Axis Bank (2009-2018): A Case Study in Mismanagement & Board Failure

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He is known for his non-consensus views on the market and on stocks. He not only critically evaluates corporate governance in companies, but also examines the entire ecosystem comprising of audit firms, regulators, sell-side and credit rating analysts and the business media.

As an independent analyst, he was one of the first to caution about the impending asset quality and corporate governance problems in Indian private sector banks, and his critical analysis on the performance of some CEOs finally led to the banking regulator refusing an extension to their tenures.

Early in his career he was fortunate to have been mentored by the late N L Hingorani (ex-director, National Institute of Bank Management) in corporate financial analysis and business strategy.

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Axis Bank: Rewarding Incompetence and Misgovernance

At a stormy meeting on April 20, 2009, the board of Axis Bank decided to overrule the Chairman and Chief Executive Officer (CEO), P.J. Nayak, set aside his preference for an internal candidate, and selected ICICI veteran Shikha Sharma as his successor. Having being decisively out-voted, Nayak took the honourable option of resigning with immediate effect.

Perhaps it was the ICICI banking culture that made Nayak reluctant to endorse his successor for Axis Bank. While ICICI Bank, under the leadership of K.V. Kamath, had successfully transformed itself from a development financial institution into a bank, it had a culture of aggressive banking practices focusing on ambitious revenue and assets targets. The then senior management was also intolerant of any critical views (as this analyst experienced first-hand when he exposed the sharp accounting practices of the erstwhile ICICI in January 1999: for nearly two decades thereafter, ICICI Bank declined to interact with this analyst).

It was under such controversial circumstances that Shikha Sharma took charge as CEO, Axis Bank, on June 1, 2009. While both Nayak and Sharma lacked exposure to commercial banking prior to joining Axis Bank, Sharma and the Axis Bank's board of directors bizarrely preferred to have negligible commercial banking expertise on the board, and this worsened from FY2016 onwards. While Nayak recruited select outsiders in senior positions where there was a lack of expertise, Sharma chose to rely on outsiders mainly from ICICI to occupy nearly all the senior positions. Unfortunately for Axis Bank, most of them had limited commercial banking experience. At the same time, the bank focused on financing large capital-intensive infrastructure and corporate loans to boost overall asset growth, which had far reaching consequences for the bank.

I had covered Axis Bank as a sell-side analyst for some years. As an independent analyst I commenced a series of critical articles on the bank from June 2016, exposing the incompetence of Shikha Sharma and the board of directors at Axis Bank. Their record was marked by poor quality credit, cooking the books of accounts, deficiencies in operational risk management, negligible oversight of senior executives, and persecution of whistle blowers. I consistently argued for Sharma's removal and the restructuring of the board.

Instead, in what has become the norm in private sector banks, the Axis Bank shareholders and the board rewarded the leadership team with salary hikes, bonuses and excessive stock options even at a time when profits were collapsing. The board of Axis Bank even went one step further by prematurely appointing Sharma for a fourth term. Fortunately, as per media reports, the Reserve Bank of India (RBI) truncated her fourth term, effectively removing her, although the official explanation was that Sharma wanted a reduced fourth term.

Axis Bank responded to my articles by protesting to the global independent research platform that hosted my research, accusing me of "maligning the institution", and even threatening not to engage with me. The bank probably thought that the lack of corporate access would silence my critical analytical commentary on the bank. But just as ICICI Bank's denial of access for nearly two decades could not prevent my critical coverage, so too Axis Bank could not stop my critical articles, and after a time they resumed their engagement.

It is interesting to observe how the founders/promoters and the ecosystem responded to this period of misgovernance. Axis Bank had on its board of directors nominees from Specified Undertaking of Unit Trust of India (SUUTI), the bank's founders, and also from the Life Insurance Corporation (LIC), who were present to monitor their investment in the bank. Apparently, their contribution was to remain silent and rubber stamp the huge stock options, salary hikes and bonuses that were awarded to the senior executive management by the very generous Nominations and Remuneration Committee (then chaired by Prasad R. Menon, independent director and a former senior executive of the Tata group) of the board.

After the banking regulator's over-ruling of the board's decision to give a full fourth term to Shikha Sharma, and given the series of lapses on her watch as the bank's CEO, the private corporate sector should have given her a wide berth, but instead blue chip companies from the Tata and Mahindra and Mahindra group, Ambuja Cement and Dr Reddy's welcomed her with open arms to join their board of directors. Jairam Sridharan, the Chief Financial Officer who signed off on two successive years of mis-reported accounts (wilful misreporting of accounts is a criminal offence under the Banking Regulation Act, 1949) was voted by sell-side analysts as their 'Best Bank CFO' in the prestigious Institutional Investor Survey in 2019. Piramal Enterprises selected Sridharan as the CEO of their consumer finance business in late 2019. When an ecosystem rewards individuals with such a track record, it is an indication of the traits the system is looking for in key posts.

Axis Bank Share Price Chart June 1, 2009 to December 31, 2018

Source: Moneycontrol

During Sharma's tenure as CEO from June 1, 2009 till December 31, 2018, Axis Bank's share price rose 4.2x and out-performed the Bank Nifty, which had increased by 3.7x in the same period. However, interestingly, from a P/BV perspective, the bank traded at around 2.6x FY2009 when Sharma took charge, but when she demitted office it was trading at 2.4x 3QFY2019. Despite outperforming the Bank Nifty, the stock had de-rated during her tenure, and that could be attributed to the self-inflicted disasters.

Sell-Side Coverage of Axis Bank

Date	BUY	HOLD	SELL	Total	Price	Price Target	Expected Return
					Rs	Rs	%
27 April 2016	37	15	6	58	476	515	8.2
7 November 2016	36	15	5	56	485	539	11.1
26 December 2016	23	19	14	56	438	516	17.7
1 March 2017	20	20	15	55	513	495	-3.6
26 February 2018	25	16	11	52	552	643	16.4
6 April 2018	26	15	10	51	500	633	26.6
10 September 2018	28	16	7	51	652	629	-3.5

Source: Bloomberg

During the period when this analyst was highlighting the mismanagement, sell-side analysts covering Axis Bank preferred to maintain the highest number of 'Buy' recommendations and avoided holding the senior executives accountable although the high number of 'Hold' recommendations probably indicated their concerns on the bank. Currently, after over a year of the new CEO taking charge, and on account of the Covid-19 crisis, the share price is traded at the level of early 2016.

In management schools, and for those interested in banking, Yes Bank under the leadership of Rana Kapoor, Indusind Bank during Romesh Sobti's tenure and Shikha Sharma's stint as CEO at Axis Bank should be analysed as classic case studies in mis-management and the failure of corporate boards of directors and auditors.

Till very recently, private sector banks were held up as models of prudence, efficiency and dynamism, in contrast to the public sector. The unstated objective of Government policy was to increase the market share of the private sector in banking, if necessary by winding up some public sector banks. The *Economic Survey 2014-15* said that the "structural problems" of the banking sector

> "relate to competition and ownership. First, there appears to be a lack of competition, reflected in the private sector banks' inability to increase their presence. Indeed, one of the paradoxes of recent banking history is that the share of the private sector in overall banking aggregates barely increased at a time when the country witnessed its most rapid growth and one that was fuelled by the private sector... Differentiation [among the public sector banks] will allow a full menu of options such as selective recapitalization, diluted government ownership, and exit."

The RBI has had (at long last) to intervene to ensure a change of management in Axis Bank and Yes Bank and State Bank of India, the largest Government-owned bank has had to lead a rescue of Yes Bank.

Equally significant is the role, or lack thereof, of the regulator. Perhaps seduced by notions of 'light-touch' regulation, it failed to crack down on Yes Bank, Indusind Bank, and Axis Bank when they under-reported

FY2016 NPAs; it merely noted the 'divergence' between their accounts and the reality. All three banks promptly under-reported NPAs the following year as well. By the time the RBI intervened, it was very late, and Yes Bank had already gone into crisis.

Finally, the market. According to the current prevailing economic theory, all the best information about financial assets is included in their price. When a publicly listed firm is mismanaged, the market will punish the firm by dumping its shares. Thus the market self-regulates. However, nothing of the kind happened with these three banks. The information which this analyst used over the years to critique these banks' performance was all in the public domain. My critiques were widely read in banking circles. Yet a deafening chorus of sell-side analysts and business media celebrated these banks, heaped awards on them, and sustained their bubbly share prices. This underlines the need for the regulator to act independently, rather than leave the markets to self-regulation. Possibly the regulator did not do so either under the spell of some currently fashionable economic theory, or due to a reluctance to prick the market bubble.

Smartkarma, the global research platform, published my articles on Yes Bank as an ebook; similarly, I released a compilation of my research notes on Indusind Bank. To complete the trilogy, I am presenting my articles on Axis Bank, critically dissecting the bank during Sharma's tenure as CEO. I am grateful to *The Wire.in* and to *Moneylife* for their permission to include articles on Axis Bank I had authored on their platforms. I would like to acknowledge the valuable insights provided by former and serving Axis Bank officials and to the Research Unit for Political Economy (RUPE).

Hopefully, the trilogy may encourage some in the sell-side and in the business media to cast away their rose-tinted lenses through which they fondly peer at corporate India and do justice to their noble professions.

Hemindra Kishen Hazari
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Axis Bank's Watchlist – Guardrails or Illusion?

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The term "watch list" is a bit misleading, giving the impression that the loans on the list may eventually turn out be healthy. But Axis Bank stated 60% of the watch list will become non-performing assets.

Axis Bank is one of the favoured stars among the new private sector banks in India, with an enviable reputation. *The Banker* gave it the Bank of the Year award in 2014; Brand Equity termed it the "Most Trusted Private Sector Bank" two years in a row (2013, 2014); *Asiamoney* called it the "Best Domestic Bank in India" in 2014; and for three years in a row (2012-14), the Institute of Chartered Accountants of India honoured it for "Excellence in Financial Reporting" in the private sector banks category. (Source: Axis Bank Fiscal Year 2015 annual report.)

Thus it came as a surprise when Axis Bank, along with its results in the fourth quarter of the fiscal year (FY) 2016, also released a corporate lending watch list of standard loans of Rs 22,628 crore [226.28 bn]. To get an idea of the dimensions of the problem: the watch list constitutes 13% of corporate assets and a significant 45% of equity capital. This disclosure was in addition to its net non-performing assets (NPA) of Rs 2,522 crore [25.22 bn], restructured standard assets of Rs 8,072 crore [80.72 bn], 5/25 scheme loans of Rs 3,740 crore [37.4 bn] and strategic debt restructuring of Rs 575 crore [5.75 bn].

The term "watch list" is a bit misleading. It gives the impression that these loans need to be watched, but may eventually turn out be healthy. But Axis Bank stated 60% of the watch list will become non-performing assets (NPA) in the next eight quarters, with a bias towards the first half of the FY2017 (April-September 2016). Moreover, the security for these loans is woefully inadequate. Instead, the bank will have to provide 70% for these NPAs.

The capital market hailed the disclosure as a model of transparency with *Jefferies*, the global brokerage, in its report on Axis Bank's asset quality dated April 26, 2016 saying,

> "You wanted clarity, now you have it !…with greater clarity comes visibility."

Bloomberg columnist, Andy Mukerjee added for good measure,

> "Shikha Sharma [CEO, Axis Bank] deserves a medal for honesty."

Before any medals for integrity, clarity and vision are bestowed, a thorough understanding of the timing of the release and the significance of the watch list is warranted as it raises important issues which need to be debated.

Timing of the release

While analysts have been estimating stressed loans of banks, Axis Bank had remained confident of its asset quality and even on its analyst conference call – held on January 20, 2016 for the third quarter of the FY2016 results, when banks had to incorporate additional stressed loans as a consequence of the Reserve Bank of India's asset quality review (AQR) – the bank unequivocally stated that even though the Reserve Bank of India (RBI) had given two quarters to disclose and provide for the additional loans, Axis Bank had said

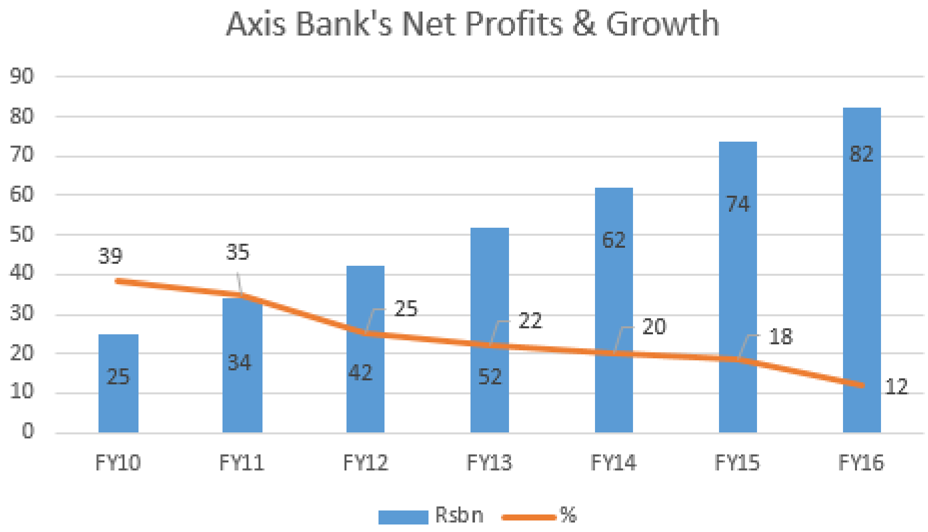
> "after going through this process of *rigorous* [RBI] *testing* [emphasis ours] of our portfolio, our asset quality metrics have come out higher than before with GNPA [Gross Non-Performing Asset] increasing from 1.38% in Q2 to 1.68% as on 31st December 2015 and Net NPA level increasing from 0.48% to 0.75%. During the quarter, fresh slippages into NPA stood at Rs 2,082 crore [20.82 bn] including the reclassifications proposed by the RBI, which comprised around half of the incremental slippages…as a prudent measure, …incorporated the full expected impact on the Bank in this quarter [3QFY2016] itself."

