermath of these scandals. This covers the reformation question. Finally, we deliberate on reforms that are still required to be carried out based on the learnings from these governance scandals in BFS companies: the normative question. In examining our research questions, while we focus on the governance scandals in BFS companies in India, we seek to make comparisons to international examples to the extent necessary. We structure our chapter essentially along the lines of three broad contributive factors that have led to scandals in BFS companies in India, and highlight the reformative and normative factors relating to each of them. For each, we select one case study involving a recent governance scandal in a BFS company in India within the last decade. The YES Bank episode (2020) illustrates the risks of star-promoter control, excessive risk-taking and wealth tunnelling. The IndusInd Bank accounting scandal (2025) highlights the failure of internal and external gatekeepers, particularly the board and auditors. The IL&FS crisis (2018) demonstrates how regulatory fragmentation, regulatory arbitrage and inter-regulatory turf wars can contribute to systemic failure. Taken together, the cases demonstrate that these governance failures require more than piecemeal responses, calling instead for a wholesale reconsideration of the corporate governance framework applicable to BFS companies.

keywords: Corporate Governance, Corporate Scandals, Banking and Financial Services, Controlling Shareholders, Gatekeepers, Regulatory Apparatus, YES Bank, Indusind Bank, IL&FS

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CORPORATE GOVERNANCE SCANDALS IN INDIA'S BANKING AND FINANCIAL SERVICES SECTOR

Param Pandya[*] *& Umakanth Varottil*[**]

1. Introduction

The conventional discourse in corporate governance operates with a sense of homogeneity at a sectoral level. It is generally agnostic to the specific type of business that the entity concerned conducts. This holds true of analyses involving corporate scandals which provoke the usual question of whether poor governance played a significant part in perpetuating the shenanigans, and what lessons emerge from that experience.

In this chapter, we propose to narrow our focus to adopt a sector-specific approach to corporate scandals in one jurisdiction, namely India, to examine how corporate governance factors contributed to the scandals on the one hand (a phenomenon we refer to as *contribution*) and how the scandals have either resulted in governance reforms or merit further legal or regulatory transformations on the other (*reformation*). In doing so, we train our sights on the banking and financial services (BFS) in India primarily for two reasons. *First*, the BFS sector in the country has witnessed a number of high-profile financial scandals over the last decade, thereby providing the contextual basis for an analysis of their correlation to corporate governance norms from the perspectives of both contribution and reformation.[1] *Second*, the financial scandals and their associated corporate governance implications in the BFS sector enables us

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1 A study of 13 major banking and stock market scams that have shaken the Indian financial landscape in 80 years of India's independence highlighted 'poor corporate governance and management practices as the core reason for financial sector failures'. See, Ankit Shreevastava, B. K. Meher, S. Kumar, R. Birau and V. Popescu, 'Major Financial Scams That Shook Post-Independent India: An Investigative Study for the Long Term Period 1950–2023' (2025) 87 Revista de Stiinte Politice 202–212.

to view governance norms through a different lens altogether compared to the typical agency problems analysis that adopts a monolithic approach.[2]

We begin by embarking on a short chronological sojourn of major corporate governance scandals at a global level that resonate with the Indian narrative when it comes to sectoral analysis. As Professor Cheffins notes, the financial services industry was largely left untouched by the swathes of corporate governance reforms generated in the wake of scandals such as Enron, WorldCom, and Parmalat at the turn of the century that reverberated across the boardrooms of companies and regulators around the world.[3] He finds that not only were financial services companies left untouched by tighter regulations such as the Sarbanes Oxley Act in the United States (US), but that banks in fact received what he refers to as a 'corporate governance pass' that enabled the managers of banks, including their powerful CEOs, to engage in excessive risk-taking that has been attributed as one of the main factors for the occurrence of the global financial crisis in 2008.[4] In that sense, one can categorise the global scandals into two waves, one in the early 2000s that afflicted various (mostly non-financial services companies) and the other later in the decade that swept in BFS companies.

Transposing this chronology to the Indian circumstances reveals considerable similarities along with some differences as well. While the world was still reeling from the effects of the global financial crisis, in early 2009 (as part of the first wave) India had its own 'Enron moment' in the form of the Satyam scandal.[5] The company's chairman confessed to having falsified the financial statements to the extent of more than US$ 1 billion. Much ink has already been spilt in dissecting the causes for this scandal, of which poor governance practices play a significant part.[6] More interesting is the slew of corporate governance reforms that emanated in the wake of the scandal with India's Parliament enacting the Companies Act, 2013 (the 'Companies Act') followed by its securities regulator, the Securities and Exchange Board of India (SEBI), issuing the SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015 (the 'LODR Regulations'). The Companies Act and the LODR Regulations, both amended from time to time since, together constitute the bulwark of corporate governance regulation for Indian companies. Similar to the global situation, the framework applies on a broader scale regardless of the specificities of governance in individual business sectors.

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2 Umakanth Varottil, 'Governance of Financial Institutions: Call For A Paradigm Shift', *Bloomberg Quint* (8 October 2018).

3 Brian R Cheffins, 'The Corporate Governance Movement, Banks, and the Financial Crisis' (2015) 16 Theoretical Inquiries in Law 1.

4 ibid 14.

5 Umakanth Varottil, 'A Cautionary Tale of the Transplant Effect of Indian Corporate Governance' (2009) 21 NLSIU Review 1, 1.

6 ibid; Vikramaditya Khanna, 'Corporate Governance in India: Past, Present and Future?' (2009) 1 Jindal Global Law Review 171, 188-89. Afra Afsharipour, 'Corporate Governance Reform and the Indian Financial Scandals: Lessons from the Satyam Case' (2010) 1 Indian Journal of Law and Economics 33-70.

Although there is insufficient systematic evidence of a 'corporate governance pass' enjoyed by managers of Indian banks (unlike their Western counterparts, as asserted by Professor Cheffins), the second wave of governance scandals nevertheless occurred in BFS companies over the last decade, and there have been several high-profile ones at that, with billions of dollars at stake. In this chapter, we confine ourselves to BFS companies due to the sheer recency of the BFS scandals in India, and the relatively scant literature concerning the governance of BFS companies despite the enormity of their scandals and their impact on the economy as a whole. With this background, we consider why corporate governance of BFS companies merits immediate attention and how the scandals and governance factors in BFS companies are different from non-financial services firms. We do so bearing in mind the broader principles that are more universal as well as those specific to the Indian circumstances.

First, the traditional corporate governance paradigm that seeks to align the interests of shareholders of a company and its managers (in companies with dispersed shareholding) or those of its controlling shareholders and minority shareholders (in companies with concentrated shareholding) breaks down in its application to BFS companies. Enter another corporate governance actor in banks: the depositors, who receive no (or limited) recognition in traditional corporate governance, even though their interests are considerably at stake. In banks (as well as in other financial firms that accept some forms of deposits, and operate as shadow banks or non-banks), depositors suffer from serious governance problems. At the outset, they are subject to information asymmetry given the opacity surrounding the quality of a bank's loan portfolio.[7] Moreover, unlike shareholders, depositors possess no control rights to exert any form of influence over management on matters that affect their interests. At the first signs of financial trouble afflicting a bank, the information asymmetry coupled with the lack of control rights leads depositors to experience collective action problems that usually leads to a run on the bank, thereby precipitating matters further and often ultimately leading to the bank's demise.[8]

Professors Macey and O'Hara, therefore, argue that the governance of banks requires a different treatment by which their directors must be 'held to a broader, if not higher, standard of care than other directors'[9] and that 'the responsibilities of corporate directors [ought to] extend beyond the confines of the shareholder population.'[10] Even if it is only one constituency, namely depositors, the governance of banks seeks to introduce some momentum in transitioning away from a pure shareholder-oriented approach that has dominated the governance discourse and moves the needle towards a more stakeholder-oriented approach.

7 Thankom Gopinath Arun and John Turner, 'Corporate Governance of Banks in Developing Economies: Concepts and Issues' in Thankom Gopinath Arun and John Turner (eds), *Corporate Governance and Development: Reform, Financial Systems and Legal Frameworks* (Edward Elgar Publishing 2009) 96, 97-98.

8 Jonathan R Macey and Maureen O'Hara, 'The Corporate Governance of Banks' (2003) FRBNY Economic Policy Review, 97.

9 ibid 102.

10 ibid 103.

Although the limitations of space in this chapter will thwart our aspirations to join the fray in engaging in a detailed discussion of the shareholder-stakeholder paradigm, suffice it to say that this debate is even more salient for Indian BFS companies because Indian corporate law has moved far along the stakeholder-end of the spectrum.[11]

Second, the implications of a governance scandal in a systemically important financial institution can be catastrophic to the financial markets and the economy of a country. This creates externalities because the adverse effects of the risk borne by a BFS company is passed on to third parties.[12] The sensitivities of governance aspects are, therefore, manifold in a bank as compared to other types of companies.

Third, all the significant actors in a BFS company suffer from moral hazard problems. At the outset, the management of large ('too-big-to-fail') BFS companies assume excessive risks with the understanding that the government or banking regulator will step in to cushion the negative effects of a governance failure due to the wider ramifications on the economy. Shareholders also suffer from a similar phenomenon as they assume limited downside risk (to the extent of their investment) but unlimited upside, which leaves them with insufficient motivation to infuse more funds to save the BFS company as they have very little skin in the game in the event of a governance failure.[13] While depositors have a relatively greater stake in ensuring the success of a BFS company, as we have already seen, they suffer from collective action problems, which are further exacerbated by a moral hazard problem when their deposits are insured or where the regulator steps in as a lender of last resort.[14]

Fourth, mainly as a result of the moral hazard problems, the managements of BFS companies may tend to engage in excessive risk-taking. This was evident during the global financial crisis with the role played by 'star CEOs' who 'contributed to the market turmoil of 2008'.[15] Since dispersion of shareholding was considered the norm in US banks, the agency problems between shareholders and managers came to the fore, essentially in the form of excessive executive

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11 Examples include an explicit recognition of non-shareholder constituencies as beneficiaries of directors' duties under section 166(2) of the Companies Act, 2013 and the regime relating to corporate social responsibility under section 135 of the Companies Act, 2013. Umakanth Varottil, 'The Stakeholder Approach to Corporate Law: A Historical Perspective from India' in Harwell Wells (ed), *Research Handbook on the History of Corporate and Company Law* (Cheltenham: Edward Elgar Publishing 2018), 396-397.

12 Jonathan R Macey and Maureen O'Hara, 'The Corporate Governance of Banks' (2003) FRBNY Economic Policy Review, 95.

13 Brian R Cheffins, 'The Corporate Governance Movement, Banks, and the Financial Crisis' (2015) 16 Theoretical Inquiries in Law 1, 32.

