

## **IndusInd Bank Crisis a wake-up call for Private Banking reforms**

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Advocates of neoliberal financial policies still argue that the post-1991 licensing of the so-called new generation private banks was a major step in enhancing competition and spurring “innovation” in the banking space. This position is maintained despite a raft of private bank “failures”—such as those that necessitated the merger of the once-celebrated Global Trust Bank with the public sector Oriental Bank of Commerce and prompted a major restructuring of Yes Bank—which dulled the RBI’s appetite for permitting new private entrants.

“Innovation” at these banks involved practices such as attracting deposits by offering higher interest rates and then diversifying lending and investment activity to riskier avenues to earn higher returns that could cover the higher cost of capital. It also involved direct and indirect exposure to volatile securities markets and opaque and risky instruments like derivatives.

Failure was the result. Yet, there are some who still believe in the tenet advanced by the Narasimham Committees of the 1990s tasked with laying out the post-liberalisation road map that it is not enough to permit and encourage private entry through the licensing of de novo banks but that many, if not all, public banks, must be privatised.

To these votaries of failure-prone markets, recent developments at IndusInd Bank must come as one more unwarranted distraction. The IndusInd “incident” involved the delayed reporting, around March 10, 2025, of an “accounting discrepancy” that, according to one estimate, led to a writedown of its derivative assets by Rs.1,530 crore. That figure was higher than its net profit in the third quarter of financial year 2024-25 and around 2.35 per cent of the bank’s net worth. Adjusting for that discrepancy would affect the bank’s capital, though not its solvency—at least not yet.

IndusInd Bank’s predicament seems to have arisen from its effort to exploit the options for enhancing the volume of its business arising from banking policy liberalisation, in pursuit of what it saw as potential for profit. Although the operations that led to this ostensible “discrepancy” are still confusing, it appears to have resulted from the decision to mobilise dollar deposits at dollar-denominated interest rates and leveraging that to lend to a domestic clientele in domestic currency. If IndusInd did that, it carried the burden of a currency mismatch. Credit assets and returns from lending will be in rupees, while liabilities are in dollars.

One potential consequence is that if the rupee depreciates, the amount of rupees it needs to garner the dollars needed to cover interest and pay back its depositors (in dollars) will be higher than the earnings from the related transactions, which can lead to losses. So, reports have it, the policy of the bank was to combine an internal hedge with an external hedge to deal with the exchange rate volatility.

The department in the bank responsible for mobilising the dollar deposits (liabilities) passes on the currency risk to the lending department. The latter commits to paying back the original dollar sum to the liabilities department irrespective of changes in the exchange rate of the rupee vis-a-vis the dollar. Since this implies losses for the lending section if the rupee depreciates

and nothing else is done, it takes on, for a small price, an external hedge in the form of a currency swap with another bank to acquire dollar sums at the exchange rate that prevailed at the time the transaction was initiated by the liabilities department.

### **What led to losses**

The problem at IndusInd appears to be that it was not adequately covered by the external hedge. This led to losses, since when “marked to market” or valued at prevailing market prices, the value of the derivatives it held was lower than the value of its actual dollar liabilities. The discrepancy arose because it did not appropriately account for losses arising from the impact of changes in the dollar valuation of the derivatives in keeping with RBI guidelines.

But the issue is not just this loss. This incident pointed to both wilful misreporting by the bank and inadequate action by the RBI despite its knowledge of this “discrepancy”. The discrepancy between the figure that would apply based on guidelines issued by the central bank effective from April 2024 and the one recorded in the bank’s accounts had been flagged to the top management as far back as September 2024. In fact, the discrepancy itself must have been present and rising for much longer, and a reasonable accounting system should not have allowed it to be recorded with a delay after the RBI issued its guidelines.

If the management has failed to “discover” the discrepancy for a long time and then failed to report it immediately on discovery, the suspicion that it could hide other information that could reveal the health of the bank’s balance sheet only increases. Moreover, there are rumours that the CEO of IndusInd and his deputy offloaded their shares in the company after the RBI’s circular was issued in September 2023 and took effect in April 2024. In the process, they made significant gains from the then high prices of the bank’s shares, which collapsed once the incident was revealed.

The RBI, too, is not without fault in this matter. First, there is reason to believe that its guidelines for accounting valuation of implicit net returns from derivative holdings involve no rocket science and should have been formulated and issued much earlier than they were. Second, it does appear that the central bank had come to know that something was amiss at IndusInd when it decided to respond to a board request to extend the appointment of the CEO for another term of three years.

It, uncharacteristically, approved only a one-year extension and subsequently asked the CEO and his deputy to step down from their positions in late March 2025. Even after the discrepancy and associated loss were reported, the central bank sought to play down the gravity of the “incident”, saying that it would not affect the solvency of the bank. Its primary concern appears to be preventing panic among depositors and averting a bank run. Save the bank and its executives even at the risk of losses to depositors if matters worsen seems to be the guiding principle.

Even if, in keeping with the RBI’s assessment, IndusInd does not suffer serious damage leading to insolvency, the incident sends out a signal: yield-hungry private banks are prone to failure. Clearly, what is needed is not more private entry and privatisation but strengthening of the much-weakened public banking sector.

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