Yet 91 days later, the bank disclosed a mammoth Rs 22,628 crore [226.28 bn] of stressed corporate standard loans, which it expects to become non-performing in a short period of time. Axis Bank has also remained silent and not provided any explanation on the timing of its release. The obvious question, which no one seems to ask, is what had changed in this period for such a large segment of corporate assets to become weak – had the economy gone into a sudden tailspin or had all efforts to hide a festering malignancy, deep in the bowels of the balance sheet, failed?

There was no major economic crisis in the world or the Indian economy to warrant a meltdown in corporate performance in the fourth quarter of the FY2016 for Axis Bank's corporate asset book to significantly deteriorate. The needle of suspicion therefore points to lack of transparency which analysts had long spoken in hushed whispers, but few had been bold to publicise.

CEO tenure and growing profits

In the absence of cataclysmic events, weak assets – constituting 13% of the corporate book, 6% of total customer assets and more importantly 45% of equity capital – cannot suddenly surface in the span of 91 days. There have been many concerns on corporate loans and banks ballooning infrastructure assets set up at inflated costs and incomplete, but nearly fully funded, capital projects. Government banks had been reporting poor results since FY2014 but new private sector banks like Axis Bank – which had significant corporate and infrastructure assets – had been defying the trend by consistently reporting growth in profits till the third quarter of the FY2016. However, despite all efforts banks cannot indefinitely defy reporting deteriorating asset quality and judgement day has to dawn.



Source: Axis Bank

Long serving CEOs (for example Shikha Sharma was appointed Axis Bank CEO since June 2009 and has been adequately rewarded in compensation) try to keep reporting consistent rise in profits as it increases the share price and more importantly justifies huge remuneration in the form of salary, bonus and stock options. In such an environment, CEOs are reluctant to report either a decline in profits or profits which are unable to meet consensus analyst forecasts. Indeed Axis Bank's FY2015 annual report had nothing but praise for its CEO and the board of directors justifying her re-appointment for a further three years from June 1, 2015

> "The Bank has in the three years of her current [2012-2015] tenure, been able to consistently deliver profitability as well as returns to its shareholders under her leadership in the challenging economic and macro environment. The NPAs and restructured assets have been kept in control, *with strong focus on guardrails* [emphasis ours]," it said.

In the light of the watch list disclosure, where slightly less than half of the bank's capital stands exposed, one wonders how the board did not question the numbers in the face of a challenging environment.

In government banks, as the tenure of CEOs is short, new CEOs tend to periodically clean up the bank and blame it on their predecessor but this is not an option for long serving new private sector banks CEOs. Globally, when major problems surface in banks, the entire senior management is rightfully removed as markets demand accountability. But in ICICI Bank (which also reported significant weak assets) and Axis Bank, the only deemed punishment is no bonus or a cut in variable pay for the senior management. In India, the regulator, the media and the analysts, who all praise the workings of the free market, do not seem to insist on implementing its key tenet: accountability.

Relevance of RBI's asset quality review

The RBI's asset quality review (AQR) was to have brought transparency to the Indian banking industry and expose the hidden NPAs in the system. But in the case of Axis Bank it failed miserably. In the third quarter of the FY2016, the AQR after "rigorous [RBI] testing" resulted in additional NPAs of around Rs 2,800 crore [28 bn] (inclusive of sale of Rs 1,800 crore [18 bn] power sector loan to an asset reconstruction company in 2QFY2016). Ninety-one days later, Axis Bank informs the public that its watch list of Rs 22,628 crore [226.28 bn] is eight times the size of RBI's AQR. How did the watch list escape the notice of RBI inspectors? The RBI's oversight in Axis Bank's case has major ramifications for the industry on the credibility of the AQR in revealing the true asset quality of Indian banks.

Negligible Credit Expertise in Board of Directors

There is a perception in the market, of the quality of the board of directors being superior in new private sector banks as compared with the government banks. Boards of new private sector banks are filled with luminaries from academia, the corporate world and former senior government bureaucrats. Such individuals are supposed to be more effective in supervising management and protecting minority shareholders. The Axis Bank board of directors has its share of luminaries, with a retired Indian administrative service officer as its non-executive chairman, eminent individuals from the financial market, technology, chemicals and power industries, and academics as its non-executive directors. But a closer inspection of its board of directors reveals a strategic weakness which could explain why the bank's poor corporate asset quality took some time to be publicly revealed.

The Axis Bank board of directors consists of 15 individuals: four executive directors (including the CEO), two nominee directors representing the interests of Special Undertaking of Unit Trust of India (SUUTI) and Life Insurance Corporation and nine independent directors (including the chairman). The background of the executive directors is revealing. Sharma, prior to being appointed as the bank's CEO in June 2009, was associated with ICICI in its life insurance, retail and investment banking divisions and early in her career had exposure to project finance. V. Srinivasan, deputy managing director, joined Axis Bank in 2009 and has a background in treasury, investment banking, capital markets and foreign exchange management. Rajiv Anand, in charge of retail banking, has a background in treasury and asset management. Finally, Rajesh Dahiya's expertise is in human resources and administration.

Even though credit risk assets at Rs 3,45,867 crore [3,458.67 bn] constitutes 84% of Axis Bank's total risk weighted assets and corporate credit at Rs 1,55,384 crore [1,553.84 bn] is the largest component (46%) of total credit in FY2016, none of the executive directors of this large and prominent Indian private sector bank have strong credit management expertise in appraising and monitoring corporate and small and medium enterprise credit.

Debt and treasury management expertise has far less weightage as they deal in highly rated ('AAA', 'AA') corporate paper, which does not require much credit appraisal and credit monitoring skills. The nominee directors are career cadre officers of their parent companies and have expertise in asset management and life insurance. The non-executive independent directors with the exception of S. Vishvanathan (ex State Bank of India) and Samir K. Barua (academic and former director, IIM, Ahmedabad) do not have a history associated with credit management. Hence in a board of 15 directors there are only two independent directors who can comprehend the intricacies of credit risk management.

The board of directors in an Indian bank (where credit is the major risk) must have a sizeable number of non-executive directors who have a background in credit and risk management – and who can grill bank executives in credit appraisal and credit monitoring – especially at Axis Bank where even the executive directors lack the required credit management skills. This is all the more important when there is a well established CEO who would like to report a consistent rise in profits for the bank even when the economy is experiencing problems. Given what we now know, Axis Bank's 21% growth in annual net profits from FY2012 till FY2015 was unwarranted and its board of directors should have exercised greater caution on why the bank was reporting significantly lower non-performing loans and higher profits when government banks having a similar corporate and infrastructure portfolio were reporting higher NPAs and lower profits.

Myth of excessive loan security and early exit

Axis Bank's watch list also exposes another myth associated with new private sector banks – they are insulated from the corporate slowdown as compared to government banks since they are prudent about demanding more security from stressed corporate borrowers and because they are able to exit such accounts at an early stage. An interesting but unappreciated feature of Axis Bank's watch list is that only 27.5 % (Rs 62.26 bn) of it is restructured and in strategic debt restructuring while 72.5% (Rs 164.02 bn) is non-restructured, standard asset.

The issue is that the bank sees that Rs 13,577 crore [135.77 bn] of standard loans is going to be NPA in a short time; so why has it been unable to exit these standard accounts by selling these loans at a discount in the market? The bank has also maintained that it will provide 70% for these soon to be bad loans which also raises another issue that they have security of only 30% for these loans. These two issues completely overturn the widely held view that new private sector banks are able to demand extra security for loans and are able to exit early when problems are detected. The simple truth is that for the watch list standard loans there is no market and it has negligible security because they have been poor quality loans for a long time.

When a bank sees that a large component of credit is going to become non-performing and there is negligible security and no exit, prudence dictates that the board of directors instructs the bank to start reporting lower profits by building up its contingency reserve at an early stage so as not to disrupt capital and future earnings. In the FY2015, not only was Axis Bank's contingency provision inadequate at Rs 1,200 crore [12 bn] but by the FY2016 it was reduced to Rs 400 crore [4 bn] – the balance sheet of a prominent new private sector bank has been left virtually defenceless to face the onslaught of the watch list.

The bank states in its watch list presentation that "the process of creating the list was driven by the bank's Risk Management led by CRO [Chief Risk Officer]". In Axis Bank's case it appears that either the risk division like *Kumbhakarna* of Ramayana fame was in deep slumber when corporate assets were rapidly falling in value; or, more likely, it was sounding the alarm, but the board of directors with their limited understanding of credit did not comprehend its gravity, and the board was unwilling to challenge a well-entrenched CEO who did not want to disrupt the annual growth in profits. Whatever the reason, it has finally culminated in exposing 45% of the bank's precious capital to corporate credit risk.

Significant impact on future earning

In FY2016, Axis Bank reported net profit of Rs 8,224 crore [82.24 bn] (nearly 12% growth over FY2015), in the next two years (FY2017 and FY2018) the bank will have to annually provide for Rs 4,750 crore [47.5 bn] for bad debts and not accrue interest (assuming 12%) of around Rs 814 crore [8.14 bn] aggregating to Rs 5,564 crore [55.64 bn] on its watch list exposure. The smooth net profit growth of the past is going to get majorly disrupted in the immediate future and although the bank states that this is the extent of its corporate loan problem and analysts to justify their “buy” recommendation are forecasting a revival in profits from FY2018, problems could emerge from the bank’s retail, small business and agricultural portfolio in the future.

Post the announcement of its watch list, analysts and commentators rushed to praise Axis Bank for its transparency without doing a deeper probe of the bank’s early warning systems – the guardrails intended to protect the sliver of equity propping up the twin mountains of liquid deposits and ill-liquid credit. These commentators proved to be no better than those institutions who grant annual awards which the bank dutifully publishes to its shareholders and the bank’s board of directors who spoke eloquently on the robustness of the ring fencing but which proved illusionary.

With the Sidelining of Its Chief Risk Officer, Axis Bank Institutionalises Conflict of Interest

OCTOBER 21, 2016

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Risk management is the control and nerve centre of a bank. The independence of control and vigilance functions like risk management and audit has to be fiercely protected by the board of directors and the banking regulator. So when a major bank starts downgrading its chief risk officer (CRO), not only depositors, but the banking regulator (the Reserve Bank of India) and the general public, ought to sit up and take notice. The question arises: what's behind such a move?

Axis Bank has quietly clipped the powers of its CRO, Cyril Anand, who was appointed on May 1, 2016. His predecessor, Bapi Munshi, reported directly to Shikha Sharma, the Chief Executive Officer, but when the new CRO took charge the reporting structure was altered. Now he also has to report to Jairam Sridharan, the bank's chief financial officer (CFO). The change in the reporting was not disclosed to the public and the stock exchanges, on the ground that the CRO is not considered "key management personnel" by the bank. But this is an extremely relevant development for depositors and investors at a time when the Indian government is planning to sell its remaining 11.5% stake in Axis Bank (valued at Rs. 14,645 crores) in late October or early November 2016.

Axis Bank confirmed to *The Wire* that the new CRO had also to report to the CFO, but the bank declined to specify his date of appointment on the grounds that it was "not public information." An email sent to the bank stating that the new CRO was appointed on May 1, 2016 and that his new reporting was concurrent from that date has not been contradicted.

Surprisingly, less than 3 months later after the new CRO's appointment, Axis claimed:

> "The Chief Risk Officer reports to the Managing Director and CEO and the Risk Management Committee of the Board oversees the functioning of the Department."

Why Axis Bank, in its June quarter results announcement, failed to disclose the factual position on the CRO's reporting remains a mystery.

Indeed, Axis Bank's latest annual report for the year ended March 31, 2016 acknowledges the role of risk management when it states,

> "The *independent* [emphasis ours] risk management structure within the Bank is responsible for managing the credit risk, market risk, liquidity risk, operational risk, and other [Basle] Pillar 3 risks like reputational risk and strategic risk and exercising oversight on risks associated with subsidiaries."

The Basel Committee on Banking Supervision Guidelines for Corporate Governance, unequivocally state that the CRO should not wear dual hats:

> "..(chief operating officer, CFO, chief auditor or other senior manager should in principle not also serve as the CRO). While formal reporting lines may vary across banks, the CRO should report and have direct access to the board or its risk committee without impediment."

By creating a dotted hierarchal line between the CRO and the CFO, Axis Bank has deliberately entered a grey area and devalued the importance of the highly sensitive post of CRO and has subordinated it to financial management.

Role of the CEO and the board

One of the critical functions of a bank CEO is to directly monitor risk and credit quality as it is weakness in these critical areas which normally adversely impacts banks. In Axis Bank, Shikha Sharma has changed this time tested tradition by incorporating a dual reporting system for the CRO, effectively passing on the responsibility of risk management from her to the CFO.

Corporate governance structures for banks encourage direct access to the board by the CRO and the post's independent direct reporting to the board is to ensure that the board is independently informed of risk management. As Axis Bank has confirmed to us that the dotted line reporting by the CRO to the CFO had the support of the board, it indicates that the board has quietly endorsed the CEO's decision for the dual reporting structure. This at a time when Axis Bank is facing asset quality stress, high retail credit growth and issues of timely disclosure. These issues require the strengthening of independence of risk management and not its dilution.

CRO instrumental in formation of "watch list"

The change in the reporting hierarchy follows the pivotal role played by risk management in convincing Axis Bank to disclose its. Rs 22,628 [226.28 bn] crore-strong "watch list" of poor quality corporate loans. These loans constitute around 45% of its equity in the fourth quarter of fiscal year (FY) 2016. In an unusual development, the bank disclosed in its "watch list" presentation that "the process of creating the list was driven by the Bank's Risk Management team, led by CRO," thereby admitting the important role of risk management. Until the 4QFY2016, and despite deterioration in corporate loans in government banks and analyst concerns on asset quality, Axis Bank and its CFO was assuring investors that the bank had no significant asset quality issue. It appears that while assurances were being generously given, risk management was sounding the alarm bells, which finally led to the public disclosure of the "watch list." By the bank's own admission, 60% of the "watch list" loans would become non-performing in a short period requiring the bank to provide 70% for these loans. This highlights the abysmally poor quality of these corporate loans, the state of corporate credit expertise and timely disclosure at the bank.