14 Jonathan R Macey and Maureen O'Hara, 'The Corporate Governance of Banks' (2003) FRBNY Economic Policy Review, 92.

15 Brian R Cheffins, 'The Corporate Governance Movement, Banks, and the Financial Crisis' (2015) 16 Theoretical Inquiries in Law 1.

compensation paid to the star managers.[16] While excessive risk has cropped up as a key phenomenon in governance scandals in Indian BFS companies, the nature of the issues differs somewhat. For instance, in companies with concentrated shareholding, the excessive risk taking is by a CEO of the bank who is also its founder and controlling shareholder (known in India as the 'promoter'), with YES Bank being a key example.[17] In another case, excessive risk taking can also become the hot button issue in a company with concentrated shareholding where the controlling shareholder is not also the CEO, and is instead an outside professional, with IndusInd Bank (IBL) being the prime illustration.[18] While BFS companies are subject to the usual governance issues concerning ineffective boards and inadequate supervision by other gatekeepers (both internal and external to the company), the excessive risk-taking propensities demonstrated by BFS companies call for more specific treatment of unique governance issues, such as asset-liability management, risk mitigation framework and an even greater emphasis on true and fair accounting.

Fifth, from a regulatory perspective, corporate governance in the BFS sector is subject to a dual regulatory regime.[19] On the one hand, BFS companies are subject to the entire slew of corporate governance regulation as any other companies. In the Indian context, this means BFS companies must comply with both the Companies Act and the LODR Regulations. Separately, they are also subject to the supervision of the banking regulator. While banking regulations are essentially focused on prudential norms, as a means of regulating the operations of the company to adequately protect the interests of the depositors, banking regulators also emphasise governance requirements. These include some control over the nature of persons who could be appointed to the senior management of a BFS company; this is usually exercised by prescribing the 'fit and proper' criteria for appointment to key managerial positions. While the dual regulatory regime enables each regulator to focus on matters relating to BFS companies that are within their respective domains, it also presents its own share of labyrinthine oversight challenges resulting in problems remaining undetected until it is too late. In India, these roles are performed in the context of BFS companies by the securities market regulator (SEBI), to a limited extent, by the Ministry of Corporate Affairs, Government of India (MCA) regarding application of the Companies Act, as well as the banking regulator, the Reserve Bank of India (RBI).

After highlighting the specific attributes in governance for BFS companies, including in the Indian context, we outline our aims for the chapter and briefly set out its roadmap. We explore three research questions. *First*, we consider whether and how poor corporate governance norms

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16 ibid 28.

17 In the promoter-CEO combination, there is also the additional risk of wealth tunnelling by the controlling shareholder, a phenomenon altogether familiar in non-banking scenarios as well. YES Bank is the paradigmatic example here; we explore this further in section 2 below.

18 We discuss the IBL case in section 3 below.

19 Dalvinder Singh, 'Legal aspects of UK Bank Corporate Governance' in Thankom Gopinath Arun and John Turner (ed), *Corporate Governance and Development: Reform, Financial Systems and Legal Frameworks* (Edward Elgar Publishing 2009) 195.

and practices contributed to the BFS scandals in India over the last decade. This is essentially the *contribution* question. *Second*, we explore the reforms, if any, that were introduced to the laws and regulations relating to corporate governance in the aftermath of these scandals. This covers the *reformation* question. *Finally*, we deliberate on reforms that are still required to be carried out based on the learnings from these governance scandals in BFS companies: the *normative* question. In examining our research questions, while we focus on the governance scandals in BFS companies in India, we seek to make comparisons to international examples to the extent necessary.

We structure our chapter essentially along the lines of three broad contributive factors that have led to scandals in BFS companies in India, and highlight the reformative and normative factors relating to each of them. For each, we select one case study involving a recent governance scandal in a BFS company in India within the last decade. The first, one that we cover in section 2, relates to the role of 'star' promoters who are founders, CEOs, and controlling shareholders that leads not only to the problem of excessive risk-taking but also to the usual governance problems pertaining to abusive related party transactions and wealth tunnelling. Here we focus on YES Bank. The second, dealt with in section 3, relates to the failure of the private gatekeepers, such as the board (including independent directors), the auditors, and credit rating agencies, that contributed to the financial decline of a BFS company. Our case study involves IBL. The third deals with chinks in India's financial regulatory apparatus that may have had a role in the failure of a BFS company, including the regulatory overlaps and associated turf wars. In doing so, we analyse what occurred in the IL&FS episode. A caveat is in order: while we situate each of these illustrations within each contributive factor, this is not to suggest that the factor discussed was specific to each case. Multiple factors contributed governance failures in each of the cases, but for ease of analysis we selected the one that mattered the most for each.

2. 'Star' Promoters and Tunnelling – YES Bank Financial Scam

A significant number of Indian companies, including some of the large entities in the Indian BFS sector, are characterised by the presence of dominant controlling shareholders, often referred to as 'promoters'.[20] In the event of laxity in corporate governance norms (either in content or implementation), it is reasonable to hypothesize that promoters are more likely to unjustly extract wealth from the underlying business of the company, engaging in conduct referred to as 'tunnelling'.[21] Promoters are likely to *tunnel* value from businesses where they have less cash flow rights to their businesses where they have high cash flow rights. For instance, take the case of a promoter who has two entities of relatively equal size and profitability under its control, Entity A and Entity B, and it has a higher shareholding in Entity

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[20] Organisation for Economic Co-operation and Development, 'Ownership Structure of Listed Companies in India' (OECD Publishing 2020) <https://doi.org/10.1787/3345d09d-en> accessed 17 January 2026.

[21] Simon Johnson, Rafael La Porta, Florencio Lopez-de-Silanes and Andrei Shleifer, 'Tunnelling' (2000) 90 American Economic Review Papers and Proceedings 2, 22–27.

B than Entity A. The promoter is more likely to tunnel value from Entity A to Entity B at the cost of other outsider shareholders of Entity A.[22] This phenomenon tends to be more acute where the corporate landscape is dotted with group companies, as in the case of India.

It is pertinent to note that, cognisant of the above concern, the RBI has always demonstrated reluctance in granting new bank licenses to promoters of large corporate houses to mitigate governance risks, connected lending, and tunnelling.[23] Additionally, the RBI has also imposed certain restrictions on promoter voting rights in banks and shadow banks to maintain diversified ownership.[24] For instance, these restrictions include the fact that (a) an acquisition of more than 5 percent but less than 10 percent of a bank's paid-up share capital or voting rights requires the acquirer to meet a board-approved 'fit and proper' criteria;[25] and (b) an acquisition of 10 percent or more would require additional disclosures, including corporate structure of the acquirer and any shareholders' agreement[26]. Moreover, such acquisitions would require a prior approval of the RBI,[27] including a fresh approval if shareholding falls below 5 percent.[28] Further, other due diligence and reporting requirements apply to an acquirer or a major shareholder.[29] Under the pretext of ensuring dispersed ownership in the BFS sector, such approval requirements may thwart the formation of a market for corporate control, thereby effectively eliminating the operation of a well-understood governance mechanism.[30] As an

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[22] Marianne Bertrand, Paras Mehta and Sendhil Mullainathan, 'Ferreting Out Tunneling: An Application to Indian Business Groups' (2002) 117 The Quarterly Journal of Economics 1, 121.

[23] 'RBI governor rules out bank licence for corporates' (*Times of India*, 25 July 2025) <https://timesofindia.indiatimes.com/business/india-business/rbi-governor-rules-out-bank-licence-for-corporates/articleshow/122899438.cms> accessed 6 February 2026. Viral V Acharya and Raghuram G Rajan, 'Do we really need Indian corporations in banking?' (Unpublished Manuscript, New York University Stern School of Business 2020) <https://w4.stern.nyu.edu/sternfin/vacharya/public_html/pdfs/acharya-rajan.pdf> accessed 10 February 2026.

[24] Reserve Bank of India, 'Reserve Bank of India (Commercial Banks – Acquisition and Holding of Shares or Voting Rights) Directions, 2025' <https://rbidocs.rbi.org.in/rdocs/notification/PDFs/145MD.PDF> accessed 6 February 2026.

[25] ibid Direction 6(1).

[26] ibid Direction 6(2).

[27] ibid Direction 7.

[28] ibid Direction 14.

[29] ibid Direction 17, 26.

[30] Umakanth Varottil, 'The Nature of the Market for Corporate Control in India' in Umakanth Varottil and Wai Yee Wan (eds) *Comparative Takeover Regulation: Global and Asian Perspectives* (Cambridge University Press 2017) 313-343.

The Indian BFS sector primarily consists of banks and non-banks or shadow banks referred to as non-banking financial companies. Promoters of NBFCs are not subject to any shareholding or voting rights restrictions like banks; however, any change in control or management, or a substantial change in unintended consequence of such restrictions, Indian banks have seen higher controlling shareholder-management entrenchment, thereby having an adverse governance impact.

In addition to the prior approval requirements, the RBI also prescribes a differential cap on shareholding in Indian banks, and the voting rights accompanying them.[31] For instance, a promoter may own 40 percent share capital (a shareholding cap that is prescribed by the RBI in a specific instance) of a bank but will be able to only exercise 26 percent of voting rights. The RBI has the power to extend or reduce the cap on a case-to-case basis; however, such a power has been sparingly used, mostly to grant extensions to comply with these requirements. In fact, these caps have been subject to litigation with regard to promoter holding in one of the leading private sector banks in India.[32]

We argue that these restrictions may also incentivise promoters to extract value from financial firms as their cash flow rights are restricted to their shareholding limited by regulatory caps.[33] Further, from a corporate governance standpoint, these restrictions do not effectively lead to dispersed ownership as, in a concentrated ownership system, institutional investors or minority shareholders may also generally align themselves with the controlling shareholder.[34] Some commentators have argued that such restrictions (particularly on voting rights of large shareholders) need to be dispensed with so as to equate ownership and control.[35]

Most importantly, in the last decade, instances of tunnelling or fraud by promoters and/or senior management have emerged in the Indian financial sector–in banks and non-banks alike. Thus, we argue that regulating tunnelling among Indian financial sector entities needs a rethink. Tools used to mitigate tunnelling by controllers in the broader corporate governance context, and

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shareholding of up to 26% or more, requires prior approval of the RBI. Thus, the argument of lack of a market for corporate control holds true in case of NBFCs as well.

31 ibid Annex I.

32 'RBI vs Kotak Mahindra Bank: Promoter shareholding dispute explained' (*The Wire*, 17 June 2025) <https://thewire.in/banking/rbi-kotak-mahindra-bank-promoter-shareholding> accessed 6 February 2026.

33 Marianne Bertrand, Paras Mehta and Sendhil Mullainathan, 'Ferreting Out Tunnelling: An Application to Indian Business Groups' (2002) 117 Quarterly Journal of Economics 1, 121-148. Cited in support, Reserve Bank of India, 'Report of the Working Group on Conflicts of Interest in the Financial Sector' (*Reserve Bank of India*, December 2012) <https://rbidocs.rbi.org.in/rdocs/Content/PDFs/68210.pdf> accessed 17 January 2026.

34 Assaf Hamdani and Yishay Yafeh, 'Institutional Investors as Minority Shareholders' (2013) 17 Review of Finance 2, 691. See also, Umakanth Varottil, 'Minority Shareholders' Rights, Powers and Duties: The Market for Corporate Influence' in Afra Afsharipour & Martin Gelter (eds) *Research Handbook on Comparative Corporate Governance* (Edward Elgar Publishing 2021).