In Axis Bank's organisational structure there is no individual directly responsible for credit, and credit responsibilities are split in different verticals. The head of corporate credit and the head of small and medium enterprise credit report to the deputy managing director, while the head of retail credit reports to the executive director in-charge of retail. The reporting structure of the credit heads remained unchanged and, it appears that to enhance the role of a rising star in the bank, the CRO's position was diluted and he was also made to report to the CFO.

CFO – Whiz kid or blue eyed boy?

The 41-year old, Jairam Sridharan, credited with the bank's successful retail foray, has had a meteoric rise since joining Axis Bank in June 2010 (Shikha Sharma was appointed as CEO a year earlier in June 2009). He has the unique distinction in the bank's history of skipping a grade (executive vice-president) in 2013 when he was promoted from senior vice-president directly to president and head, consumer lending and payments. Thereafter, and within two years, he was appointed CFO in October 2015. He has a background in retail banking with Capital One and in ICICI Bank, where he worked with Shikha Sharma. However, he has limited exposure to corporate credit and risk management. According to an *Economic Times* article, the best advice he received in his life, has been from Shikha Sharma, "finish what you start". Given his phenomenal rise within the bank the admiration appears to be mutual.

In the age of capital markets and the global dominance of financial capital, investor relations has emerged as a larger-than life function. This division, which nestles within a CFO's responsibilities, is to facilitate and educate institutional investor access, but its main role is to present the bank in the best possible light, deflect criticism, manage analysts' expectations and improve banks' stock market valuation. There is a direct and dangerous conflict of interest when the CRO is made to report to the CFO as the latter is instrumental in preparing internal budgets and forecasts and also providing a favourable impression of the bank to the capital markets. Typically the Axis Bank CFO on analyst calls has provided future guidance on critical parameters as fresh slippages of non-performing loans, credit costs (bad debt provisions as a percentage of loans), net interest margins, credit growth et al. If post such budgets and forward guidance given by the CFO, the CRO assesses that conditions have deteriorated necessitating a downward revision in the CFO's projections, will the CFO readily agree to the downgrade and a loss to his personal reputation if the CRO were to report to him?

Such conflicts of interest are normally understood by the senior management of banks and hence the CRO normally reports directly and only to the CEO or a senior executive director (not responsible for any business function) so as to not dilute the authority of risk management. Risk management is the edifice of a bank and it is shocking that the board of directors at Axis Bank consisting of supposedly independent and eminent individuals have rubber-stamped this dilution at a time when the bank is facing grave issues of timely disclosure, corporate asset quality and high retail credit growth. It is even more alarming that the Reserve Bank of India, the banking regulator is a mute spectator to this spectacle.

Post the publication of this article, the Reserve Bank of India on April 27, 2017 introduced norms for protecting the autonomy and independence of the post of CRO and Axis Bank was compelled to change the reporting structure for its CRO.

Profits Have Many Parents, Fiascos Are Orphans

NOVEMBER 7, 2016

Axis Bank shocked analysts when it declared profits of only Rs 3.19 bn for the quarter ended September 30, 2016 (2QFY2017). This was a precipitous fall of 83% from a year ago. The reason: a large chunk of its corporate watch list loans were reported as non-performing. The same analysts in the March-end quarter (4QFY2016) had hailed the bank for its transparency when it declared its watch list. At that time, the management's guidance was that 60% of the watch list would become non-performing within 8 quarters. By October 25, Axis Bank was stating that "materially more than 60%" of the watch list would become bad, as the economy was unfavourable and the tools announced by the banking regulator for asset recovery were inadequate. Blaming the external environment for performance shortfalls is a time honoured tradition for entities unwilling to accept responsibility. If negative developments are to be attributed to extraneous factors, then why should management exist and why should they be so highly paid?

Shocker in September 30, 2016 Quarter (2QFY2017)

	27-Oct-15	22-Jul-16	25-Oct-16	YoY	QoQ
Rsmn	2QFY16	1QFY17	2QFY17	%	%
Net interest income	40,621	45,169	45,140	11.1	(0.1)
Other income	20,414	27,383	25,397	24.4	(7.3)
Total income	61,035	72,552	70,537	15.6	(2.8)
Salaries	-8,293	-9,632	-9,888	19.2	2.7
Overheads	-16,462	-18,227	-19,645	19.3	7.8
Total Operating expenses	-24,755	-27,859	-29,533	19.3	6.0
Operating Profit	36,280	44,693	41,004	13.0	(8.3)
Bad debt provisions	**-6,190**	**-18,230**	**-36,480**	**489.3**	**100.1**
Std asset provisions	-150	-2,380	220		
Investment provisions	-720	180	370		
Other / Contingent provisions	-13	-31	-250	1,823.1	706.5
Restructured assets		-710	-89		
Taxes	-10,051	-7,967	-1,584	(84.2)	(80.1)
Total provisions	-17,124	-29,138	-37,813	120.8	29.8
Net profit	**19,156**	**15,555**	**3,191**	**(83.3)**	**(79.5)**

Source: Axis Bank

The surgical strikes Axis Bank inflicted on analysts in 2QFY2017 were three-fold:

1. Net profit at Rs 3.2 bn as against expectations of Rs 14-19 bn. The net profit should have been reported as even lower, as the bank depleted its contingency provision by Rs 2.32 bn.

2. Credit costs at 409 basis points (bps) as compared with 198 bps in 1QFY2017 (April-June 2016). More importantly, the guidance given by Axis Bank in 1QFY2017 of 125-150 bps for FY2017 has been sharply revised to 305 bps.

3. The guidance that 60% of watch list will become NPA provided in 4QFY2016 has been abandoned. Axis is now stating that the final figure will be "materially more", but is not quantifying the number.

Axis Bank's Impaired Loans

Rsmn	1QFY2017	2QFY2017	QoQ (%)
Gross NPA	95,532	163,787	71.4
Watchlist	202,950	137,890	-32.1
Standard Restructured Assets	36,815	30,726	-16.5
5/25 refinance	35,000	45,666	30.5
Strategic Debt Restructuring	2,550	0	
Security Receipts	7,710	14,000	81.6
Gross Impaired Loans (GIL)	**380,557**	**392,069**	**3.0**
Provisions Held	55,430	86,187	55.5
Net NPA	40,102	77,600	93.5
Net Impaired Loans (NIL)	**325,127**	**305,882**	**-5.9**
Total Loans	3,761,091	3,927,734	4.4
CET-I	517,604	520,794	0.6
Gross NPAs (%)	2.5	4.2	
Net NPAs (%)	1.1	2.0	
GIL (%)	10.1	10.0	
NIL (%)	8.6	7.8	
NIL/CET-I (%)	**62.8**	**58.7**	

Source: Axis Bank

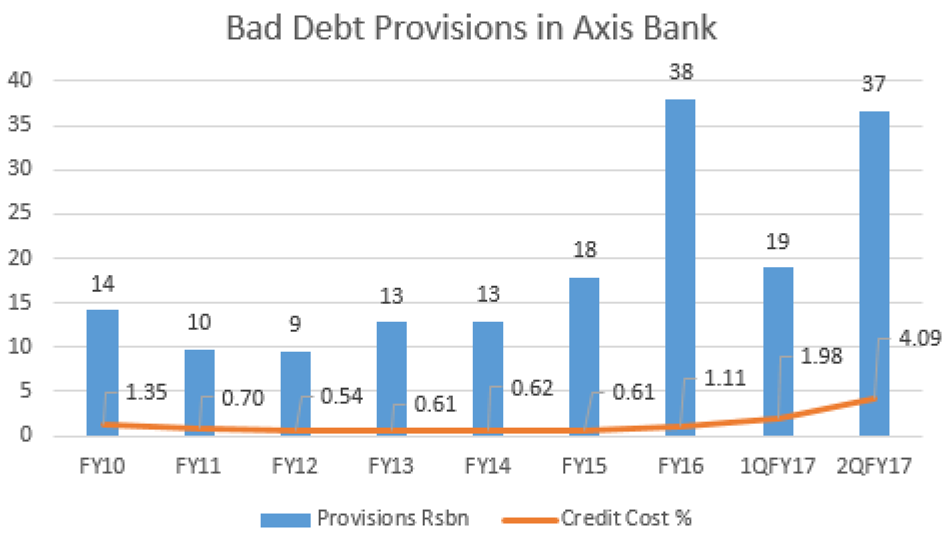
Blame It on the Environment

Defending the pathetic results and the revised downward guidance, Axis Bank essentially blamed the weak global and domestic economy, government policy and the ineffective tools introduced by the Reserve Bank of India for NPA resolution. This lame defence prompted some brokerages to voice their reservations. *Kotak Institutional Equities* in their report dated October 26, stated,

> "It is a bit disappointing that the bank has chosen to blame part of the slippages on extraneous factors,"

while *IDFC Securities* on October 25, added,

> **"Axis Bank's NPLs are rising with a lag to the sector. We believe accounts like Essar Steel, Bhushan Steel, Varun Shipping, Alok Textiles, Lavasa, that have been recognized by all other banks we track as NPLs over 3Q16-1Q17, have been recognized by Axis as NPLs in 2Q."**



Source: Axis Bank

Is No One Accountable?

Even though some analysts are articulating their concerns, to date no one is demanding accountability from those in Axis Bank responsible for the quality of corporate credit and for the belated disclosure of these poor quality standard loans which have negligible security. Normally, bank CEOs directly monitor credit quality and risk management, as these are the two critical areas which can cripple banks. But

- Shikha Sharma has chosen to remain silent on her personal commitment, as 80% of the watch list was sanctioned in FY2010-FY2012, post her appointment as CEO.

- V Srinivasan has been responsible for corporate credit since he joined Axis Bank in 2009 and it was under his watch, and with the endorsement of the CEO and the board of directors, that the bank aggressively expanded corporate and infrastructure loans. How is it that the corporate watch list of loans remained standard but suddenly deteriorated to the point where there was negligible security, exposing nearly half of the bank's capital? Unlike many Indian banks crippled by the corporate and industrial slowdown, in Axis Bank the CEO and head of corporate credit have been in-charge since 2009 and have to be held accountable.

- The CFO's main duty is the integrity of the accounts, and the office of financial management has to accept responsibility on why these accounts were treated as standard for so long and why the bank did not increase the contingency reserve and lower earlier years' profits as a prudent measure to protect the capital of the bank. CFOs have also become important conduits for providing guidance to analysts. How is it that, despite saying 60% of watch list would become NPAs in a short time and would require 70% provisioning in 4QFY2016, Jairam Sridharan in 1QFY2017 provided an unrealistic low guidance on credit costs of only 125-150 bps for FY2017, which he thereafter in 2QFY2017 doubled to 305 bps? The CFO is in charge of internal budgets, but in this case, he appears to be out of his depth in comprehending the extent of the bad debt problem in his own bank.

Senior Management at Standard Chartered Bank Held Accountable

Standard Chartered Bank took on similar high-risk corporate exposures in India under an adventurous management, but the remedial action was swift and brutal – practically the entire senior management of their India operations was fired, as was the global CEO, and the bank reported a loss of US$ 981 mn on its India operations in 2015. In contrast, Axis Bank blames extraneous factors and the concerned individuals are rewarded with higher remuneration and with added responsibilities.

Axis Bank - Answerable to Nobody?

The protracted industrial slowdown in India has impacted many banks, but it has **exposed a strategic fault line at Axis Bank: its CEO, head of credit and CFO have limited credit and risk management expertise, but a huge risk appetite, and this stands revealed in the watch list fiasco and the aggressive credit growth.** Axis Bank under the current leadership plans to outgrow the problem of poor quality corporate lending by a retail credit push in an environment of a general slowdown. Such a strategy may further compound its asset quality problem. As Indian banks have significant corporate and credit exposures, the earlier the Axis Bank board of directors and the regulator resolves the problem the less damage will be inflicted on its shareholders.

Axis Bank: License to Launder?

DECEMBER 26, 2016

Since the announcement of demonetisation , Axis Bank, India's third-largest private sector bank, has found itself repeatedly caught in the act of laundering 'black money', its staff arrested, reputation sullied and in unprecedented humiliation. The regulator (the Reserve Bank) had to issue a press release stating that Axis's banking license would not be revoked. While Shikha Sharma, the Axis Bank CEO, publicly attributes these instances to a "handful of people", they highlight a deeper malaise: a top-down strategy of meeting ambitious performance targets at any costs, diluting critical operations and audit functions, removing seasoned bankers and replacing them with less experienced management graduates, and persecuting employees who exposed regulatory lapses. To prevent a repeat of such events, the board needs to be restructured and executive management replaced.

Money laundering is not alien to Axis Bank. On July 26, 2011, an investigation by the online media firm, *Cobrapost*, showed officials of both private and government banks soliciting clients for laundering black money and offering bank lockers to store the black money. The sting videos revealed these practices to be so widespread, even systemic, and not the work of rogue employees even at Axis Bank. In June 2013, Axis Bank was not only fined Rs 50 mn, the maximum possible by the RBI for these transgressions but it received the highest fine amongst all the banks featured in the sting operation. Post the penalty, Axis Bank assured the public that remedial action had been undertaken but yet 3 years later it seems as if the business of money laundering is booming.

Time Line of Money Laundering at Axis Bank

Date	Branch & Location	Amount	Comment
		Rsmn	
21-Dec-16	NOIDA Sector 18, near Delhi		Income Tax probing 23 suspicious accounts
12-Dec-16	Branches in Delhi		Suspends some bullion dealer accounts
09-Dec-16	Chandini Chowk, Delhi	100	44 fake accounts detected
07-Dec-16			Axis Bank suspends 19 officials
07-Dec-16	NOIDA Sector 51, near Delhi	600+	More than 24 accounts being investigated
05-Dec-16	Kashmere Gate, Delhi	390	2 Axis Bank managers arrested
	Total	1,090+	

Source: Media Reports

Since the announcement of demonetisation on the night of November 8, 2016, authorities have unearthed more than Rs 1 bn of such laundering at Axis Bank, arrested 2 Axis Bank staff, leading to the suspension of 19 of its officials. The widespread publicity to these events has shaken the public's confidence in the bank and even led to an article in an obscure regional newspaper stating that the Reserve Bank of India (RBI) plans to revoke its banking license. To add to the humiliation, the RBI had to specifically issue a press release explicitly stating that no such action was being contemplated and the bank in its wisdom prominently displayed this notice on its website as if showcasing an accolade.

On *Twitter*, Axis Bank has been a subject of ridicule.

> **Dhaval Patel** @dhaval241086 Dec 15
> I think **Axis Bank** took PM Modi's "Make in India" Initiative too seriously and started own version of Swiss Bank in India itself.
> 13 replies293 retweets265 likes
>
> **Sucheta Dalal** @suchetadalal Dec 9
> Sucheta Dalal Retweeted
> I do think @AxisBank should tell us how it has attained market leadership in demonetisation laundering scams!! @rajivanand
>
> **Manoj Nagpal** @NagpalManoj Dec 9
> **AXIS Bank** says it is co-operating with authorities First they were co-operating with those depositing the money Very Co-operative Bank ;)
> 23 replies178 retweets228 likes

Axis Bank staff have not even been spared at private social engagements: as a serving bank officer informed this writer,

> "we are confronted with acquaintances and strangers mockingly requesting us to convert 'black money' and it has become embarrassing for us to introduce ourselves as employees of the bank."

Belatedly reacting to the waves of negative publicity, Shikha Sharma, CEO of Axis Bank, sent an email to all its customers on December 18, 2016, stating,

> "The recent media reports around the conduct of a few of our employees have left me embarrassed and upset. We have fallen short of your expectations because a handful of people did not follow our fully compliant and robust processes. We have taken the toughest action against such employees and we will do so in every case of divergence from our Code of Conduct."

Absolving oneself of any responsibility and blaming a few rotten apples is a time-honoured tradition of CEOs when confronted with widespread illegality, and Shikha Sharma is no exception. She appears oblivious to the fact that, since taking charge of the bank in June 2009, she has implemented a strategy promoting excessive risk to achieve ambitious performance targets at any cost. Indeed, it could be

argued that the bank's association with money laundering is but a natural outcome of the culture that she, with the full support of the board of directors, introduced and fostered in the bank.

Interactions with serving and former Axis Bank staff reveal a very different picture from that portrayed by the senior management. **Since taking charge, more than seven years ago, Shikha Sharma changed the organizational structure to promoting marketing and selling of financial products while weakening control and operations. In banks, the sales and marketing functions have to be counter-balanced with stronger operational risk and audit management, and the latter must have seasoned and more senior bankers well versed in banking regulation, RBI circulars and risk management as compared with the marketing teams, so as to rein in sales.**

The branches are the main hives of business activity in banks and retail liability branches had three separate units: sales, responsible primarily for acquiring new customers for current and savings deposits and fee income from sale of third party products (like insurance and mutual funds), driven by targets and incentives; operations, responsible for anti-money laundering (AML) and know your customer (KYC) regulations, handling cash, clearing and compliance; and, finally, relationship management for high net worth clients. For new client acquisition and selling of any product to a client, the first cross check is done by operations.

In the past, the branch manager oversaw all these functions, and he/she in turn reported to the regional head, who had responsibility for around 40-50 branches. The regional head was assisted by regional heads of sales, operations, relationship and audit, who supervised their counterparts in the branches. After the appointment of Shikha Sharma, in order to facilitate higher growth of business and reduce costs, the post of 'cluster head' was introduced between the branches and the regional office. This post had responsibility for around 15 branches, and was responsible for only sales. For cost reasons, there were no cluster heads for operations, relationships or audit, and no secretarial staff. The individuals responsible for operations and relationships at branches had to report to the cluster head. Hence the orientation in the bank tilted sharply towards marketing and sales at the cost of operational and risk management. In the new dispensation, even the operational staff at branches were given sales targets, and the focus of the bank became meeting performance targets. Checks and balances such as operations and audit were regarded as cost centres and impediments to growing the balance sheet.

In tune with this aggressive marketing strategy, the bank systematically removed or sidelined seasoned bankers recruited from government banks, especially in critical departments like operations and audit, and replaced them with inexperienced management graduates. Government-bank staffers are schooled in doing banking through time-tested procedures and complying with regulations, as government banks have tough internal auditors, and come under the Central Vigilance Commission. MBA graduates have tended to pay less attention to, or have failed to comprehend, regulatory guidelines. They are more tuned to marketing, meeting targets and ruthlessly climbing up the corporate ladder.

In the bank's unpopular voluntary retirement scheme in 2015, many senior, experienced bankers were 'persuaded' to cut short their careers. Three presidents (one of whom was responsible for inspection and audit) out of a total of 10-11 presidents, and 17 senior vice-presidents (SVPs) of around 100-120 SVPs in the bank accepted it. With the loss of seasoned bank staff, the banking knowledge level of employees declined as preference was given to employees with a marketing and selling orientation from consumer products companies where achieving sales targets is all important.

In the tenure of P.J. Nayak, the chairman and CEO (January 2000 – April 2009) of Axis Bank, every effort was made to ensure that the retail operations and corporate risk management functions were headed by senior and higher grade officers as compared with their marketing/business counterparts. Operations and risk management never reported to business heads; the former reported to the heads of operations and risk management, who reported either directly to the CEO or an executive director not responsible for business functions. In contrast, during Shikha Sharma's tenure, Krishna Kumar, senior vice-president, retail liabilities, operations reports to Sanjay Sailas, executive vice-president retail banking (in-charge of retail branches, liabilities and business). By subordinating retail operations to retail business, Shikha Sharma has sent a clear message to the entire retail network that retail business growth is far more important than operational parameters of AML and KYC.

The stiff and unrealistic performance targets (for example, regarding fee income, current and savings deposits, third party distribution) set by the senior management for branch staff are onerous to achieve if one complies with prudential banking regulations. In its annual employee performance appraisal, on a rating of 5, a rating of 2 and below is likely to get the candidate fired, while a high rating of 4-5 earns high monetary rewards and promotion. Hence employees realise that meeting the target by any means, fair or foul, gets significant rewards while low grades result in the huge downside of dismissal. Therefore, since the entry of Shikha Sharma, a culture has seeped into the organization of bypassing regulatory norms and accepting high-risk business to achieve performance targets.

Axis Bank has also shown itself to ruthlessly subdue conscientious whistle-blowers who expose regulatory lapses by firing them using the draconian clause 3.5 of the Bank's Staff Rules. The said clause enables the bank to terminate the services of an employee without assigning any reason for the termination. Rule 3.5 is invoked for termination of employees whom the management finds itself not comfortable with due to extraneous reasons, i.e., reasons other than incompetence and non-performance. In these cases, Axis Bank states that the termination letter is to be treated as the relieving letter, thus denying any future employment for the employee in any other entity. **Incorporating such harsh measures effectively silences any honest banker from complaining against any regulatory lapses which could disrupt the growth of business.**

Shaiwali Paliwal, a former assistant vice-president with 14 years of banking experience, of which 6 years was with Axis Bank, was the bank's first woman branch head in Rajasthan. She was posted at Banipark, Jaipur Branch, and under her leadership, the branch received its best audit ratings; it was also the first branch in Jaipur Circle (regional office) to get 'AAA' Operations Audit Rating. At her branch, she pointed out certain lapses in mutual funds entries in the bank software to her higher authorities which were inflating mutual fund sales in October 2012, which exposed the conduct of her seniors at the regional office. Thereafter charges of misconduct were levelled against her and she was persecuted through transfers and disciplinary hearings. She filed three whistle-blowing complaints: in September 2013 pertaining to mutual fund entries, in March 2014 pertaining to money laundering and in May 2014 implicating executive directors in framing false charges against her. She was fired under Clause 3.5 on July 31, 2014 and she filed a case against the bank on grounds of wrongful termination on September 6, 2014 in the Jaipur district court.

Sharad Shukla was a 9-year veteran at the bank and a former vice-president and chief investment officer of Axis Bank's wealth management division who was consistently rewarded for his performance. On March 17, 2015, Shukla reported to the concerned bank authorities via email after he found he had free access to the highly restrictive dealing room of Axis Capital, a subsidiary of the bank. Instead of complimenting him for exposing this breach, he was orally warned of dismissal if he were to document such lapses again. After waiting six months for the bank to reply to him, he filed a whistle-blower complaint on August 10, 2015. On August 28, 2015 he was informed that the complaint was closed and 3 days later, he was summoned and fired under Clause 3.5. He has subsequently filed a case in the Bombay High Court on March 17, 2016 for wrongful dismissal.

The aggression of sales, the weakening of operations and audit, removal of seasoned bankers and persecution of those pointing out regulatory lapses is compounded by the negligible commercial banking experience of the executive directors prior to joining Axis Bank. In Axis Bank, none of the executive directors (including the CEO and even the head of retail banking) have ever worked in a bank branch in their career. To date, the Axis Bank luminary-filled board of directors have endorsed all these actions and in doing so have exposed themselves as ornamental nameplates. Blaming the money laundering instances on a few employees and suspending officials may deflect public and regulatory criticism but the cancer is widespread and it can be eradicated only with a complete restructuring of the board and the replacement of its executive directors.

DISCLOSURE & CERTIFICATION

I, Hemindra Hazari, am a registered Research Analyst with the Securities and Exchange Board of India (Registration No. INH000000594) I have no exposure to Axis Bank referenced in this Insight. Views expressed in this Insight accurately reflect my personal opinion about the referenced securities and issuers and/or other subject matter as appropriate. This Insight does not contain and is not based on any non-public, material information. To the best of my knowledge, the views expressed in this Insight comply with Indian law as well as applicable law in the country from which it is posted. I have not been commissioned to write this Insight or hold any specific opinion on the securities referenced therein. This Insight is for informational purposes only and is not intended to provide financial, investment or other professional advice. It should not be construed as an offer to sell, a solicitation of an offer to buy, or a recommendation for any security.

Woes Continue in 3QFY2017

JANUARY 23, 2017

The new year has been unkind to Axis Bank, India's third largest private sector bank. The waves of negative publicity following demonetisation, involving the arrest and suspension of its branch officials on money laundering in late December continued with the announcement of its results for the quarter ended December 31, 2016 (3QFY2017), when the bank reported a 73% yoy decline in net profit to Rs 5,796 mn. Axis Bank's problems are structural and the market is under-estimating the asset quality of its non-watchlist corporate and retail loans. Analysts appear unconcerned about the accountability of senior management and its pivotal role in the corporate asset and operational risk fiascos and instead assure their clients that earnings normalcy will seamlessly resume by March 31, 2019. How the bank can recover from these major setbacks under the same unapologetic senior management remains a mystery.

Axis Bank 3QFY2017 Results

Rsmn	Q2FY17	Q3FY16	Q3FY17	Change	Change
				(YoY %)	(QoQ %)
Net interest income	**45,140**	**41,620**	**43,337**	**4.1**	**(4.0)**
Fee income	19,353	18,847	18,050	(4.2)	(6.7)
Trading	5,357	3,378	**15,250**	351.5	184.7
Other income	25,397	23,378	34,002	45.4	33.9
Total income	70,537	64,998	77,339	19.0	9.6
Salaries	-9,888	-8,295	-9,919	19.6	0.3
Overheads	-19,645	-16,852	-21,016	24.7	7.0
Total Operating expenses	-29,533	-25,147	-30,935	23.0	4.7
Operating Profit	**41,004**	**39,851**	**46,404**	**16.4**	**13.2**
Bad debt provisions	**-36,480**	**-6,260**	**-35,760**	**471.2**	**(2.0)**
Std asset provisions	220	-710	810	NA	268.2
Investment provisions	370	150	-320	NA	NA
Other / Contingent provisions	**-250**	**-310**	**-2,520**	**712.9**	**908.0**
Restructured assets	-89	4	-170	NA	91.0
Taxes	-1,584	-10,972	-2,648	(75.9)	67.2
Total provisions	-37,813	-18,098	-40,608	124.4	7.4
Net profit	**3,191**	**21,753**	**5,796**	**(73.4)**	**81.6**

Source: Axis Bank

The weakness and negative surprises in Axis Bank continued in the 3QFY2017 with its net profit significantly below the estimate of Rs 8.32 bn by 20 analysts polled by *Bloomberg*. Bad debt provisions increased by nearly 5x and other provisions rose by 7x resulting in the 73% yoy decline in 3QFY2017 net profits, despite a 3.5x rise in volatile treasury profits. A common practice in the banking industry in a falling interest rate cycle is to sell government securities and book profits to either report higher overall profits or to compensate for the rise in bad debt provisions. When such a practice is undertaken of booking future profits, the subsequent treasury yield gets reduced. In the analyst conference call, the management assured that the sale of government securities will not result in a subsequent fall in treasury and hence overall yields.

Analysts on the conference call were also concerned about the rise in corporate non-watch list loans as they naively believed that all the poor quality corporate loans were classified in the watch list declared in 4QFY2016 (quarter ending March 31, 2016). In 3QFY2017, out of the total corporate slippages of Rs 35.54 bn, the watch list contributed Rs25.79bn and other corporates contributed Rs 9.75 bn. Analysts had conveniently under-estimated the poor asset quality of the entire corporate exposure of the bank. Wisdom is beginning to belatedly dawn on the market that the entire corporate exposure of the bank may have an asset quality issue.