35 Richard Herd, Vincent Koen, Ila Patnaik and Ajay Shah, 'Financial Sector Reform in India: Time for a Second Wave?' OECD Economics Department Working Papers No 879 (OECD Publishing 2011) <https://www.oecd.org/content/dam/oecd/en/publications/reports/2011/07/financial-sector-reform-in-india_g17a1fe6/5kg8ghvzr2jk-en.pdf> accessed 6 February 2026.

restrictions to maintain dispersed ownership, are inadequate to address the harms caused by such activity in the financial sector, given the specific governance implications. Unlike in non-financial entities, frauds or tunnelling by promoters in a financial sector entity may exacerbate externalities in form of contagion risks thereby impacting overall financial stability, and also adversely affect the interests of non-shareholder constituencies such as depositors. We further amplify our argument by critically engaging with the issues that transpired in the YES Bank scandal.

YES Bank is an Indian private sector bank, co-founded in 2003 by three experienced bankers, Rana Kapoor, Ashok Kapur, and Harkirat Singh.[36] Due to certain differences regarding appointment of Ashok Kapur as the non-executive Chairman of YES Bank, Harkirat Singh resigned the same year.[37] YES Bank commenced its operations in 2004. Upon Ashok Kapur's untimely death in 2008,[38] and after a prolonged succession battle with the legal heirs of Ashok Kapur,[39] Rana Kapoor emerged as the 'star' promoter who helmed YES Bank to transform it to an innovative tech-focused financial institution.[40]

From 2004 until 2010, YES Bank clocked a compound annual growth rate of 74 percent.[41] Under Kapoor's leadership, in 2010-2011 it became India's fourth-largest private sector bank. In 2010, while unveiling the new strategy for YES Bank for period between 2010 and 2015, Kapoor candidly admitted that he ran the bank with "outright gut entrepreneurship".[42] In 2017, Rana Kapoor became India's second billionaire, solely on account of his 11.6 percent stake in YES Bank.[43]

Early signs indicated that all was not well at YES Bank, when the RBI's Asset Quality Review (AQR) in 2015 brought to light that the bank's book was built largely upon loans to risky

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36 'History Repeating Itself at Yes Bank Says Harkirat Singh' *The Economic Times* (27 June 2013).

37 ibid.

38 Knowledge at Wharton Staff, 'Can YES Bank, India's Youngest and Fastest-growing Bank, Be a Model for Newer Entrants?' (*Knowledge at Wharton*, 1 February 2012) <https://knowledge.wharton.upenn.edu/article/can-yes-bank-indias-youngest-and-fastest-growing-bank-be-a-model-for-newer-entrants/> accessed 25 January 2026.

39 Madhura Karnik, 'How YES Bank's Rana Kapoor Went from Being an Intern at Citibank to India's Newest Billionaire' (*Scroll.in*, 24 January 2017) <https://scroll.in/article/827466/how-yes-banks-rana-kapoorwent-from-being-an-intern-at-citibank-to-indias-newest-billionaire> accessed 17 January 2026.

40 ibid.

41 ibid.

42 ibid.

43 Sterling Wong, 'YES Bank turns Rana Kapoor into a billionaire as stock climbs' (*LiveMint*, 19 January 2017) <https://www.livemint.com/Money/RH67fHuEftClopPhYReOVP/YES-Bank-turns-Rana-Kapoor-into-a-billionaire-as-stock-climb.html> accessed 25 January 2026.

borrowers with doubtful creditworthiness.[44] There was a lack of transparency and failure in appropriate treatment of these loans as non-performing assets (NPAs). As of March 2016, YES Bank's NPAs stood at ₹4,925.68 crores, which was seven times higher than the disclosed amount.[45] Despite high NPAs, YES Bank's loan portfolio ballooned from around ₹98,210 crores in March 2016 to ₹132,263 crores in March 2017 and to around ₹203,534 crores in March 2018.[46] This raised more eyebrows and, finally, in 2018, a whistle-blower complaint brought to light major violations regarding falsification of NPAs coupled with conflict of interests in lending arrangements and alleged kickbacks to Rana Kapoor and his family.

Although the NPA crisis was first flagged by the RBI's AQR, YES Bank continued to follow aggressive lending practices. It had extended loan facilities at higher interest rates to companies facing financial turbulence in India's real estate, shadow banking, financial, and infrastructure sectors.[47] Loans worth around ₹30,000 crores given under the tenure of Rana Kapoor (2004-2019) have turned into bad loans and out of these, ₹20,000 crores have become NPAs.[48]

The Yes Bank episode also revealed a series of related party transactions that evidence wealth tunnelling. Under Kapoor's leadership, the bank gave a series of loans to several handpicked corporate groups, such as Dewan Housing Finance Limited (DHFL), Anil Dhirubhai Ambani (ADA) group and Infrastructure Leasing & Financial Services Limited (IL&FS), some of which ultimately flowed through to certain Kapoor family-controlled firms.[49] To take one egregious example, Yes Bank subscribed to debentures of DHFL worth more than ₹3,700 crores, nearly ₹600 crores of which DHFL in turn lent to firms beneficially owned and

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44 Anup Roy and Chandan Kishore Kant, 'YES Bank under-reported FY16 bad loan, finds RBI audit' (*Business Standard*, 13 May 2017) <https://www.business-standard.com/article/finance/private-banks-hid-substantial-bad-debts-reveals-rbi-mandated-disclosure-117051200539_1.html> accessed 25 January 2026.

45 ibid. Please note that ₹ = Indian Rupee; 1 crore = 10 million; 10 crore = 100 million; 100 crore = 1 billion. In terms of exchange rate, as of 29 June 2026, 1 USD = ₹ 94.39.

46 Vinod Rai, 'Lessons from the YES Bank Saga' ISAS Insights No 605 (*Institute of South Asian Studies, National University of Singapore*, 21 March 2020) <https://www.isas.nus.edu.sg/wp-content/uploads/2020/03/ISAS-Insight-605_Vinod-Rai.pdf> accessed 25 January 2026.

47 Andy Mukherjee, 'View: Yes, Bank on Things Being Worse Than They Look' (*The Economic Times*, 16 May 2019) <https://economictimes.indiatimes.com/industry/banking/finance/banking/view-yes-bank-on-things-being-worse-than-they-look/articleshow/69352130.cms?from=mdr> accessed 17 January 2026.

48 J Jagannath, 'Yes Bank Case: ED Attaches Assets Worth ₹2,500 Cr of Rana Kapoor and Wadhawans' (*LiveMint*, 9 July 2020) <https://www.livemint.com/news/india/yes-bank-case-ed-attaches-assets-worth-rs-2-200-cr-of-rana-kapoor-and-wadhawans-11594289867494.html> accessed 17 January 2026.

49 Andy Mukherjee, 'View: Yes, Bank on Things Being Worse Than They Look' (*The Economic Times*, 16 May 2019) <https://economictimes.indiatimes.com/industry/banking/finance/banking/view-yes-bank-on-things-being-worse-than-they-look/articleshow/69352130.cms?from=mdr> accessed 17 January 2026.

controlled by Kapoor and his family.[50] Yes Bank extended loans worth around ₹5,010 crores to companies belonging to the ADA group, despite poor credit rating, which were allegedly diverted to shell firms and other group entities. Out of the total amount, ₹3,337.5 crores turned NPAs by December 2019.[51] Much of the proceeds of the Kapoor's family's ill-gotten wealth were siphoned off to overseas entities, thereby attracting investigation by the Indian government's Enforcement Directorate (ED).[52] Ultimately, Kapoor was ousted from his role as the CEO, was arrested along with the promoters of DHFL and ADA group companies.

The YES Bank crisis adversely impacted multiple stakeholders. Shareholders' value eroded drastically. YES Bank shares fell from all-time high of ₹400 (in 2018) to an all-time low of ₹5 (in 2020), a whopping 95 percent fall.[53] In terms of the turnaround of YES Bank, existing shareholders had to undergo substantial equity dilution and bondholders (which also included certain retail investors) suffered a complete write-down.[54] Additionally, depositors risked their deposits and suffered from restrictions on withdrawal with other banking services impacted; employees were also left worse off; and all of these posed a systemic risk for the Indian financial system.[55]

Rana Kapoor was also forced to exit his shareholding in order for the regulator to step in and restructure YES Bank.[56] Commentators have questioned the RBI for its late and reactionary role in the YES Bank crisis, calling for more systemic reforms in the BFS sector.[57] In the

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50 'YES Bank-DHFL case timeline: When and how it happened' (*The Economic Times*, 25 March 2022) <https://bfsi.economictimes.indiatimes.com/news/industry/yes-bank-dhfl-case-timeline-when-and-how-it-happened/90425996> accessed 27 January 2026.

51 'Yes Bank Suffered Over Rs 2,700 Cr Loss Due to Transactions with Anil Ambani-Led Companies: CBI' (*The Economic Times*, 29 October 2025) <https://economictimes.indiatimes.com/news/company/corporate-trends/yes-bank-suffered-over-rs-2700-cr-loss-due-to-transactions-with-anil-ambani-led-companies-cbi/articleshow/124905876.cms> accessed 17 January 2026.

52 J Jagannath, 'Yes Bank Case: ED Attaches Assets Worth ₹2,500 Cr of Rana Kapoor and Wadhawans' (*LiveMint*, 9 July 2020) <https://www.livemint.com/news/india/yes-bank-case-ed-attaches-assets-worth-rs-2-200-cr-of-rana-kapoor-and-wadhawans-11594289867494.html> accessed 17 January 2026. 'Rana Kapoor, Yes Bank Enforcement Directorate Anil Ambani money laundering case' (*The Hindu*, 20 December 2025) <https://www.thehindu.com/news/national/rana-kapoor-yes-bank-enforcement-directorate-anil-ambani-money-laundering-case/article70398264.ece> accessed 25 January 2026.

53 Salil Gupta, 'India: Yes Bank Moratorium, 2020' (2025) 7 Journal of Financial Crises 2.

54 ibid.

55 Shakeb Akhtar, Mahfooz Alam and Mohd Mohsin Khan, 'YES Bank Fiasco: Arrogance or Negligence' (2021) 3 Emerging Economies Cases Journal 95.

56 'As Yes Bank Crisis Team Heads for Exit, a Relook at India's Biggest Bank Bailout' (*Moneycontrol*, 15 June 2022) <https://www.moneycontrol.com/news/business/banks/as-yes-bank-crisis-team-heads-for-exit-a-relook-at-indias-biggest-bank-bailout-8685141.html> accessed 18 January 2026.