Slippages to Non-performing Assets

Rsmn	Q1FY17	Q2FY17	Q3FY17
Slippages	36,380	87,720	45,600
Corporate Slippage	29,110	81,930	35,540
Watch list *Slippage*	*26,800*	*72,880*	*25,790*
Non-WL Corp Slippage	*2,310*	*9,050*	*9,750*
Retail Slippage	2,570	1,680	2,740
SME Slippage	3,060	1,630	3,820
Other Slippage	1,640	2,480	3,500

Source: Axis Bank

In another disconcerting development, the bank provided Rs 2.52 bn under other provisions for a non-fund based exposure on a single corporate which it expects to devolve in the near future. To put this number in perspective, the entire corporate fee booked in 3QFY2017 was Rs3.6 bn. It is unusual for a bank to provide for a devolvement of a non-fund based exposure prior to its occurrence. One of the techniques of ever-greening is to provide a guarantee to another bank to raise funds for a corporate about to default, the proceeds of which is to meet the interest obligation of the guaranteeing bank. In such cases, it is possible for the bank to know with some certainty if and when the corporate will default on its non-fund based exposure as the bank may have reached the limits of ever-greening a particular account. Many banks to satisfy analysts' obsession with fees and the superior valuation associated with it, aggressively booked corporate fee income upfront (maximum 1% of the non-fund based amount), oblivious to the quality of the exposure.

While the bank has been unable to arrest the deterioration on its corporate loans it continues to aggressively grow its retail loans. What is surprising and even alarming is that in the period of demonetisation which resulted in a sharp contraction in demand in the economy, Axis Bank increased its retail loans by 19% yoy and within retail, automobile loans rose by 49%, personal unsecured loans by 30% and loans against property (LAP) by 34%. Axis Bank stated that in this period they did not purchase any retail loans from other intermediaries and have directly originated these loans. It appears strange that in a time of demand constriction the bank has been able to rapidly increase its retail loans.

Retail Loan Growth at Axis Bank

Rsmn	Q2FY17	Q3FY16	Q3FY17	Change	Change
				(YoY %)	(QoQ %)
Housing loans	671,778	591,241	702,829	18.9	4.6
Auto loans	**134,356**	**100,637**	**149,538**	**48.6**	**11.3**
Personal loans	**179,141**	**138,376**	**179,446**	**29.7**	**0.2**
Loan against property	**134,356**	**100,637**	**134,584**	**33.7**	**0.2**
Other	149,284	327,070	119,630	NA	(19.9)
Agriculture	223,926	NA	209,353	NA	(6.5)
TOTAL	1,492,840	1,257,960	1,495,380	18.9	0.2

Source: Axis Bank

In LAP, the underlying business is trading, micro small and medium enterprises and self-employed individuals. It is precisely this segment which has been adversely impacted by demonetisation since November 8, 2016. The bank's retail loans are likely to become problem assets in the future and the market and analysts' attention is unfortunately focused only on the corporate asset quality. Presently, Axis like most of the other banks are reporting very healthy retail asset quality but as these loans are rapidly increasing in a backdrop of an economic slowdown, the NPAs are going to also come from this segment in the future.

The worsening corporate asset quality, the aggressive growth in retail loans and its poor operational risk management exposed in the money laundering unearthed by the authorities in late December is a direct reflection on Axis Bank's senior management. Axis Bank in its hugely unpopular early retirement option (ERO) in December 2014, coerced middle-level management (vice-presidents, senior vice-presidents and above) to accept it, ostensibly on performance grounds. Yet, perusing through the numerous institutional sell-side research reports on the bank's 3QFY2017 results, analysts appear unconcerned about the accountability of senior management and its pivotal role in the corporate asset and operational risk fiascos and instead assure their clients that earnings normalcy will seamlessly resume by March 31, 2019. How the bank can recover from these major setbacks under the same unapologetic senior management remains a mystery.

DI*SCLOSURE & CERTIFICATION*

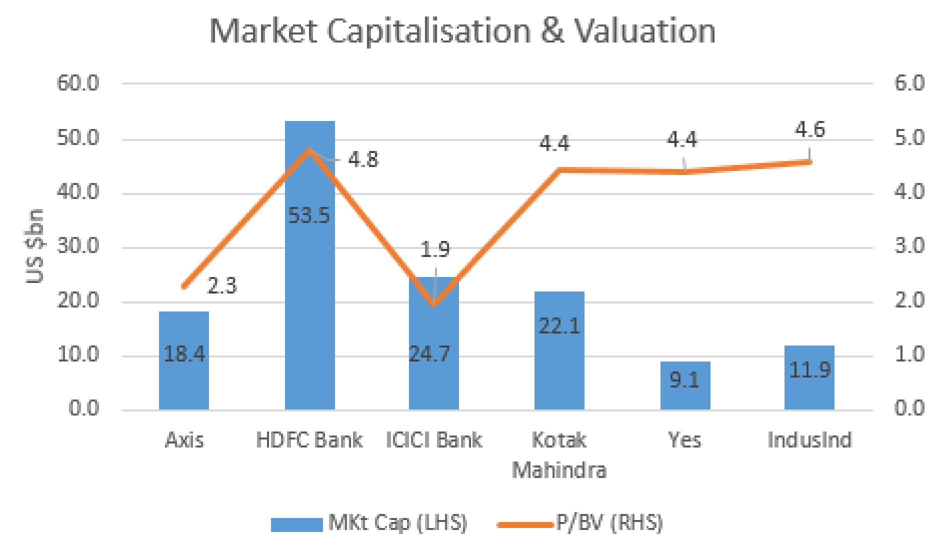
I, Hemindra Hazari, am a registered Research Analyst with the Securities and Exchange Board of India (Registration No. INH000000594) I have no exposure to Axis Bank referenced in this Insight. Views expressed in this Insight accurately reflect my personal opinion about the referenced securities and issuers and/or other subject matter as appropriate. This Insight does not contain and is not based on any non-public, material information. To the best of my knowledge, the views expressed in this Insight comply with Indian law as well as applicable law in the country from which it is posted. I have not been commissioned to write this Insight or hold any specific opinion on the securities referenced therein. This Insight is for informational purposes only and is not intended to provide financial, investment or other professional advice. It should not be construed as an offer to sell, a solicitation of an offer to buy, or a recommendation for any security.

Axis Bank Merger Reports - Issues to Consider

MARCH 1, 2017

Axis Bank is back in the spotlight, as news reports allege that some private sector banks have approached the government for purchasing its stake in the bank. Although Axis Bank has explicitly denied the news, the government has chosen to remain silent, thus fuelling the speculation. Any prospective bank interested in merging with Axis Bank in this depressed economic climate must carefully ascertain the quality of the bank's credit and operational risk management and whether the current valuation of Axis Bank factors these issues and does not weigh down the combined entity in the likely event of a merger.

Axis Bank had scarcely recovered from the demonetisation fiasco wherein some of its officials were arrested for money laundering and its non-watch list corporate loans slipping into non-performing category in 3QF2017 when news reports emerged of a possible merger with some new private sector banks. The share price rallied providing relief to shareholders and Axis Bank staff holding stock options but alarm bells rung in senior management regarding job security in the likelihood of a merger. Allaying fears within the bank, Shikha Sharma, Axis Bank CEO went on record to state, "there is absolutely no truth to this [merger]". However, in the case of Axis Bank, the government directly and indirectly through ownership of life and general insurance companies owns around 30% of Axis Bank and it has been exploring divesting SUUTI's 12% stake in Axis Bank to meets its divestment target in the Union Budget. Interestingly, till date, no senior government official or an official from the Life Insurance Corporation (LIC), which holds 14.5% stake has gone on record to explicitly deny the rumour of a merger.

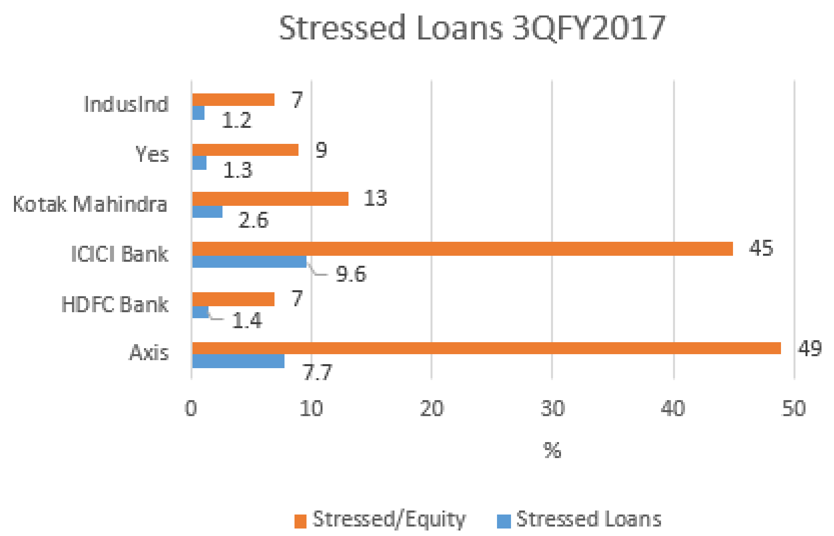


Source: Moneycontrol

As Indusind Bank and Yes Bank's market capitalization is significantly below Axis Bank, the possibility of a merger of these banks with Axis appears remote and since ICICI Bank like Axis is facing issues of asset quality, a merger of these two banks is also unlikely. Analysing a prospective merger of Axis Bank with other banks, *Bank of America Merrill Lynch (BoAML)* has concluded, "EPS accretive benefits would exist only for a potential combination with Kotak Bank, in our view." Hence, according to BoAML it is not profitable for the other new private sector banks to merge with Axis Bank.

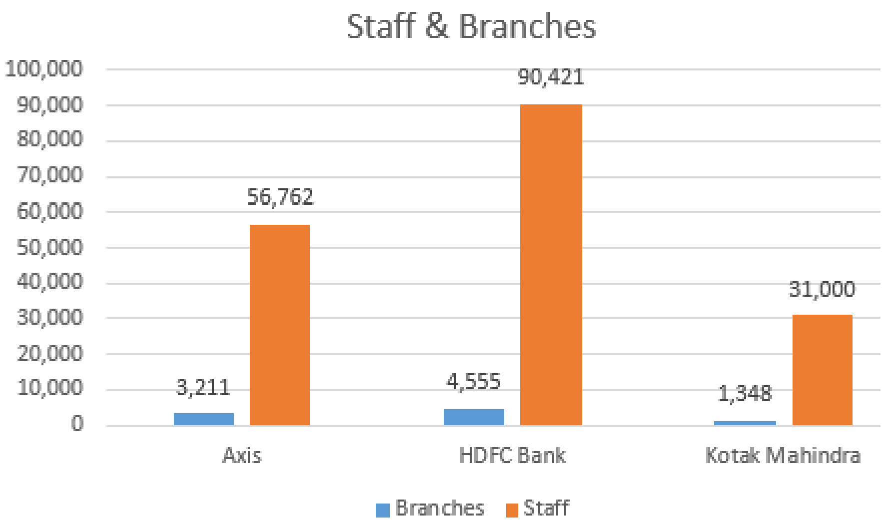
In any merger, especially in this bleak economic environment, two critical issues need to be addressed (i) Does the book value of the bank truly reflect its assets and liabilities? (ii) Is the price to book value multiple realistic? These two indicators are critical for understanding the fundamentals of the bank and its valuation. For outsiders, the answers to both questions are subjective and it depends on the assumptions taken to factor the 'adjusted' book value.

The market should remember lessons from the past, in January 2000, Bank of Madura (BoM) merged with ICICI Bank at an exchange ratio of two shares of ICICI Bank for one share of Bank of Madura. However, the merged accounts revealed that practically the entire equity of BoM had to be written down as the bank had under provided liabilities which was unfortunately not revealed during the due diligence resulting in ICICI Bank overpaying for the bank. In January 2001, Axis Bank (then called UTI Bank) to shore up its capital base, nearly merged with Global Trust Bank (GTB) which reported strong capital ratios, at a proposed merger ratio of 9 shares of UTI Bank for 4 shares of GTB. Fortunately for UTI Bank, the merger was called off on account of rigging up of GTB's share price. In FY2002, following a stringent Reserve Bank of India inspection, the accounts of GTB underwent a drastic deterioration and GTB's capital was completely eroded to the tune of a negative Rs 10 bn for bad debts which was finally borne by the government-owned Oriental Bank of Commerce which acquired it to bail-out GTB's depositors in June 2004. **The lesson to be learnt is audited accounts cannot be taken at face value and a comprehensive due diligence is required prior to any merger.**



Source: Bank of America Merrill Lynch 'Crowded' Indian banking space?; Scenario analysis on private banks' consolidation, February 27, 2017

In the case of Axis Bank, the quality of its loans needs to be minutely examined as this writer had questioned the [sudden appearance] of its corporate watch list in 4QFY2016 and analysts in FY2017 are perturbed on the deterioration of corporate loans not only from the watch list but also from the broader corporate loan portfolio. Moreover, the bank like many banks has been aggressively increasing its retail loans in a period of an economic slowdown and reports low retail NPAs. The quality of the retail book also needs to be thoroughly examined in any due diligence exercise. As per the BoAML report, in 3QFY17, Axis Bank has stressed assets of 7.7% constituting nearly half of its equity, the worst in its sample of private banks. It is only after a comprehensive review of Axis Bank's loans by independent auditors and experienced bankers can it be determined whether its reported book value is credible and its current market valuation realistic. Banks like HDFC Bank and Kotak Mahindra Bank have a credible history of not overpaying for assets.



Source: Annual Reports, Quarterly Results Presentations

Another critical issue which does not get the attention it deserves is integrating the staff and culture of the merged bank. Unlike quantifiable assets and liabilities which seamlessly and clinically merge in excel spread sheets, integrating organizational structures, reorienting reporting and responsibilities and redrawing staff career paths poses a significant human resource challenge for the merged entity. In Axis Bank's case it is unlikely that HDFC Bank or KMB will allow the senior managers at Axis Bank in controlling positions in the merged entity and therein lies the sense of job insecurity in the higher echelons of Axis Bank post the news reports of a merger. For KMB which has recently absorbed ING Vysya Bank, to merge a further 1.8x its present staff and an additional 3,211 branches is going to be a mammoth task in human resource and organizational management and the sheer number of employees of Axis Bank may overcome the work culture of KMB which may not be desirable for the latter.

Any well-managed bank which merges with Axis Bank, also needs to be aware that during the tenure of the existing Axis Bank CEO, the organisational structure of the bank was geared towards promoting marketing and selling of financial products while weakening control and operations to achieve ambitious sales targets. Checks and balances such as operations and audit were regarded as cost centres and impediments to growing the balance sheet and experienced bank staff well versed in control and operations were systematically weeded out in favour of younger sales oriented inexperienced bankers. It is this transformation in the organisation which finally got exposed in the demonetisation period when its staff were arrested for money laundering.

In light of the current depressed economic environment, the asset quality and operational control concerns at Axis Bank, interested banks may need to carefully determine whether the current valuation of Axis Bank factors these issues and does not weigh down the combined entity in the likely event of a merger.

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Crisis of Credibility

MAY 5, 2017

In a shocking development, the implications of which have been largely ignored by the media and sell-side analysts, Axis Bank disclosed that the Reserve Bank of India (RBI), the banking regulator, had detected an additional gross non-performing assets (NPAs) of Rs 94.78 bn as compared with the audited gross NPA of Rs 60.88 bn, an increase of 1.6x for the year ended March 31, 2016 (FY2016). Despite the significant divergence in the financials, the chief executive officer (CEO) and the auditor who certified FY2016 accounts have endorsed the FY2017 accounts as well, thereby raising grave concerns about the credibility of the Axis Bank's reported NPAs and financials for FY2017. It is highly disturbing for shareholders and depositors that senior management and the statutory auditor at Axis Bank lack accountability for such a glaring lapse. Such conduct is all the more concerning as junior staff are fired for transgressions but different rules of conduct seem to apply to key managerial personnel and the auditor at Axis Bank, who apparently enjoy the blessings of the banking regulator and the bank's board of directors.

In Axis Bank's 4QFY2017 results conference call with analysts on April 26, 2017, Jairam Sridharan, the chief financial officer (CFO) made a startling disclosure,

> "As part of the Risk Based Supervision exercise for 2016 which concluded in Q3 FY17 [December 31, 2016], the RBI pointed out certain modifications in the Banks' asset classification and provisioning as on March 31, 2016. The total reclassification in respect of additions to Gross NPAs as assessed by RBI was Rs 9, 478 crores [94.78 bn].

As per the bank's audited accounts for FY2016, duly signed by its board of directors, including Shikha Sharma, CEO, Jairam Sridharan, CFO and certified by Viren H. Mehta, partner, Batliboi and Co. LLP (a member firm of Ernst & Young), the bank's gross NPAs were Rs 60.88 bn i.e. the regulator had found that Axis Bank's gross NPAs was 156% higher than the number reported in its audited annual financials.

The RBI notification of April 18, 2017 entitled "Disclosure in the "Notes to Accounts" to the Financial Statements- Divergence in the asset classification and provisioning," specifically deals with such cases where there is considerable variance between gross NPAs reported by banks in their annual accounts and NPAs which are identified by RBI inspection teams. An excerpt from the notification states,

> "**There have been instances of material divergences in banks' asset classification and provisioning from the RBI norms, thereby leading to the published financial statements not depicting a true and fair view of the financial position of the bank** [bold ours]… it has been decided that banks shall make suitable disclosures as per Annex, wherever either (a) the additional provisioning requirements assessed by RBI exceed 15 percent of the published net profits after tax for the reference period or (b) the additional Gross NPAs identified by RBI exceed 15 percent of the published incremental Gross NPAs1 for the reference period, or both."

What was alarming was the extent of divergence between the RBI's assessment and Axis Bank's which far exceeded the stipulation of 15% over the bank's audited gross NPAs. Attempting a lame defence of this grave lapse, Axis Bank stated that of the total amount identified by RBI, the bank had identified Rs70.71bn as NPA by 3QFY2017 and the balance amount of Rs24.07bn was regularised as a standard asset by March 31, 2017, but how it was regularised has not been elaborated. Although in their FY2017 schedules, banks have to quantify the impact of the RBI divergence on gross and net NPAs, bad debt provisions and on net profits for FY2016, Axis Bank is not providing these details to analysts prior to the publication of the annual report.

ICICI Bank with a similar risk profile, in its 4QFY2017 results announced on May 3, 2017, reported a much smaller gross NPA divergence despite having a much larger balance sheet than Axis Bank and even quantified the impact on its net profits.

Divergence in Gross NPAs in FY2016 - Standalone Axis & ICICI Bank

Rsmn	Axis	ICICI
Gross NPAs Reported (1)	60,876	262,213
Divergence in Gross NPAs (2)	94,780	51,050
Gross NPAs by RBI (1+2)	155,656	313,263
% Change in Gross NPA (2/1)	**155.7**	**19.5**
Net Profit Reported (3)	82,237	97,263
Divergence in Net Profits (4)	NA	7,000
Net Profits by RBI (3-4)	NA	90,263
% Change in Net Profits (4/3)	NA	7.2

Source: Axis & ICICI Bank. NA Not Available

Responding to this writer's queries on the revised RBI calculations of its gross NPAs for FY2016, Axis Bank's investor relations head stated,

> "Please note that as per the extant RBI guidelines, we shall disclose the required details in the Notes to Accounts with respect to the Bank's Annual Report for the financial year 2016-17. At this point, we would not like to comment on your calculations or observations, and request you to kindly await the publication of the Annual Report. In the meantime, for the benefit of our investors and other shareholders, we have, as a responsible institution, proactively provided the relevant details in our Q4 FY 17 earnings conference call."

What is also highly unusual that although the divergence in FY2016 NPAs was announced in the analysts' conference call and the transcript is available on Axis Bank's website, sell-side banking analysts have refused to acknowledge the significance of this development on the bank's credibility in their reports.

Many of the sell-side reports on Axis Bank, perused by this writer ignore the significance of the NPA divergence detected by the RBI and instead, analysts are complimentary of the bank's decision to classify the accounts as NPA in FY2017. *Citibank*, in its report dated April 27, 2017, reiterated a "Buy" with a target price of Rs 600 and Axis Bank is its "top pick in the sector." *Jefferies*, in its report dated April 26, 2017, summarised Axis Bank's defence of the amount being classified as NPA in FY2017 and maintained a "Hold" recommendation with a price target of Rs 500. According to *Bloomberg*, post the sell-side result reviews of Axis Bank the street is divided, 56 analysts cover the bank, with 39% having a "Buy" recommendation, 36% having a "Hold" recommendation and 25% keeping a "Sell" recommendation.

The divergence in its gross NPAs lucidly exposes the senior management at Axis Bank. The integrity of the Axis Bank accounts is primarily the responsibility of Shikha Sharma, CEO, Jairam Sridharan, the CFO and the audit committee consisting of independent directors. If the management was derelict in its duty in disclosing the actual state of asset quality, the auditor should have recorded his dissent. But, in Axis Bank's case, in its FY2016 accounts, Viren H. Mehta, partner, S.R. Batliboi & Co. LLP (a member firm of Ernst and Young) had not qualified the accounts. This writer has submitted a detailed questionnaire (see Annexure 1) to the auditor and if and when he responds, an update will be published.

The wide divergence between the regulator's assessment and the bank's audited NPAs for FY2016 reflects poorly on the CEO, CFO, audit committee and the auditor. To safeguard the reputation of the institution, the board of directors and the regulator should have replaced the individuals once the RBI detected the huge variance in the NPAs. But, in a bizarre development, Axis Bank's FY2017 accounts have been signed by the same CEO, CFO and certified by the same auditor, raising significant concerns regarding the credibility of the bank's FY2017 asset quality, earnings and capital adequacy.

In Axis Bank, staff at the lower levels are disciplined severely for transgressions and whistle-blowers in the bank have also been summarily dismissed for revealing regulatory lapses. During the demonetisation phase (November 8, 2016 to December 31, 2016) when some employees at branches were apprehended by the authorities on charges of money laundering, they were immediately suspended. At that time, responding to the negative press publicity, Shikha Sharma sent an email on December 18, 2016, to all the bank customers stating,

> "We have taken the toughest action against such employee and we will do so in every case of divergence from our Code of Conduct"

But, when the RBI detected a huge divergence in the bank's NPAs, reflecting on the CEO, CFO, audit committee and the auditor of Axis Bank, no action appears to have been taken by the board of directors. Apparently, a far more liberal Code of Conduct is applicable to individuals at the summit of the corporate hierarchy. It is no surprise, that Rajiv Tyagi, chairman of the Securities and Exchange Board of India (SEBI), the capital markets regulator, commenting on the pathetic state of corporate governance in Indian companies said,

> "If the auditors' committee is not working, independent directors are not independent and there is no code of conduct for institutional investors, then the system is clearly not working..."

The regulators (RBI, SEBI, Company Law Board and the Institute of Chartered Accountants of India) need to take remedial action on the work ethic and culture pervading the higher echelons in Axis Bank before its depositors take flight.

Annexure 1. Questionnaire Sent to Viren H. Mehta, Auditor, Axis Bank

May 3, 2017

Mr. Viren H. Mehta,
Partner, M/s S. R. Batliboi & Co. LLP (a member firm of Ernst & Young)
Ruby Tower,
Senapati Bapat Marg,
Dadar,
Mumbai, Maharashtra 400028

Dear Sir,

Re: RBI Inspection of Axis Bank's Financial Performance for the Year Ended March 31, 2016

1. I am addressing you in your capacity as the statutory auditor of Axis Bank. I am an independent analyst who writes frequently for international and national publications. Business TV channels also invite me for my views on the economy and specific companies and banks. Axis Bank is a prominent private sector bank which is listed on the recognised stock exchanges. Axis Bank has significant quasi government shareholding by the Life Insurance Corporation, and other government-owned insurance companies, global and domestic institutional investors and considerable public shareholding. In the circumstances, the true financial health of Axis Bank is very much a matter of public interest.

2. This questionnaire is part of my pre-publication due diligence exercise whereby I am writing to you as the statutory auditor of Axis Bank to invite your response to critical reports against your audit of the financial performance of Axis Bank for the financial year ended March 31, 2016 (FY2016).

3. The annual accounts of Axis Bank for FY2016 which was signed by the Board of Directors, Mr Jairam Sridharan, chief financial officer (CFO) and audited and signed by you as the partner of M/s S.R. Batliboi & Co. LLP (a member firm of Ernst & Young) had reported additions to gross non-performing assets (NPAs) of Rs 7,345 crores and a closing balance gross NPAs of Rs 6,088 crores (page 144 of Axis Bank annual report for FY2016). However, the Reserve Bank of India's (RBI) risk based supervision of the same accounts

detected additional gross NPAs of Rs 9,478 crores (see page 4, Talking Points for the Conference Call for Q4FY17) which seemed to have completely escaped your attention.

4. According to the RBI inspection, Axis Bank should have reported closing balance gross NPAs of Rs 15,566 crores (Rs 6,088 crores as disclosed by Axis Bank plus additional Rs 9,478 crores detected by the RBI). This is a huge divergence of 156% from the gross NPAs of Rs 6,088 crores as certified by you.

5. The RBI notification of April 18, 2017 entitled "Disclosure in the "Notes to Accounts" to the Financial Statements- Divergence in the asset classification and provisioning.," specifically deals with such cases where there is considerable variance between gross NPAs reported by banks in their audited balance sheet and profit and loss accounts released to the public and NPAs which are identified by RBI inspection teams.

6. According to para 3 of the RBI notification of April 18, 2017 compels banks to disclose the details in their annual report if the divergence exceeds "either (a) the additional provisioning requirements assessed by RBI exceed 15 percent of the published net profits after tax for the reference period or (b) the additional Gross NPAs identified by RBI exceed 15 percent of the published incremental Gross NPAs for the reference period, or both."

7. In the above circumstances you are requested to give your response to the following specific queries pertaining to the annual accounts of Axis Bank for the year ended March 31, 2016, signed by you as the statutory auditor and the divergence in gross NPAs as detected by the RBI.

i. As the statutory auditor of Axis Bank, how do you explain the difference between the Rs 6,088 crores certified by you and the additional Rs 9,478 crores detected by the statutory regulator?

ii. Are these additional Rs 9,478 crores separate accounts which were not disclosed to you by Axis Bank?

iii. Are these additional Rs 9,478 crores pertaining to accounts which you had audited but which Axis Bank had 'evergreened' by giving fresh loans or other credit facilities to the same or related borrowers so that they could maintain the account as standard?

iv. Is there a difference in the methodology adopted by you and the RBI in identifying NPA accounts which could explain how you as statutory auditor failed to identify the said additional Rs 9,478 crores as NPA as identified by RBI?

v. What lessons have you learnt as statutory auditor from the above exercise where your identification of bank NPAs has been grossly deficient so that future bank audits by you meet the more rigorous standards of RBI as the statutory bank regulator?

vi. Did Axis Bank co-operate fully with you when the statutory audit was being undertaken?

vii. In the light of this significant RBI divergence of gross NPAs could you please explain why you did not qualify the FY2016 audited accounts?

viii. As there is a material difference in the gross NPAs, bad debt provisions and net profits certified by you and the RBI's inspection of the FY2016 audited accounts, could you please explain the precautions you have undertaken in the audited FY2017 accounts for the RBI divergence to be minimal when the RBI conducts its FY2017 inspection.

ix. As the divergence of NPAs for FY2016 is significant and material and challenges the true and fair view of the accounts have the regulatory agencies; RBI, Securities and Exchange Board of India (SEBI), Company Law Board and the Institute of Chartered Accountants contacted S.R. Batliboi & Co. (a member firm of Ernst & Young) for an explanation?

x. S.R. Batliboi (a member firm of of Ernst & Young) has been the auditor of Axis Bank from FY2007 till FY2010 and from FY2015 till FY2017 and you have been the partner certifying the accounts in this period. Has there been such a significant divergence between the RBI's assessment of the bank's gross NPAs and your certification during these years?