57 'Too slow to act on Yes Bank, RBI has eroded depositor faith' (Editorial, *Indian Express*, 7 March 2020) <https://indianexpress.com/article/opinion/editorials/yes-bank-crisis-reserve-bank-of-india-rbi-sbi-6302977/> accessed 26 January 2026. Vinod Rai, 'Lessons from the Yes Bank Saga in India' ISAS Insights

aftermath of the crisis, the RBI revisited corporate governance mechanisms in banks by enacting the Reserve Bank of India (Commercial Banks – Governance) Directions, 2025 (BG–Master Directions).[58] These directions represent the first consolidated exercise by the RBI to focus on bank governance. The BG–Master Directions aim to address certain key learnings from the YES Bank fiasco. They require that a promoter or a major shareholder who is also a Managing Director or CEO cannot hold such position for more than 12 years.[59] While this term is extendable at the sole discretion of the RBI, it can in no event exceed 15 years.[60] This requirement seeks to introduce a separation of ownership and control; however, it may not effectively mitigate the risk of 'star' promoters or CEOs from engaging in 'empire building'.

The RBI has also re-evaluated its related party transactions framework in the aftermath of the Yes Bank fraud. It amended the Reserve Bank of India (Commercial Banks – Credit Risk Management) Directions, 2025, to (a) expand the coverage of related parties, which includes relatives of promoters, directors, key managerial personnel and their relatives, major shareholders holding 10 percent or more; (b) provide for board-approved policy along with making the board responsible for effective oversight; (c) introduce transaction-based materiality thresholds.[61] Thus, the RBI has incorporated related party transactions in banks' operational credit risk framework thereby effectively integrating governance mechanisms into prudential regulation. The effectiveness of these reforms lies in its operationalisation and enforcement. The RBI has required banks to keep a list of related parties of specified employees to mitigate the risk of related party lending.[62] This requirement may impose compliance costs and may be operationally demanding as well. However, these directions also provide for various enforcement avenues including the imposition of monetary penalty, the requirement of full provisioning, directions to conduct staff accountability exercises, forensic audits, and

No 605 (*Institute of South Asian Studies, National University of Singapore*, 21 March 2020) <https://www.isas.nus.edu.sg/papers/lessons-from-the-yes-bank-saga-in-india/> accessed 26 January 2026. 'Yes Bank's Financial Failure Is First for a New Age Private Bank: Was RBI Late in Acting?' (*Moneycontrol*, 6 March 2020) <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> accessed 18 January 2026.

58 Reserve Bank of India, 'Reserve Bank of India (Commercial Banks – Governance) Directions, 2025' <https://www.rbi.org.in/Scripts/BS_ViewMasDirections.aspx?id=13161> accessed 27 January 2026.

59 Reserve Bank of India, 'Corporate Governance in Banks – Appointment of Directors and Constitution of Committees of the Board' (*Reserve Bank of India*, 26 April 2021) <https://www.rbi.org.in/scripts/NotificationUser.aspx?Id=12078&Mode=0> accessed 26 January 2026.

60 ibid.

61 Reserve Bank of India, 'Reserve Bank of India (Commercial Banks – Credit Risk Management) Directions,2025' <https://www.rbi.org.in/Scripts/BS_ViewMasDirections.aspx?id=13153#13> accessed 9 February 2026.

62 ibid para 42M.

restrictions, which should serve as credible deterrence.[63] Interestingly, stringent related party lending restrictions were also the need of the hour in the aftermath of another fraud perpetrated by a 'star' CEO in a professionally managed leading Indian private bank.[64]

Currently, while proceedings are ongoing against Yes Bank promoter CEO, Sumitomo Mitsui Banking Corporation (SMBC) a Japanese financial company, has acquired 24 percent stake in YES Bank and is likely to further acquire controlling stake in the Bank.[65]

A commentator simply calls 'YES Bank fiasco' as 'a corporate governance failure';[66] however, it is the case that such a governance failure in a bank has even far-reaching consequences for the entire financial system. In any event, the YES Bank crisis continues to pose critical questions regarding the effectiveness of regulating tunnelling by 'star' promoters or CEOs in banks and financial institutions.

3. Gatekeepers' Failure – The IBL Derivative Accounting 'Fraud'?

In the global corporate governance discourse, 'gatekeepers' are conceptualised as actors tasked with preventing fraud, even as scholarship and enforcement actions increasingly document their role in facilitating financial fraud.[67] They are independent professionals who pledge their reputational capital to protect the interests of dispersed investors who cannot easily take collective action.[68] For the purposes of the current discussion in the context of the BFS sector in India, we refer to the board of directors (particularly, independent directors, the audit

63 ibid para 42T.

64 ICICI Bank's senior management was under the scanner for preferential lending amounting to ₹1875 crores made to Videocon and its group companies. ICICI Bank MD Chanda Kochhar was arrested on alleged conflict of interests and corruption charges. See, Afra Afsharipour and Manali Paranjpe, 'The Evolution of Risk Management Oversight by Indian Boards' (2021) 33 National Law School of India Review 327.

65 Siddhi Nayak and Advait Palepu, 'India Yes Bank Eyes Wealth Foray After Deal With Japan's SMBC' (*Bloomberg*, 19 September 2025) <https://www.bloomberg.com/news/articles/2025-09-19/india-yes-bank-eyes-wealth-foray-after-deal-with-japan-s-smbc> accessed 26 January 2026.

66 Ritam Deb, 'YES Bank Fiasco: A Corporate Governance Failure' (2021) 48 Decision 2, 181–190.

67 John R Boatright, 'Reluctant Guardians: The Moral Responsibility of Gatekeepers' (2007) 17 Business Ethics Quarterly 4, 613–632.

68 Ronald J. Gilson and Ranier H. Kraakman, 'The Mechanisms of Market Efficiency' (1984) 70 Vanderbilt Law Review 549, 613-21 (coined the term 'gatekeepers' and discussed the role of investment bankers as gatekeepers). Reiner H. Kraakman, 'Gatekeepers: The Anatomy of a Third-Party Enforcement Strategy' (1986) 2 Journal of Law, Economics, and Organization 1, 53–104. John C. Coffee, Jr., 'Brave New World?: The Impact(s) of the Internet on Modern Securities Regulation' (1997) 52 Business Lawyer 1195, 1210-13, 1232-33 (discussed the role of underwriters, accountants, lawyers, and directors as 'gatekeepers' and 'reputational intermediaries').

committee and the risk management committee) as ‘internal’ gatekeepers,[69] and statutory auditors and credit-rating agencies as ‘external’ gatekeepers. These entities are ‘repeat players’ in the market and are generally deterred by reputational consequences in the event of a fraud.

In this section, however, we explore whether controlling shareholders may directly or indirectly skew the incentives for internal and external gatekeepers alike, weakening effective oversight and corporate governance, ultimately leading, at least in some cases, to fraud or financial misappropriation of wealth. For instance, ‘reputation intermediaries’ such as independent directors may conduct themselves differently in the presence of a strong controlling shareholder: they may refrain from raising probing questions or from being overly critical of the management as they may not be given a second term or be labelled as a ‘difficult’ director.[70] Further, while not being ‘related’ to promoters, some appointees may have strong social and professional relationships with controlling shareholders, often leading to ineffective board governance.[71]

Controlling shareholders are more likely to develop a sphere of influence on external gatekeepers as well. Such gatekeepers may choose to either turn a blind eye or be complicit in a financial misdealing at the behest of the promoters.[72] Rarely, but yet possible, is that controlling shareholders are insufficiently familiar with the day-to-day operations of the business, particularly owing to the complex nature of business operations such as in the BFS sector. Such shareholder apathy (albeit emanating from a promoter), similar to companies in a dispersed shareholding setting, may in turn incentivise managers to act opportunistically.[73] We

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69 Roman Tomasic, ‘Corporate Governance Failure: The Role of Internal and External Gatekeepers in UK Banks and Financial Institutions’ (2010) 10 Corporate Governance – International Journal for Enhanced Board Performance 1, 8-11, 26-27. Andrea Minto, ‘Enlisting Internal and External Financial Gatekeepers: Problems of Multiple Centres of Knowledge Construction’ (2018) 9 European Journal of Risk Regulation 2, 283-309.

70 Bharat Vasani and Varun Kanan, ‘Gatekeepers of Governance: Independent Directors’ (*Cyril Amarchand Mangaldas India Corporate Law Blog*, 3 December 2022) <https://corporate.cyrilamarchandblogs.com/2022/12/gatekeepers-of-governance-independent-directors/> accessed 27 January 2026.

71 Vikramaditya Khanna and Shaun J Mathew, ‘The Role of Independent Directors in Controlled Firms in India: Preliminary Interview Evidence’ (2010) 22 National Law School of India Review 1, 35-66. Guido Ferrarini and Marilena Filippelli, ‘Independent Directors and Controlling Shareholders Around the World’ ECGI Law Working Paper No 258/2014 (*European Corporate Governance Institute*, May 2014) <https://www.ecgi.global/sites/default/files/working_papers/documents/ssrn-id2443786.pdf> accessed 27 January 2026.

72 In the BFS sector, Yes Bank fraud serves as a prime example of active involvement of the controlling shareholder (as well management) i.e., Rana Kapoor in extracting pecuniary private benefits of control. See section 2 above.

73 Interestingly, the state as a controlling shareholder also exhibits shareholder apathy. Indian public sector banks have been subject to multiple scams in the last decade, primarily, due to poor governance practices and the lack of effective oversight. See, Param Pandya, ‘Public Sector Banks in India: Revisiting Regulatory and Corporate Governance in the light of the PNB Scam’ (*South Asia @ LSE Blog*, 30 May 2018) <https://blogs.lse.ac.uk/southasia/2018/05/30/public-sector-banks-in-india-revisiting-regulatory-and-corporate-governance-in-the-light-of-the-pnb-scam/> accessed 27 January 2026. See generally, Gautam Chikermane, ‘The Regulatory Opportunity in the Nirav Modi-PNB Crisis’ (*Observer Research*

illustrate the latter phenomenon in the context of the most recent fraud that rocked the Indian BFS sector – the case of IBL, India's fifth largest private bank, controlled by the Hinduja Group.[74]

On 10 March 2025, IBL disclosed to the stock exchanges that an internal review of the books of account of the bank revealed improper accounting of derivatives transactions that had an adverse impact of ₹1,529.88 crores, or approximately 2.35 percent of the bank's net worth as of December 2024.[75] The shares of the company declined 27.9 percent upon the announcement. The company faced further scrutiny for accounting discrepancies in its microfinance portfolio. All of these resulted in the services of the top management being terminated and independent agencies being appointed to scrutinise the affairs of IBL.

One expert identifies the key accounting incongruity.[76] Under the RBI guidelines, derivatives are to be accounted for on a marked-to-market (MTM) basis.[77] While IBL had used MTM for its derivatives transactions with external participants, it failed to do so for internal derivatives trades among different departments within the organisation. This portrayed an incorrect picture about the financial implications of the transactions that showed IBL's financial health to be in better shape than it was. Even though the issue first came to light in December 2023, as evident from internal company communication, it was publicly disclosed only in March 2025.

The role of the senior management, audit committee, risk management committee, and the controlling shareholder has been called into question. Whether the senior management was

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Foundation, 23 March 2018) <https://www.orfonline.org/expert-speak/regulatory-opportunity-crisis-nirav-modi-pnb> accessed 27 January 2026. Due to space constraints, we are not discussing scandals and governance issues of Indian public sector banks, in this chapter.