You are kindly requested to give your response to the above queries at the earliest which will be incorporated in my analytical report on Axis Bank's financial performance which is due to be published shortly.

Thanking you,

Yours truly,
Hemindra Hazari
hkh@hemindrahazari.com

May 4, 2017

Mr. Viren H. Mehta,
Partner,
M/s S. R. Batliboi & Co. LLP (a member firm of Ernst & Young)
Ruby Tower,
Senapati Bapat Marg,
Dadar,
Mumbai, Maharashtra 400028

Dear Sir,

Do let me know by 8 pm today (May 4, 2017) if you will be responding, otherwise I will go ahead with the publication of my analytical report on Axis Bank.

Yours truly,
Hemindra Hazari

DI*SCLOSURE & CERTIFICATION*

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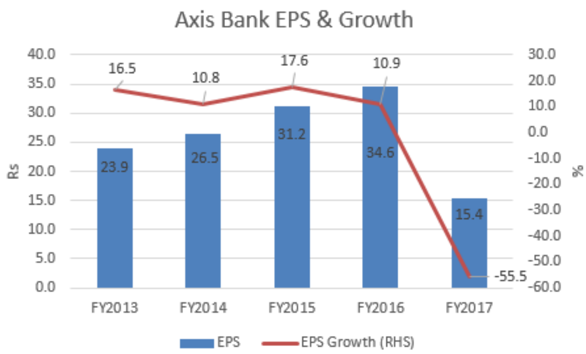
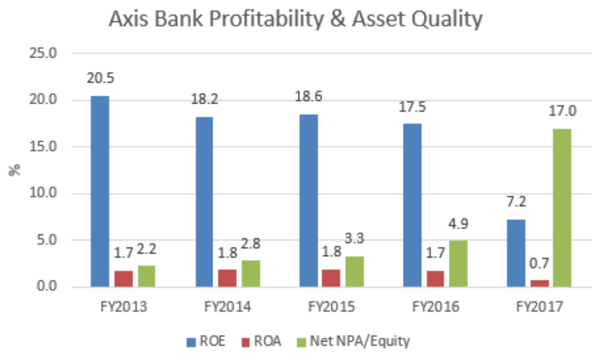
Rewarding Failure

JUNE 27, 2017.

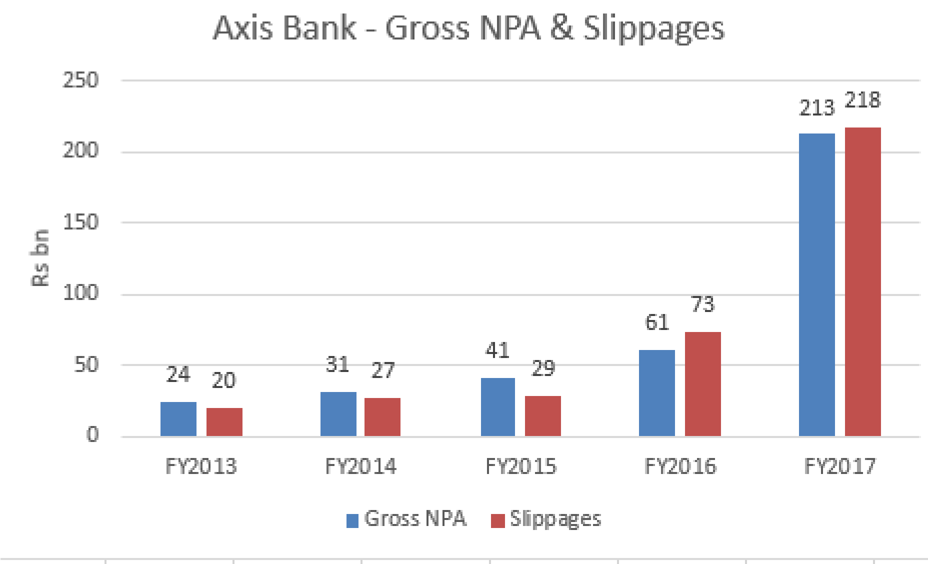
The senior and key managerial personnel at Axis Bank live a charmed existence. In a year when net profit was halved, corporate asset quality soured, demonetisation woes resulted in bank staff becoming guests of the state on charges of money laundering, and mandatory disclosures revealed financial statements not depicting a true and fair view, the board of directors, in its wisdom, has been generous in showering senior management with increments, bonuses and stock options. By displaying such largesse, the board of directors of Axis Bank is proudly proclaiming to the public that the senior management is not only unaccountable for any of these misfortunes but has to be rewarded to continue with its dismal performance. Such is the standard of corporate board room governance in India's private sector banks.





Source: Axis Bank

In FY2017, Axis Bank's EPS more than halved to Rs 15.4, and it is 36% below the EPS of FY2013. Profitability plummeted with ROE in single digits at 7.2%, as asset quality deteriorated with gross NPAs rising 3.5x to Rs 213 bn. Corporate borrowers accounted for 85% of the slippages to NPAs. Gross NPAs in non-priority sector industry increased from 2.3% (Rs 28.2 bn) of gross loans in that sector in FY2016 to 10.7% (Rs 133 bn) of gross industry loans by FY2017. As a result overall net NPAs to equity shot up from 5% to 17% in FY2017.



Source: Axis Bank

The deterioration in credit risk was matched by poor operational risk controls. The regulator on July 27, 2016 issued a warning to Axis Bank for certain lapses in Know Your Customer (KYC)/ Anti-Money Laundering (AML) on monitoring of transactions in customer accounts and Foreign Exchange Management Act, 1999 (FEMA) provisions (Axis Bank FY2017 annual report, p. 172). Subsequently, during demonetisation (post November 8, 2016) the full extent of the bank's poor operational risk management manifested with its staff being arrested for money laundering, as the bank decided to exploit the demonetisation opportunity to increase low cost deposits with scant regard to KYC norms. The resulting loss in public confidence amidst rumours of the regulator cancelling the bank's license led the Reserve Bank of India to release a public statement specifically stating that it was not planning to cancel the bank's license.

Divergence in Asset Quality and Net Profits Detected by the RBI

Rsmn	FY2016
Gross NPAs Reported	60,876
Gross NPAs Detected by RBI	155,655
Divergence in Gross NPA	94,779
Net NPAs Reported	25,221
Net NPAs Detected by RBI	96,852
Divergence in Net NPAs	71,631
Provisions for NPAs	33,934
Provisions for NPAs by RBI	57,082
Divergence in Provisions	23,148
Reported Net Profits	82,237
Net Profits by RBI	66,878
Change (%)	
Gross NPA	155.7
Net NPA	284.0
Provisions	68.2
Net Profits	-18.7

Source: Axis Bank FY2017 Annual Report p. 153

The glaring shortfalls by the senior management finally culminated in the recent disclosures revealing that the bank had mis-reported its FY2016 accounts, with the RBI detecting additional gross NPAs of 156% as compared with the reported and audited numbers and far exceeding the 15% divergence cut-off set by the regulator. Pertinently, in the bank's FY2017 annual report, there is no discussion in the CEO's Message to Shareholders, Directors' Report or the Management Discussion and Analysis sections on how the banking regulator detected such an embarrassingly large divergence in asset quality, shaming the senior management of the bank including its CEO, chief financial officer (CFO), audit committee of the board and the auditor.

In a professionally managed bank, any one of these concerns would have resulted in the heads of the concerned divisions being replaced, and in the case of Axis Bank, the poor credit and operational risk management combined with mis-reporting of financial statements should have resulted in a complete restructuring of the senior management. However, the board of directors at Axis Bank, in its infinite wisdom, decided not only to retain the senior management but also to give increments, bonuses and stock options to the key management personnel as a reward for their performance.

The nominations and remuneration committee of the board consists of 4 non-executive directors, chaired by Prasad R Menon, and it reviews and recommends to the board the remuneration inclusive of fixed pay, bonuses, increments for the senior management. In FY2017, the committee,

> "commissioned McLagan Aon Hewitt, a globally renowned compensation benchmarking firm, to conduct market benchmarking of employee compensation. The Bank participates in the salary benchmarking survey conducted by Aon Hewitt every year. Aon Hewitt collects data from multiple private sector peer banks across functions, levels and roles which is then used by the Bank to assess market competitiveness of remuneration offered to Bank employees." (Axis Bank FY2017 annual report, p. 175).

It is possible that McLagan Aon Hewitt provided the critical inputs to determine the increments and bonuses for the executive senior management at Axis Bank for FY2017.

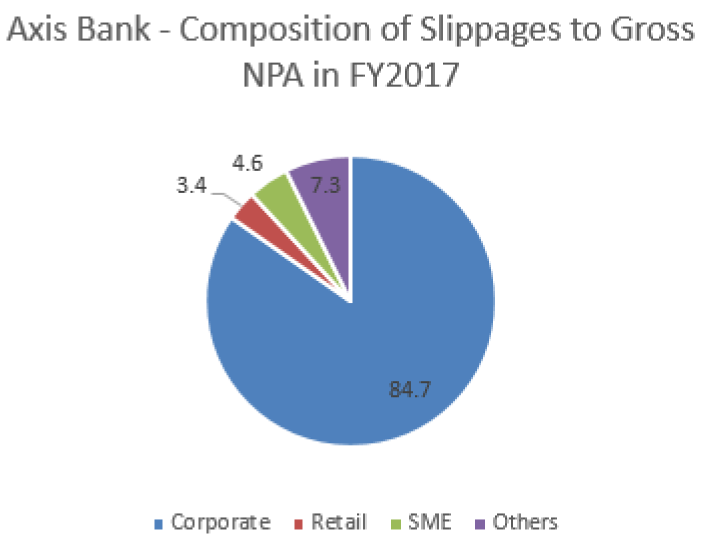
Shikha Sharma, the Axis Bank CEO since June 2009, and the individual with overall responsibility of credit and operational risk and for true and fair financial statements, was not only given an increment of 6.5% inclusive of a bonus on her enhanced basic salary, but also additional stock options of 900,000. In a year when the bank's EPS not only halved and is 36% below the level of FY2013, her remuneration (excluding stock options) in FY2017 is 102% higher than in FY2013.

Remuneration of Shikha Sharma

Rs	FY2013	FY2014	FY2015	FY2016	FY2017
Basic Salary	15,498,000	21,240,000	22,171,080	25,140,996	27,037,866
Leave Fare Concession	1,000,000	1,390,410	1,226,500	132,916	1,461,000
House Rent Allowance	5,952,000	6,448,000	7,405,290	8,392,818	9,019,330
Variable	3,801,667	8,435,483	6,753,265	11,258,155	13,506,896
Leave Travel	NA	NA	NA	1,226,500	NA
Medical	29,416	24,532	78,999	92,696	364,971
Perks	NA	NA	NA	2,479,109	2,762,023
Furnishing Reimbursement Allowance	NA	NA	NA	2,000,000	NA
Utility	6,622	NA	NA	89,676	NA
Utility through voucher	NA	NA	NA	277,823	NA
Contribution to Provident Fund	1,859,760	2,548,800	2,660,530	3,016,920	3,244,544
Contribution to Superannuation Fund	1,549,800	2,124,000	2,217,108	2,514,100	2,703,787
Contribution to Gratuity Fund	-	-	-	-	-
Total	**29,697,265**	**42,211,225**	**42,512,772**	**56,621,709**	**60,100,417**
Increase (%)	3.6	42.1	0.7	33.2	6.1
Stock Options (nos.)	675,000	875,000	1,125,000	900,000	900,000
Increase in Basic (%)	1.9	37.0	4.4	13.4	7.5
Variable/Basic (%)	**24.5**	**39.7**	**30.5**	**44.8**	**50.0**

Source: Axis Bank, Annual Reports. For FY2017 p. 82

The second-in command, V Srinivasan, in-charge of corporate credit since September 2009, in FY2017 was given a 10% increase in remuneration, inclusive of a bonus (31% of his basic salary) and stock options of 500,000. The tidal wave of corporate NPAs that swamped the bank appears to have bypassed the individual with direct responsibility for it.



Source: Axis Bank

Jairam Sridharan, the Chief Financial Officer whose primary responsibility is the integrity of accounts, and who certified FY2016 NPAs and financial statements which the regulatory subsequently found not to be true and fair, was richly rewarded for his performance and his increment in FY2017 remuneration was 19.2%.

Increase in Remuneration

%	FY2015	FY2016	FY2017
Shikha Sharma, Managing Director, CEO	15.0	12.9	6.5
V Srinivasan, Deputy Managing Director	14.0	13.5	10.0
Rajiv Anand, ED Retail Banking	NA	NA	15.0
Rajesh Dahiya, ED Corporate Centre	NA	NA	19.3
Jairam Sridharan, CFO	NA	NA	19.2
Girish Koliyote, Company Secretary	NA	NA	9.5
Median remuneration of employees	6.2	6.5	9.3
Average remuneration non-managerial staff	8.0	8.2	9.7
Average remuneration managerial staff	15.0	15.4	11.0

Source: Axis Bank Annuals Reports. For FY2017 p. 115

Interestingly, despite having significantly higher base salaries, these key individuals with the exception of the CEO were given higher percentage increments than the median employee and the average non-managerial employees at the bank.

Axis Bank's FY2017 annual report provides an insight into the board's evaluation of its performance in a year marred with senior management-linked setbacks.

> "The Board had adopted a formal mechanism for evaluating the performance of its Committees, Individual Directors, including the Independent and Non-Independent Directors, the Chairman of the Board and the Board as a whole…The Board had engaged the service of an external agency for setting the methodology and determining the process of evaluation and advising the Board on the measures pursuant to outcome of such evaluation. The Board of Directors were satisfied with the evaluation results, which reflected the overall engagement of the Members and the effectiveness of the Board and of its Committees." (Axis Bank FY2017 annual report, p. 84).

What kind of external agency can set up a methodology whereby the outcome can result in satisfaction in the face of self-inflicted calamities remains a mystery.