74 A Continental European equivalent of the IBL accounting violation would be the Parmalat scandal. The Parmalat scandal was characterised by failure of gatekeepers in the light of the controlling shareholder who perpetrated the fraud. Guido Ferrarini and Paolo Giudici, 'Financial Scandals and the Role of Private Enforcement: The Parmalat Case' ECGI Law Working Paper No 040/2005 (*European Corporate Governance Institute*, May 2005) <https://www.ecgi.global/sites/default/files/working_papers/documents/ssrn-id730403.pdf> accessed 27 January 2026.

75 Shweta Punj, 'IndusInd Bank shares under selling pressure ahead of PwC report on accounting discrepancies' (*Moneycontrol*, 28 March 2025) <https://www.moneycontrol.com/news/business/markets/indusind-bank-shares-under-selling-pressure-ahead-of-pwc-report-on-accounting-discrepancies-12978720.html> accessed 7 February 2026. Securities and Exchange Board of India, Interim Order (28 May 2025) <https://www.sebi.gov.in/sebi_data/attachdocs/may-2025/ibl_interim_order.pdf> accessed 27 January 2026.

76 Samir Barua, 'What went wrong at IndusInd bank? Derivatives Accounting Mess and Insider Trading' (*LinkedIn*, 20 May 2025) <https://www.linkedin.com/pulse/what-went-wrong-indusind-bank-derivatives-accounting-mess-samir-barua-aokvf > accessed 27 January 2026.

77 Reserve Bank of India, 'Reserve Bank of India (All India Financial Institutions – Classification, Valuation, and Operation of Investment Portfolio) Directions, 2025' < https://www.rbi.org.in/scripts/BS_ViewMasDirections.aspx?id=12975> accessed 27 January 2026.

complicit in the accounting fiasco is currently being investigated.[78] Some news reports, including a letter from a former CFO, have indicated that the board of directors and audit committee did not ask tough questions for fear of reprisals in case they are seen as being 'too critical'.[79]

In the IBL saga, the key issue that sticks with the board (particularly the members of the audit and risk management committees) is that the directors failed to disclose the accounting violation when it was detected in December 2023. Further, despite an inquiry in February 2024, it took the board more than a year to make the actual market disclosure on 10 March 2025. Between May 2023 and June 2024, the Managing Director (MD) and CEO, and Deputy CEO were also found to have engaged in insider trading based on the unpublished price sensitive information regarding the accounting violation.[80] The board failed to take any internal action based on such a sale transaction as well. In July 2024, IBL's board imposed a penalty on an independent director for 'inadvertently' trading 667 shares of IBL during the period when trading in shares was frozen.[81] However, according to a news report, in May 2025 the board was evaluating the possibility of imposition of penalties on the MD and CEO, and Deputy CEO for trading shares worth ₹134 crores and ₹82 crores respectively.[82] As recently as 23 January 2026, a news report, citing the bank's joint statutory auditors, has noted that 'IBL had initiated and has now completed the process of disciplinary action against majority of the persons involved in the discrepancies and irregularities'.[83] The IBL fiasco highlights that if the senior

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78 'IndusInd Bank Under SFIO Probe: What Triggered The Investigation' (*NDTV Profit*, 18 December 2025) <https://www.ndtvprofit.com/business/indusind-bank-under-sfio-probe-what-triggered-the-investigation-9836447> accessed 27 January 2026.

79 Former IBL CFO Gobind Jain wrote to Prime Minister Narendra Modi asserting that he was the first to uncover long-standing irregularities in the bank's treasury operations. He claims that these irregularities persisted for over a decade. Additionally, Jain alleged that statutory and forensic audit reports were influenced by the board in exchange for substantial fees, while regulators such as the RBI and SEBI refrained from taking direct action. According to him, although consultants and auditors were engaged, their findings were shaped to protect the board's interests.

See, Outlook Business Desk, 'Ex-CFO Claims IndusInd Accounting Scandal Covered Up by Chair, Writes to PM Modi; Bank Refutes Allegations' (*Outlook Business*, 5 September 2025) <https://www.outlookbusiness.com/corporate/ex-cfo-claims-indusind-accounting-scandal-covered-up-by-chair-writes-to-pm-modi-bank-refutes> accessed 18 January 2026.

80 Securities and Exchange Board of India, Interim Order (28 May 2025) <https://www.sebi.gov.in/sebi_data/attachdocs/may-2025/ibl_interim_order.pdf> accessed 27 January 2026.

81 'IndusInd Bank's Former Top Bosses May Face Board Penalty for Insider Trading: Sources' (*Moneycontrol*, 14 May 2025) <https://www.tradingview.com/news/moneycontrol%3A06d1dc83d094b%3A0-indusind-bank-s-former-top-bosses-may-face-board-penalty-for-insider-trading-sources/> accessed 27 January 2026.

82 ibid.

83 'IndusInd Bank Initiates Disciplinary Action Against Officials Over Past Accounting Lapses' (*Moneycontrol*, 23 January 2026) <https://www.moneycontrol.com/banking/indusind-bank-

management may benefit from the company skirting compliance, internal gatekeepers may turn a blind eye to compliance failures or may not probe them seriously.[84] Additionally, the lack of effective oversight by the controlling shareholder may further exacerbate the crisis.

We now move on to the role of the auditors of IBL. When the accounting violation regarding IBL's internal trades of derivatives was doing the rounds, IBL's internal audit department found on 20 May 2025 that an amount of ₹172.58 crores was incorrectly recorded as fee income in the microfinance business over past three quarters, which has since been reversed in the fourth quarter of the financial year 2025.[85] Both these accounting violations brought to light lapses by IBL's auditors. The National Financial Reporting Authority (NFRA), the regulator tasked with maintaining the integrity of financial reporting called into question the scope and auditing exercise of the past auditors of IBL. According to reports, IBL's auditors removed 'derivative valuation' from their key audit matters for the financial year 2023–24, notwithstanding its prominence as a significant audit concern in earlier periods.[86] This omission occurred even as the RBI issued directives in 2023 that materially affected the bank's accounting treatment of derivatives.

Currently, a Serious Fraud Investigation Office (SFIO) probe into IBL for accounting discrepancies is underway, and time may reveal more about the nature of these violations.[87] Though investigations are ongoing, there has been a significant regulatory response in the aftermath of this crisis. The RBI's Senior Supervisory Managers have been scrutinising board agendas, deliberation quality in terms of inputs offered by independent directors, and board

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initiates-disciplinary-action-against-officials-over-past-accounting-lapses-article-13791714.html> accessed 27 January 2026.

84 Roy Shapira and Luigi Zingales, 'Is Pollution Value Maximizing? The DuPont Case' (2023) 50 Harvard Environmental Law Review (they illustrate this view that managers and shareholders are likely to turn a blind eye when it is beneficial for them, particularly in case of environmental pollution which is a negative externality). We argue that this applies in case of a financial fraud, which is a negative externality, and may work well with controlling shareholders' interest of mitigating any reputational or financial harm in the near term.

85 'IndusInd Bank Fraud Scandal: Hinduja's Response and Regulatory Investigations Unfold' (*The Economic Times*, 22 May 2025) <https://legal.economictimes.indiatimes.com/news/corporate-business/indusind-bank-fraud-scandal-hindujas-response-and-regulatory-investigations-unfold/121338705> accessed 18 January 2026.

86 Sugata Ghosh, 'IndusInd Auditors on Derivative Valuation: From "key matter" to Silence' (*The Economic Times*, 3 April 2025) <https://economictimes.indiatimes.com/industry/banking/finance/banking/indusind-auditors-on-derivative-valuation-from-key-matter-to-silence/articleshow/119916937.cms?from=mdr> accessed 27 January 2026.

87 'Ministry of Corporate Affairs Orders SFIO Probe into IndusInd Bank Citing Public Interest' (*The Economic Times*, 26 December 2025) <https://economictimes.indiatimes.com/industry/banking/finance/banking/ministry-of-corporate-affairs-orders-sfio-probe-into-indusind-bank-citing-public-interest/articleshow/126044569.cms> accessed 18 January 2026.

sub-committee performance.[88] They are also focusing on discrepancies between meeting recordings and minutes, signalling tighter expectations on board oversight.[89] Unless the RBI takes any action on this basis, one may not witness any major change in practice in compliance by banks and financial institutions.

In November 2025, the RBI also put in place the BG–Master Directions covering vital aspects of bank governance: appointment of directors and senior management and the role and functions of audit and nomination and remuneration committees.[90] Most importantly, they impose more prescriptive requirements, with a key focus on 'gatekeepers', as compared with corporate governance requirements stemming from the Companies Act and the LODR Regulations, considering the systemic importance of banks.

First, the chair of the board of directors is required to be an independent director, and the person shall not chair either the audit committee nor the nomination and remuneration committee.[91] The BG–Master Directions also require a higher quorum requirement for board meetings consisting of members higher than 1/3rd or three, with at least half of them being independent directors.[92] The BG–Master Directions also prescribe an eight year tenure for any non-executive director, subject to a cooling-off period of three years.[93] Second, the BG–Master Directions mandate an audit committee (consisting of only independent directors) and a risk management committee (consisting of majority of independent directors), with a broader mandate of reviewing risk controls, regulatory compliance, and effectiveness of internal controls.[94] Third, these directions prescribe details of the appointment and qualifications of certain key managerial personnel such as the Chief Risk Officer, Chief Financial Officer, and Chief Technology Officer.[95] These reforms aimed at strengthening 'gatekeeper oversight' appear to be stemming from the governance failures that led to the IBL case. While the BG-Master Directions seek to introduce several formal requirements regarding board structure, composition, and functions, their effectiveness would depend upon the manner in which these norms are implemented in practice by the individuals holding management and supervisory positions within the banks' governance structures.

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88 'RBI Tightens Oversight of Bank Board Deliberations: Report' (*Moneycontrol*, 23 June 2025) <https://www.moneycontrol.com/banking/rbi-tightens-oversight-of-bank-board-deliberations-after-indusind-episode-report-article-13162104.html> accessed 27 January 2026.

89 ibid.

90 Reserve Bank of India, 'Reserve Bank of India (Commercial Banks – Governance) Directions, 2025' <https://www.rbi.org.in/Scripts/BS_ViewMasDirections.aspx?id=13161> accessed 27 January 2026.

91 ibid Paragraph 46 (applicable to private banks).

92 ibid Paragraph 13 (applicable to private banks).

93 ibid Paragraph 48 (applicable to private banks).

94 ibid Paragraph 20(1) (audit committee); Paragraph 21(1) (risk management committee).

95 ibid Paragraph 29 to 33, 36.

While the renewed focus on an 'independent' board with 'gatekeeper oversight' is a welcome move, the true nature of 'independence' from the influence of the controlling shareholder, if any, needs to be tested. Since the IBL saga continues to unfold, we are yet to see more action on this front.[96] However, it underscores the need to progressively and systemically strengthen gatekeeper regulation for the Indian BFS sector.

4. Regulatory Failure and Turf Wars - IL& FS: India's Evergrande Moment?

As compared to banks in India, non-banking entities have long enjoyed a regulatory arbitrage. This difference in regulatory obligations is rationalised on the ground that banks accept deposits from the public whereas non-banking financial companies (NBFCs) are largely non-deposit-taking and lend based on owned or borrowed funds. NBFCs mostly obtain funds from banks or through issuance of debt instruments. Between 2015 and 18, Indian NBFCs expanded credit at around double the rate of banks, posing systemic risk.[97]

Further, from a regulatory standpoint, while banks fall within the sole purview of the RBI's oversight, since NBFCs are formed as companies within the Companies Act, and may also be listed, their regulation additionally falls within the ambit of the MCA and the SEBI. However, as discussed earlier, such a sectoral regulatory structure is susceptible to regulatory arbitrage – 'where the same activity is portrayed as belonging in the sector where the law is conducive to a higher profit rate'.[98]

The IL&FS crisis exposed these loopholes more glaringly. IL&FS is an infrastructure lending NBFC in the business of financing various infrastructure projects. The IL&FS group consisted of IL&FS, which served as an unlisted holding company, and 24 direct subsidiaries, 135 indirect subsidiaries, six joint ventures, and four associate companies, spanning across various

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[96] In June 2026, a fresh whistle-blower complaint made to the RBI, SFIO, NFRA, and Prime Minister's Office, has levelled serious allegations including 'manipulation of financial records, evergreening of microfinance loans, suppression of audit findings and attempts by senior management and board members to conceal irregularities'. Shristi Acharya, 'IndusInd Bank's Treasury Lapses Led to ₹1,817-Cr Profit Overstatement, PwC Review Finds' (*Outlook Business*, 5 June 2026) <https://www.outlookbusiness.com/corporate/indusind-banks-treasury-lapses-led-to-1817-cr-profit-overstatement-pwc-review-finds> accessed 29 June 2026.

[97] Faisal Ahmed, Marco Casiraghi and Sumiko Ogawa, 'Banking Sector and Nonbanking Financial Companies' in Alfred Schipke, Jarkko Turunen, Nada Choueiri and Anne-Marie Gulde-Wolf (eds), *India's Financial System: Building the Foundation for Strong and Sustainable Growth* (International Monetary Fund 2023) ch 3.

[98] '*In India, so far, the financial regulatory structure has been defined by sector, with multiple laws and often multiple agencies covering various sectors. This has led to inconsistent treatment, and regulatory arbitrage. Regulators have sometimes been lax in developing required protections out of notions of facilitating growth in the industry'*. See, Government of India, 'The Report of the Financial Sector Legislative Reform Commission - Volume I' (2013) <https://macrofinance.nipfp.org.in/fslrc/documents/fslrc-report_volume1.pdf> accessed 26 January 2026. This report further goes on to define regulatory arbitrage as quoted above.

sectors.[99] At a point in time, IL&FS had collected over ₹91,000 crores in debt instruments.[100] Financial conglomerates pose different risks–idiosyncratic risks, largely derived from diversification and inter-connectedness of businesses, risks associated with intra-group transactions, risks emanating from conflicts of interests and double gearing (same capital pool may be used to evaluate capital adequacy for parent and subsidiary companies, while overall capital level remains low).[101] These risks materialised starkly in the form of the IL&FS crisis.

Owing to tailwinds in the infrastructure sector, and high leverage, between July and September 2018, two subsidiaries of IL&FS defaulted on their loan payments and other credit instruments.[102] Credit rating agencies downgraded other credit instruments issued by IL&FS and its subsidiaries as 'junk', leading to a system-wide panic and a substantial crash in the Indian equities market. Primarily, the issues concerning IL&FS emerged from excessive risk taking, failure of adequate debt governance measures, and the failure of the board of directors, auditors, and credit-rating agencies alike.[103] However, a contagion risk was imminent as IL&FS was a systemically important financial institution. The IL&FS crisis epitomises the nature and extent of how poor governance practices could pose systemic risk, due to the size and financial interconnectedness of a group structure, all of which differentiates this case study from the two bank frauds discussed earlier.

The IL&FS crisis was ultimately contained. The board of directors was replaced, and the Central Government appointed a veteran banker as the Chairman, so that a proper resolution could be reached.[104]The resolution process is still ongoing, which highlights the complex nature of operations of a major financial group structure. As we stand to dissect the crisis and the nature of its resolution, we find it appropriate to focus on the failure of the regulatory

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99 'IL&FS: The Crisis that has India in Panic Mode' (*The Economic Times*, 3 October 2018) <https://economictimes.indiatimes.com/industry/banking/finance/banking/everything-about-the-ilfs-crisis-that-has-india-in-panic-mode/articleshow/66026024.cms?from=mdr> accessed 27 January 2026.

100 ibid.

101 John Farrar, 'The Governance and Regulation of Complex Conglomerates' in Thomas Clarke and Douglas Branson (eds), *The Governance and Regulation of Complex Conglomerates* (SAGE Publications 2012) 520-530. See, Takahiro Yasui, 'Corporate Governance of Financial Groups' OECD Corporate Governance Working Papers No 20 (OECD Publishing 2016) <https://doi.org/10.1787/5jlv1m6zq3nx-en> accessed 27 January 2026.

102 'How the IL&FS Crisis Ravaged India's NBFC Sector: A Timeline' (*The Economic Times*, 31 March 2022) <https://bfsi.economictimes.indiatimes.com/news/nbfc/how-the-ilfs-crisis-ravaged-indias-nbfc-sector-a-timeline/90541212> accessed 16 January 2026.

103 IL&FS was in its prime during the rise of the Indian infrastructure industry. However, it sailed into rough weather due to excessive leveraging coupled with slowdown in the infrastructure space owing to delays in land acquisition, lengthy judicial processes, cost escalation, corruption, and other issues. See, Afra Afsharipour & Manali Paranjape, 'Handbook on Corporate Governance in India' (*The Conference Board*, 2021) <https://www.conference-board.org/pdfdownload.cfm?masterProductID=27575> accessed 27 January 2026.

104 ibid.

apparatus as this is an underemphasised phenomenon in the academic literature on financial sector governance in India.

The failure of the regulatory apparatus is analysed from twin focal points. First, given that the complex business activities of IL&FS were subject to a multiplicity of regulators, swift action through regulatory coordination became more difficult. In fact, there emerged a regulatory turf war of sorts as to the purview of regulation and, by extension, where the responsibility for this fiasco ought to rest. Second, the IL&FS saga underscored the need for a resolution framework to govern insolvency for financial entities that are too-big-to-fail.[105] The existing framework for corporate insolvency proved inadequate to deal with financial entities, let alone a complex financial group structure.[106]

It is pertinent to note that a law was proposed for a resolution framework for financial entities; however, it was shelved on many counts, with a salient reason being that financial sector regulators, including the Ministry of Finance, Government of India, were reluctant to let go of their regulatory 'turf'.[107] We argue that a regulatory cooperation mechanism that operates under a resolution framework for financial entities would *ex-ante* better inform governance in financial sector entities. There is an inextricable link between bank governance and bank resolution. An effective bank resolution framework that does not rely on a 'bail-out' from the government would incentivise greater risk discipline and mitigate excessive risk-taking by bank managers.[108] A credible threat of insolvency would also incentivise bank boards and executives to adopt robust internal governance mechanisms such as risk management to prevent insolvency in the first place. We further illustrate our argument using the IL&FS crisis as a case-in-point.

First, the scale and magnitude of the IL&FS highlighted the regulatory gaps in the oversight of financial sector regulators–the MCA, the RBI, SEBI, and other relevant ministries of the

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105 Ila Patnaik, 'It's broke, fix it' (*Indian Express*, 21 September 2018) https://openlib.org/home/ila/MEDIA/2018/Its-broke-fix-it.html accessed 27 January 2026. Umakanth Varottil, 'Governance of Financial Institutions: Call for a Paradigm Shift', *Bloomberg Quint* (8 October 2018).

106 John Farrar, 'The Governance and Regulation of Complex Conglomerates' in Thomas Clarke and Douglas Branson (eds) *The Governance and Regulation of Complex Conglomerates* (SAGE Publications 2012) 520-530. See, Takahiro Yasui, 'Corporate Governance of Financial Groups' OECD Corporate Governance Working Papers No 20 (OECD Publishing 2016) <https://doi.org/10.1787/5jlv1m6zq3nx-en> accessed 27 January 2026.

107 Archis Mohan and Somesh Jha, 'Conflicting Views Between Govt and RBI Led to Withdraw of FRDI Bill' (*Business Standard*, 7 August 2018) <https://www.business-standard.com/article/economy-policy/conflicting-views-between-govt-and-rbi-led-to-withdraw-of-frdi-bill-118080200031_1.html> accessed 28 January 2026.

108 Giovanni Dell'Ariccia, Maria Soledad Martinez Peria, Deniz O Igan, Elsie Addo Awadzi, Marc Dobler and Damiano Sandri, 'Trade-offs in Bank Resolution' Staff Discussion Note No 18/002 (*International Monetary Fund*, February 2018) <https://www.imf.org/-/media/files/publications/sdn/2018/sdn1802-trade-offs-in-bank-resolution.pdf> accessed 7 February 2026.

Government of India. The IL&FS crisis was also an early case under the then new company legislation, the Companies Act, 2013, where the Central Government invoked its powers to appoint a new board in 'public interest' as the earlier board was found to have mismanaged the affairs of the company. The MCA was faced with a predicament concerning its jurisdiction over IL&FS and related group companies as they operated in the BFS sector which is regulated by the RBI. Further, there were certain subsidiary or associate companies which fell with the purview of the MCA but were inter-connected with other entities in the BFS sector. This situation was further complicated as SEBI regulated all listed entities within the IL&FS group.

Critics have also pointed out that the RBI failed in its supervision of IL&FS as earlier RBI Financial Stability Reports had not flagged systemic stress in IL&FS.[109] Additionally, the Standing Committee on Finance noted the role of credit rating agencies in exacerbating the IL&FS crisis by downgrading the rating of the debt instruments after default, and attributed such failure to a 'weak monitoring mechanism' by the Ministry of Finance, SEBI, and the RBI.[110] The then Economic Affairs Secretary, Government of India had also remarked that the IL&FS crisis points to several lacunae in the regulation of NBFCs as well as lack of data and 'interaction with the government or the regulators'.[111] The government and regulators exhibited differing views on which authority was responsible for the oversight lapses at IL&FS, highlighting gaps in accountability mechanisms.

Second, the need for the resolution framework is itself evident from the fact that the resolution is still not complete. IL&FS maintains that as of March 21, 2025, since the resolution of 197 entities out of 302 entities has been concluded, a debt of ₹45,281 crores has been resolved, out of the debt resolution target of ₹61,000 crores.[112] Many commentators have expressed the need for a specific resolution framework, especially in light of the IL&FS crisis and that of DHFL,

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109 'RBI's Reports Never Mentioned Possible IL&FS Crisis: Arvind Subramanian' (*The Indian Express*, 12 July 2019) <https://indianexpress.com/article/business/rbi-reports-ilfs-crisis-arvind-subramanian-5827064/> accessed 22 January 2026. Ajay Chhibber, 'Why is India's Financial Sector in Such Trouble: A Whodunnit?' IIEP Working Paper No 2021-09 (*Institute for International Economic Policy, The George Washington University*, 2021) <https://www2.gwu.edu/~iiep/assets/docs/papers/2021WP/ChhibberIIEP2021-09.pdf> accessed 28 January 2026.

110 Parliamentary Committee on Labour, Textiles and Skill Development, 'Fifty-Seventh Report on Guidelines, Monitoring, Rating and Regulatory System, Status of Investment in Bonds and such Instruments - (Example of Infrastructure Leasing and Financial Services (IL and FS) by PF Funds, Pension Funds pertaining to the Ministry of Labour and Employment' (*Digital Library, Parliament of India*, 13 February 2019) <https://elibrary.sansad.in/items/61777406-1527-4ad1-979d-d622df7c1c4b> accessed 28 January 2026.

111 Special Correspondent, 'IL&FS Crisis Shows Gaps in NBFC Regulation, Data: Garg' (*The Hindu*, 5 January 2019) <https://www.thehindu.com/business/Industry/ilfs-crisis-shows-gaps-in-nbfc-regulation-data-garg/article25920863.ece> accessed 22 January 2026.

112 PTI, 'IL&FS Group Discharges Rs 45,281 cr Debt to its Lenders as of March 2025' (*The Economic Times*, 7 April 2025) <https://economictimes.indiatimes.com/industry/banking/finance/ilfs-group-discharges-rs-45281-cr-debt-to-its-lenders-as-of-march-2025/articleshow/120058790.cms?from=mdr> accessed 22 January 2026.

another NBFC that was under the scanner for fraud.[113] However, they have also raised the issue that a regulatory turf war has precluded consensus on the draft law governing resolution of financial entities, which also envisages the formation of a joint regulatory body that is responsible for adopting a comprehensive and coordinated approach to resolution of financial firms.[114]

We argue that a coordinated regulatory approach coupled with an effective resolution framework that is apt for financial entities, in the *ex-ante* sense, would improve governance practices in these institutions. With lax enforcement against delinquent directors, and resolution of financial entities resorted to with public money, directors and senior management are prone to excessive risk-taking. Directors' and senior managers' interests are also (perversely) aligned.[115] This phenomenon would be a more serious concern given the presence of strong controlling shareholders of Indian entities operating in the BFS sector. While the RBI has issued Master Directions aimed at improving governance of banks and financial institutions, a dedicated framework that effectively monitors systemic risk would complement these directives.[116] A dedicated regulator, which is sector agnostic, with adequate powers to supervise systemically important financial entities is more likely to monitor them better. This, in effect would improve risk management, allowing sectoral regulators to focus more on governance.

Though the Evergrande real estate crisis in China followed the IL&FS crisis, the latter was indeed India's 'Evergrande moment'. Evergrande was a leading Chinese real estate company that suffered a debt crisis in 2021 and was finally liquidated. Since its scale of operations was massive–1300 projects under development in 280 cities–it had a massive impact on China's economy.[117] With complete resolution still pending in the case of IL&FS, and reforms being enacted as late as this year, the lessons learnt continues to inform the BFS sector in India.

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113 In terms of non-banking financial institutions, the promoters of the Dewan Housing Finance Limited (DHFL) had been alleged to have siphoned off funds to the tune of ₹34,000 crores and diverted them to shell entities. Deepak Tiwary and Aditi Sahay, 'DHFL Meltdown: The Corporate Governance Lapses' (2021) 20 Asian Journal of Management Cases 1, 9–22.

114 Archis Mohan and Somesh Jha, 'Conflicting Views Between Govt and RBI Led to Withdraw of FRDI Bill' (*Business Standard*, 7 August 2018) <https://www.business-standard.com/article/economy-policy/conflicting-views-between-govt-and-rbi-led-to-withdraw-of-frdi-bill-118080200031_1.html> accessed 28 January 2026.

115 Katrien Morbee, 'The Role of Corporate Governance in a Macroprudential Framework' (*The University of Chicago Law Review,* 07 January 2025) <https://lawreview.uchicago.edu/online-archive/role-corporate-governance-macroprudential-framework#heading-5> accessed 28 January 2026.

116 Reserve Bank of India, 'Reserve Bank of India (Commercial Banks – Governance) Directions, 2025' <https://www.rbi.org.in/Scripts/BS_ViewMasDirections.aspx?id=13161> accessed 27 January 2026. Reserve Bank of India, 'Reserve Bank of India (Non-Banking Financial Companies – Governance) Directions, 2025' <https://www.rbi.org.in/Scripts/BS_ViewMasDirections.aspx?id=12960> accessed 27 January 2026.

117 Peter Hoskins, 'Chinese Property Giant Evergrande Delisted After Spectacular Fall' (*BBC News*, 25 August 2025) <https://www.bbc.com/news/articles/c14g7r44566o> accessed 10 February 2026. For more details on the Evergrande scandal, see Virginia Harper Ho [*Chapter Name*] in this book.

5. Reform Agenda and Conclusion

As we have sought to establish in this chapter, there is an inextricable linkage between governance failures and corporate scandals in the BFS sector in India. The governance issues range from the role of 'star' promoters and their excessive risk taking and wealth tunnelling to the failure of gatekeepers, both internal and external, and finally to regulatory overlaps and turf wars. To be fair, this phenomenon has not gone unnoticed by the law reformers. Several efforts have been made, as we have discussed in sections 2 to 4 of this chapter, to address individual deficiencies in the governance framework of BFS companies that have come to light in the various scandals analysed. We argue, however, the *reformative* responses to the scandal constitute knee-jerk reactions that adopt a piecemeal approach to seemingly address individual issues on a somewhat isolated basis.

On the contrary, what is required is a wholesale reconsideration of the corporate governance framework governing BFS companies. It is true that, over the last decade or so, law reformers in India have paid significant attention to governance issues of banks and non-banking financial institutions,[118] but the recommendations have not been implemented with the comprehensiveness that they deserve. Instead, corporate governance in the financial sector ought to be viewed through a different lens altogether. While it is rather ambitious for us to undertake a comprehensive analysis of such far-reaching reforms within the confines of this chapter, we set out the contours of a possible framework.

118 Committee on the Financial System, 'Report of the Committee on the Financial System' (Reserve Bank of India 1991) (M Narasimham, Chair) <https://ibbi.gov.in/uploads/resources/Narasimham%20Committee%20I-min.pdf> accessed 29 June 2026; Committee on Banking Sector Reforms, 'Report of the Committee on Banking Sector Reforms' (Reserve Bank of India 1998) (M Narasimham, Chair) <https://rbidocs.rbi.org.in/rdocs/PublicationReport/Pdfs/90192.pdf> accessed 29 June 2026 (PSB autonomy; prudential regulation; capital adequacy; board professionalism); Committee on Financial Sector Reforms, 'A Hundred Small Steps: Report of the Committee on Financial Sector Reforms' (Planning Commission, Government of India 2008) (Raghuram G Rajan, Chair) <https://www.jrvarma.in/reports/Raghuram-Rajan/cfsr_all.pdf> accessed 29 June 2026 (regulatory architecture; market discipline; governance incentives; systemic stability); Committee on Comprehensive Financial Services for Small Businesses and Low Income Households, 'Report of the Committee on Comprehensive Financial Services for Small Businesses and Low Income Households' (Reserve Bank of India 2014) (Nachiket Mor, Chair) <https://rbidocs.rbi.org.in/rdocs/PublicationReport/Pdfs/CFS070114RFL.pdf> accessed 29 June 2026 (financial inclusion; differentiated banking; NBFC framework; institutional governance); Committee to Review Governance of Boards of Banks in India, 'Report of the Committee to Review Governance of Boards of Banks in India' (Reserve Bank of India 2014) (P J Nayak, Chair) <https://rbidocs.rbi.org.in/rdocs/PublicationReport/Pdfs/BCF090514FR.pdf> accessed 29 June 2026 (board independence; ownership reform; fit-and-proper criteria; accountability mechanisms); Standing Committee on Finance, 'Banking Sector in India: Issues, Challenges and the Way Forward' (Lok Sabha Secretariat, Sixteenth Lok Sabha, 31 August 2018) (M Veerappa Moily, Chair) <https://elibrary.sansad.in/items/e705d0a0-da55-48d3-afce-654b0793f745> accessed 29 June 2026 (NPA crisis; risk management failures; oversight deficits; governance reform).

First, lessons from the case studies analysed in this chapter highlight the unique agency problems in the BFS sector in India. On the one hand, BFS companies are subject to the typical agency problems afflicting companies with concentrated shareholdings, namely the conflicts between controlling shareholders and the minority shareholders. On the other hand, the regulatory focus for BFS companies mandates that controlling shareholders not only dilute their shareholding down to non-controlling positions, but also that the voting rights of shareholders are capped. This introduces the phenomenon of an ostensibly 'weak controller'. In these circumstances, the weak controller may be incentivised to engage in tunnelling to extract a disproportionate value from the company due to the limitations imposed on obtaining a higher shareholding. In that sense, the weak controller will likely utilise tunnelling mechanisms to make up for the low shareholding (and consequently proportionate cash flow rights) it has in the company. In addition, the weak controller may also be less incentivised to exercise oversight over the management of the BFS company who may enjoy a freehand compared to a company with concentrated shareholding, thereby exacerbating the agency problems between managers and shareholders.

Further, this ostensibly weak owner may also command 'influence' over the board of directors and the senior management.[119] Instances of such exercise of influence may be stark in case of 'star' promoters. 'Star' promoters may also be part of the C-suite that grant them with more powers to take executive decisions. For instance, in the case of Yes Bank, Rana Kapoor, who had a minority shareholding, continued to exercise considerable influence over vital decisions by virtue of being the CEO. While such influence is hard to be brought under the regulatory scanner, the reform process relating to the corporate governance of BFS companies needs to be preceded by greater conceptual clarity on the role promoters and managers thereof, especially for privately owned BFS companies.[120] Furthermore, strong disincentives may be introduced against promoters and managers for wrongful conduct, including disgorgement of any ill-gotten gains and clawback of remuneration (especially any variable pay).

Second, the time may be ripe to consider reframing the corporate governance archetype for banks and financial institutions. For instance, it is crucial to impose more onerous responsibilities on gatekeepers in BFS companies. One reform agenda that has already been proposed relates to enhancing the duties of directors and officers of BFS companies as opposed

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[119] A SEBI Consultation Paper notes that 'By virtue of being called promoters, such persons may have influence over the listed entity disproportionate to their economic interest, which may not be in the interests of all stakeholders'. Securities and Exchange Board of India, 'Consultation Paper on Review of the Regulatory Framework of Promoter, Promoter Group and Group Companies as per Securities and Exchange Board of India (Issue of Capital and Disclosure Requirements) Regulations, 2018' (*Securities and Exchange Board of India*, 11 May 2021) <https://www.sebi.gov.in/reports-and-statistics/reports/may-2021/consultation-paper-on-review-of-the-regulatory-framework-of-promoter-promoter-group-and-group-companies-as-per-securities-and-exchange-board-of-india-issue-of-capital-and-disclosure-requirements-re-_50099.html> accessed 29 April 2026.

[120] Despite some similarities, public sector banks exhibit different agency problems due to the predominant ownership by the state.

to other companies.[121] This not only relates to the content of the duty but also its interpretation and implementation by the courts and regulators. In reframing the duties of directors of BFS companies, there is a need to focus on non-shareholder constituencies, primarily depositors, as a beneficiary of good corporate governance in BFS companies and, as a corollary, victims of poor governance. This perhaps necessitates not only a stakeholder approach to governance of banks and financial institutions but also a reframing of the corporate purpose debate for such companies.[122]

The directors' duty framework under section 166 of the Companies Act, which requires directors to consider the interests of a wide range of stakeholders in corporate decision-making, can serve as a guideline. However, absent any effective mechanism to enforce section 166,[123] it needs to be re-calibrated to better address the governance issues in BFS companies. We make a two-fold argument: (i) directors of BFS companies must be held to a higher standard of care; and (ii) the regulator and courts must also enforce it effectively against bank boards. While a nuanced reading of the law reveals this higher standard, it should be clearly articulated under applicable law.

This view stems from law and jurisprudence on the required standard of care of directors of BFS companies. A judicial reading of section 46A of the Banking Regulation Act, 1949 (BR Act), a law that regulates all banking companies, deems every chairman, managing director, and director of a banking company (including private banks) to be a 'public servant'.[124] The law has entrusted these officers with a public function and they are held to the strictest standards of probity under criminal law.[125] The underlying rationale also stems from the fact that a director of a bank who does not exercise her supervisory functions operates in an altogether different risk environment. Such a failure, even in the case of a single institution, can cascade through the financial system, destroy household savings, disrupt credit to entire industries, and compel the state to expend public resources in rescue.[126] These observations reflect an

121 Jonathan R Macey and Maureen O'Hara, 'The Corporate Governance of Banks' (2003) FRBNY Economic Policy Review, 92. See also Klaus J. Hopt, 'Corporate Governance of Banks and Financial Institutions: Economic Theory, Supervisory Practice, Evidence and Policy' (2021) 22 European Business Organization Law Review 13 (observing that bank governance places special emphasis on board qualification, risk oversight, and directors' liabilities in relation to risk and compliance, which supports a heightened objective standard for bank boards).

122 See Elizabeth Pollman, 'Corporate Purpose' 112 Georgetown Law Journal 1413 (2024); ibid.

123 Mihir Naniwadekar and Umakanth Varottil, 'The Stakeholder Approach towards Directors' Duties under Indian Company Law' in Mahendra Pal Singh (ed) *The Indian Yearbook of Comparative Law* (Oxford University Press 2017).

124 *Central Bureau of Investigation v. Ramesh Gelli* (2016) 3 SCC 788. This deemed classification as a public servant is instrumental in enforcing public law duties against these bank officers under the Prevention of Corruption Act, 1988.

125 ibid.

126 In the Indian context, the IL&FS crisis was a prime example of a systemically important entity that led to a shock in the financial markets with wider adverse ramifications for various sectors. See, Afra Afsharipour

asymmetry between the private interests of bank directors and the public interests held in their stewardship and justifies a correspondingly higher standard of duty of care in case of directors of BFS companies. Thus, it would be incongruous for civil law to evaluate that same director's conduct by the relatively moderate standard applicable to directors of an ordinary company.[127] The elevated accountability that imputes public servant status must therefore also be adequately reflected in the civil standard by which a breach of directors' duties is assessed.

This higher standard is also reinforced by the statutory framework governing the composition of bank boards. The duty of care has not been purely subjective unlike under the Companies Act; it incorporates an objective element, asking what a reasonably diligent person with the knowledge, skill, and experience expected of someone in the director's position would have done.[128] For bank directors, the floor of that objective standard is set at a materially higher level. Under section 10A of the Banking Regulation Act, at least 51 per cent of the board of a banking company must consist of persons with special knowledge or practical experience in banking, finance, economics, accountancy, or law. A chairman or managing director must additionally possess special knowledge of the working of a banking or financial institution. By mandating that bank directors bring specialist expertise to the boardroom, the law has implicitly calibrated the 'reasonable director' standard to the level of a person actually possessing that expertise. A bank director who ignores warning signs of asset deterioration, or fails to

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& Manali Paranjape, 'Handbook on Corporate Governance in India' (*The Conference Board*, 2021) <https://www.conference-board.org/pdfdownload.cfm?masterProductID=27575> accessed 27 April 2026.

Further, while India has not seen a direct bailout by the Government of India, however, state-owned banks, in particular, have often been required to infuse equity in or merge with BFS companies which were marred by corporate scandals. See, D Subbarao, 'Merger of Public Sector Banks in India: The Imperative to Make Haste Slowly' ISAS Brief No 463 (*Institute of South Asian Studies, National University of Singapore*, 11 April 2017) <https://www.isas.nus.edu.sg/wp-content/uploads/media/isas_papers/ISAS%20Brief%20No.%20463%20-%20Merger%20of%20Public%20Sector%20Banks%20in%20India.pdf> accessed 27 April 2026.

Some other instances include the case of Yes Bank (2020) and Lakshmi Vilas Bank (merger with DBS Bank in 2020). See, Gopika Gopakumar, 'DBS Bank India's Rescue of Lakshmi Vilas Bank Shows RBI Has Learnt Finesse' (*LiveMint*, 18 November 2020) <https://www.livemint.com> accessed 30 April 2026.

127 Section 166(3), Companies Act, 2013. This provision is largely viewed as a subjective standard for holding directors liable if they do not exercise their duties with 'due and reasonable care, skill and diligence'. Given that the Companies Act is a generic legislation, this standard may be justified. However, this standard is inadequate and ill-suited for holding directors of BFS companies liable.

128 An RBI Consultation Paper, while noting the duties of directors, requires directors to 'use such degree of skill as may be reasonable to expect from a person with the same knowledge or experience as well as a board level position'. See, Reserve Bank of India, 'Discussion Paper on Governance in Commercial Banks in India' (*Reserve Bank of India*, 11 June 2020) <https://www.rbi.org.in/scripts/PublicationsView.aspx?Id=19613> accessed 30 April 2026. However, the direction issued pursuant to this Consultation Paper does not specifically elaborate on the duties of directors. See, Reserve Bank of India, 'Reserve Bank of India (Commercial Banks – Governance) Directions, 2025' <https://www.rbi.org.in/Scripts/BS_ViewMasDirections.aspx?id=13161> accessed 27 April 2026.

interrogate risk management frameworks cannot, therefore, take shelter behind the general business judgment rule that protects directors of ordinary companies from hindsight scrutiny.

The regulatory direction also appears to support the argument to hold directors of BFS companies to a higher standard. In the aftermath of a recent resignation of the Chairman of the largest private bank in India, citing 'ethical' concerns, the RBI has set an higher standard of care for bank board governance.[129] The RBI seeks to 'facilitate a more focussed and qualitative engagement on strategy and risk governance'.[130] It has amended the recently enacted BG–Master Directions to restate that the 'ultimate responsibility for the bank's performance, conduct and control rests with the [b]oard'.[131] Further, it reemphasises that banks must comply with requirements under various statutes and or regulations in relation to the role and responsibilities of the board.[132] This reiteration may also pave the way for a more stakeholder centric focus on board governance, given that provisions under Indian company and securities law are stakeholder-centric. This amendment requires that a bank's board shall ensure that 'it receives sufficient information from the management to discharge its role effectively'.[133] This requirement further raises the standard of care for bank directors, as they will not be able to argue that a vital board decision was taken without seeking any further clarifications or relevant information from the management.

However, a 'proverbial' higher standard of care for directors of BFS companies, without enforcement, would be counter-productive. Thus, courts and the regulator would have to ensure that such standard is enforced, particularly, in high profile scandals in the BFS companies. In India's legal architecture, the RBI is better placed to use a combination of supervisory and enforcement tools to sensitise directors of BFS companies, and take action when necessary. If directors are aware that elevated expectations are likely to attract legal, regulatory, or reputational consequences when breached, the standard may also influence ex-ante behaviour and mitigate excessive risk-taking.

Third, and perhaps the most complex exercise, would be for the Indian corporate, securities, and banking regulators to exercise a greater level of coordination while dealing with

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129 Veena Venugopal, 'What is going on at India's HDFC Bank?' (*Financial Times*, 7 April 2026) <https://www.ft.com/content/af367739-4aac-4493-af51-b73d54bc4331?syn-25a6b1a6=1> accessed 15 April 2026. See also 'RBI Proposes Major Governance Overhaul for Banks Amid HDFC Bank Tussle' (*The Economic Times*, 10 April 2026) <https://bfsi.economictimes.indiatimes.com/articles/rbi-proposes-major-governance-overhaul-for-banks-amid-hdfc-bank-tussle/130157784> accessed 30 April 2026.

130 Reserve Bank of India, 'Draft Reserve Bank of India (Commercial Banks – Governance) Amendment Directions, 2026' <https://www.rbi.org.in/scripts/bs_viewcontent.aspx?Id=4972> accessed 15 April 2026. These amendments will be part of the BG-Master Directions from 1 September 2026.

131 ibid para 19B(i).

132 ibid para 19B(ii).

133 ibid para 19B(iv).

governance matters pertaining to BFS companies. In 2010, the Government of India constituted the Financial Stability and Development Council (FSDC), which consists of heads of all financial sector regulators and is chaired by the Finance Minister.[134] The FSDC is tasked with inter-regulatory coordination and deals with vital issues of financial stability, and was formed on the basis of the Report of the Committee on Financial Sector Reforms, headed by Dr Raghuram Rajan (Rajan Committee).[135] A dedicated sub-committee of FSDC should be constituted with the aim of prevention of and enforcement in case of corporate scandals in the BFS companies. In the near term, this would help in mitigating the impact of any scandal on various stakeholders (including shareholders and depositors) and, in the long term, reduce the probability that such scandals will erupt in the first place, at least due to misgovernance as a contributive factor. In the long term, the FSDC needs to be provided with a legal backing through a legislative enactment. This was also a critical recommendation of the Rajan Committee. Such reform would ensure that greater coordination and information sharing could be carried out, particularly regarding supervision and enforcement, without violation of secrecy rules.[136]

In all, as we seek to illustrate in this chapter using BFS companies in India, there appears to be a two-way relationship between corporate governance and corporate scandals. On the one hand, poor corporate governance clearly has a strong tendency to contribute financial scandals. On the other hand, the occurrence of scandals tends to trigger governance reforms, either at the firm level or economy level. Nevertheless, a microscopic response is unlikely to yield the desired results. A broader reform process is the imperative.

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