A questionnaire dated June 21, 2017 was sent to Axis Bank for a detailed explanation for the basis of the increments, bonuses and stock options awarded to key managerial (see Annexure 1) and the NPA divergence. Axis Bank's reply on June 23, 2017 stated,

> "In the last six months alone, we have noticed that you have run three stories targeting Axis Bank, its management, its Board and have made attempts to undermine its credibility in the

> market. We find it strange that you should use your journalistic license to mount what appears to us as an inspired campaign of maligning the institution.
>
> You are a respected analyst with some standing in the market. Therefore, we went out of way to accommodate your queries and present the Bank's version in each instance. Unfortunately, we are constrained to note that despite our explanations, insights and views, you have chosen to write what you intended to write in the first place. Our point of view has almost always been relegated to the footnotes, while you have run the story based on your pre-conceived narrative.
>
> Axis bank is India's third largest private sector bank and enjoys the trust of millions of depositors, shareholders, and borrowers. It has an eminent Board of Directors, which exercises oversight on the professional management. Further, I am sure you are aware that Indian banks operate in a very tightly regulated environment and Axis Bank has always complied with the guidelines and directives stipulated by the regulators. We see no reason for you to run a campaign to malign the fair name of the Bank, its Management and its Board, unless you have been led to believe otherwise by vested interests for their own ulterior motives.
>
> Under the circumstances, we regret we do not wish to entertain your queries any further and therefore, we decline to answer your queries, this time and in future."

In all the prior critical articles on Axis Bank published by this writer, the bank had neither challenged the facts which had been taken from the bank's own disclosures nor sent a rejoinder. Prior to the publishing of each of the earlier articles a detailed questionnaire was sent to the bank and Axis Bank's response was incorporated in the main body of the articles. It appears from the bank's response that when they are unable to credibly challenge the facts, declining to answer specific queries and not entertaining any further queries in the future is their only response.

In a free market economy, the independent directors on a bank's board are appointed to safeguard the interests of unsecured depositors and shareholders and rein in executive management. In Axis Bank, however, the disasters in corporate credit, operational risk management and accuracy of financial statements which took place on the watch of the present senior management are not only tolerated by a compliant board, but the senior management are rewarded for their dismal performance. And the banking regulator, mandated by parliament to protect depositors, watches, patiently and silently and permits the senior management to continue in their posts.

Annexure I – Questionnaire Sent to Axis Bank dated June 21, 2017

The questionnaire is part of my pre-publication due diligence exercise to give a fair opportunity to your bank to respond to critical reports against your bank so that you can rebut the same with facts.

1. In light of the following performance of Axis Bank as disclosed in the FY2017 annual report

   i. 55% decline in net profits to Rs 36.79 bn in FY2017 as compared with FY2016 reported net profits of Rs 82.2 bn

   ii. 250% increase in gross NPAs to Rs 212.8 bn in FY2017 as compared with Rs 60.9 bn in FY2016

   iii. Slippage to gross NPAs of Rs 218 bn in FY2017 as compared with slippage of Rs 73.4 bn in FY2016, mainly from corporate loans

   iv. Significant RBI divergence in FY2016 of gross NPAs by 156% to Rs 155.7 bn as compared with the audited and reported gross NPA of Rs 60.9 bn in FY2016 and consequent increase in net NPAs, provisions and a decline in net profits by 19% to Rs 66.9 bn in FY2016

2. Could you please explain on what parameters did the board of directors decide to give the following increments, variable bonus and stock options to the following senior managerial personnel?

   i. Shikha Sharma, CEO, was given a 6.5% annual increase in total remuneration in FY2017, including a variable bonus of Rs 13.5 mn (50% of her basic salary) and stock options of 900,000.

   ii. Shikha Sharma's variable component increased from Rs 11.3 mn in FY2016 (45% of basic) to Rs 13.5 mn in FY2017. Specifically on what basis did the board believe that she deserved a hike in absolute as well as a % of her enhanced basic salary in FY2017?

   iii. V. Srinivasan, deputy managing director and in-charge of corporate credit in Axis Bank since September 8, 2009 received a 10% increase in remuneration in FY2017 including a variable bonus of Rs 5.8 mn – 31% of his basic salary as compared with Rs 9 mn (52% of basic) in FY2016. He was also given stock options of 500,000 in FY2017. As the bulk of the increase in gross NPAs in Axis Bank has been on account of corporate loans, which is V. Srinivasan's direct responsibility, on what basis was he given an increase in remuneration and a variable bonus in FY2017?

   iv. Jairam Sridharan, Chief Financial Officer (CFO), received a 19.2% increase in remuneration and 140,000 stock options in FY2017. He was the CFO who certified FY2016 accounts and the integrity of the accounts is his primary responsibility. Despite the statutory regulator, the Reserve Bank of India detecting a huge and material divergence in NPAs and provisioning resulting in a 19% decline in reported FY2016 net profits, on what basis did the board of directors give an increase to the CFO's remuneration?

v. What was Jairam Sridharan's basic salary and variable component for FY2016 and FY2017?

vi. Rajiv Anand, ED, Retail Banking was given a 15% increase in remuneration and 230,000 stock options in FY2017. During demonetisation, retail Axis Bank staff were arrested by authorities and many were also suspended by the bank for engaging in money laundering, leading to a loss of public confidence which compelled the RBI to specifically issue a press release stating that it will not revoke Axis Bank's banking license. As head of retail banking, he is directly responsible for the conduct of the retail staff. Hence on what basis was he given an increase of 15% in his remuneration? What were Rajiv Anand's basic salary and variable component for FY2016 and FY2017?

vii. The % increase in median remuneration of employees was 9.3% and the average increase in remuneration for non-managerial staff was 9.7% as compared with the average increase in remuneration of managerial staff at 11% in FY2017. Despite the base of both senior managerial staff and managerial staff being significantly higher than non-managerial staff, how is it that in a year when there was a huge increase in corporate NPAs and a divergence in NPAs and net profits in FY2016, which is a direct reflection on managerial staff the latter (especially V. Srinivasan and Jairam Sridharan) received a higher % increase in remuneration than non-managerial staff.

3. As the NPA divergence is now fully disclosed in the annual report, 2 months after the announcement of the FY2017 results. Could you please specifically explain

i. How did the NPA divergence in FY2016, escape the notice of the CEO, CFO, Audit Committee and the statutory auditor of Axis Bank in FY2016?

ii. If there is a difference in perception of how an account is classified please specify the said RBI NPA guideline which resulted in a difference of view

iii. Had the RBI detected evergreening of loans as the reason for the divergence in FY2016?

iv. Whom does the Board of Directors hold accountable for the divergence of NPAs?

I would appreciate a response at the earliest. Thanking you,

Yours truly,

Hemindra Hazari

DISCLOSURE & CERTIFICATION

I, Hemindra Hazari, am a registered Research Analyst with the Securities and Exchange Board of India (Registration No. INH000000594) I have no exposure to Axis Bank referenced in this Insight. Views expressed in this Insight accurately reflect my personal opinion about the referenced securities and issuers and/or other subject matter as appropriate. This Insight does not contain and is not based on any non-public, material information. To the best of my knowledge, the views expressed in this Insight comply with Indian law as well as applicable law in the country from which it is posted. I have not been commissioned to write this Insight or hold any specific opinion on the securities referenced therein. This Insight is for informational purposes only and is not intended to provide financial, investment or other professional advice. It should not be construed as an offer to sell, a solicitation of an offer to buy, or a recommendation for any security.

Axis Bank's Nose Grows and Grows and Grows

OCTOBER 19, 2017.

Even in the rowdy game of football, two yellow cards result in dismissal from the field of play. Indian banking, though, adheres to lower standards. For two consecutive years, Axis Bank has been exposed by the regulator for mis-reporting in its financial statements; yet the bank's board of directors has allowed the same chief executive officer (CEO), chief financial officer (CFO) and auditor to continue in their posts. Apparently, the banking regulator has a high tolerance for banks disregarding its instructions and under-reporting non-performing assets, as to date no action has been taken against the concerned individuals at Axis Bank. Even normally docile analysts could be heard openly questioning the management during the 2QFY2018 results conference call on the numbers reported by the bank; one implied whether the bank might score a hat trick in misreporting its financials for FY2018 as well. With such a dismal track record, analyzing the bank's results becomes meaningless.

Sell-side analysts were caught by surprise when Axis Bank reported results for the quarter ended September 30, 2017 (2QFY2018), as they expected the bank to repeat the performance of 1QFY2018, when it declared net profits of Rs 13 bn and slippages to gross non-performing assets (NPAs) of Rs 39 bn. Instead, the bank reported a net profit of a paltry Rs 4.3 bn and slippages to gross NPAs of Rs 89.4 bn. Worse, the bank disclosed that as per the Reserve Bank of India's (RBI) inspection, it had under-reported its gross NPAs for the year ended March 31, 2017 by 27% and overstated net profits by 24%, the second consecutive year of mis-reporting its financial statements.

Divergence in Axis Bank's Asset Quality, Provisioning and Net Profits

Rs mn	**FY2016**	**FY2017**
Gross NPAs Reported	60,876	212,805
Gross NPAs as assessed by RBI	155,655	269,133
Divergence in Gross NPA	**94,779**	**56,328**
Net NPAs Reported	25,221	86,267
Net NPAs as assessed by RBI	96,852	129,437
Divergence in Net NPAs	**71,631**	**43,170**
Provisions for NPAs	33,934	122,057
Provisions for NPAs as assessed by RBI	57,082	135,214
Divergence in Provisions	**23,148**	**13,157**
Reported Net Profits	82,237	36,793
Net Profits as assessed by RBI	66,878	27,940
Divergence in Net Profits	**-15,359**	**-8,853**
Divergence (%)		
Gross NPA	**155.7**	**26.5**
Net NPA	**284.0**	**50.0**
Provisions	68.2	10.8
Net Profits/Losses	-18.7	-24.1

Source: Axis Bank

A RBI notification on April 18, 2017 entitled "Disclosure in the 'Notes to Accounts' to the Financial Statements- Divergence in the asset classification and provisioning ," is causing tremendous discomfort to Axis Bank, by providing some transparency regarding the quality of its financial statements. An excerpt of the notification states,

> "There have been instances of material divergences in banks' asset classification and provisioning from the RBI norms, thereby leading to the published financial statements not depicting a true and fair view of the financial position of the bank… it has been decided that banks shall make suitable disclosures as per Annex, wherever either (a) the additional provisioning requirements assessed by RBI exceed 15 percent of the published net profits after tax for the reference period or (b) the additional Gross NPAs identified by RBI exceed 15 percent of the published incremental Gross NPAs for the reference period, or both."

As some banks were not transparent in quantifying or even revealing the divergence at the time of announcing their FY2017 results (mandatory disclosure only in annual report), the Securities and Exchange Board of India (SEBI), the capital markets regulator, in its circular dated July 18, 2017 compelled banks to file the divergence disclosures with the stock exchanges,

> "along with the annual financial results filed immediately following communication of such divergence by RBI to the bank."

The only saving grace, if any, in the divergence of FY2017 for Axis Bank is that in percentage terms and absolute amounts it was lower than FY2016 for NPAs and provisions; however, the net profit divergence in percentage terms was higher in FY2017.

In an earlier insight, Axis Bank - Crisis of Credibility dated May 5, 2017, this writer had highlighted how Shikha Sharma, CEO, Jairam Sridharan, CFO and Viren H Mehta, auditor, S.R. Batliboi & Co, a member firm of Ernst & Young, had certified the FY2016 accounts, yet had continued in their posts for FY2017 and FY2018. This writer had stated,

> "The wide divergence between the regulator's assessment and the bank's audited NPAs for FY2016 reflects poorly on the CEO, CFO, audit committee and the auditor. To safeguard the reputation of the institution, the board of directors and the regulator should have replaced the individuals once the RBI detected the huge variance in the NPAs. But, in a bizarre development, Axis Bank's FY2017 accounts have been signed by the same CEO, CFO and certified by the same auditor, raising significant concerns regarding the credibility of the bank's FY2017 asset quality, earnings and capital adequacy."

It is therefore no surprise that the regulator detected significant divergence in FY2017 financial statements as the board and indeed the regulator itself permitted the same individuals to continue in their crucial posts. For any bank to report divergence in excess of the RBI's liberal tolerance levels (up to 15%) is a matter of shame; for a bank to report a divergence for two consecutive years reveals a lack of accountability and professionalism by the senior management of Axis Bank.

The repeated divergence at Axis Bank has finally shaken the docile banking analysts. During the bank's 2QFY2018 results conference call, Nilang Mehta, a buy-side analyst from HSBC Asset Management asked,

> "what is the risk of FY18 springing up more surprises [divergence]…otherwise…these numbers seem meaningless." (p. 12 2QFY2018 results conference call transcript)

Axis Bank's defence of the latest divergence says the RBI reclassified 9 corporate accounts (around 9.5% of Axis Bank's capital in FY2017), which were classified as standard by most consortium banks as on June 30, 2017. However, interestingly, around 6% of the banks classified these accounts as NPAs. The very fact that some banks had already classified the accounts as NPA is a sufficient indicator of the quality of these accounts. In one of the 9 accounts, Axis Bank was the sole banker to an unnamed IT/ITES company, and the outstanding was Rs 11.43 bn, as compared with its aggregate outstanding to 3 power sector accounts (out of the 9 reclassified accounts) aggregating to Rs 16.85 bn. Axis Bank expects recovery in the IT/ITES account and stated,

> "A significant part of this [IT/ITES] account is expected to get repaid soon, post a business sale transaction, for which a binding agreement is already in place."

The high exposure to an IT/ITES account, which normally has negligible fixed asset security apart from real estate, throws some light on the bank's risk and credit appetite.

Fund-Based Outstanding of 9 Accounts Classified as Standard as on June 30, 2017

Sector	No. of Accounts	Fund-based Outstanding (Rsbn)
Steel	1	11.28
Power	3	16.85
IT/ITES	1	11.43
Others	4	9.11
Total	9	48.67

Source: Axis Bank

The NPA divergence in FY2016 was not a universal phenomenon. The highest mis-reporting was from the new private sector banks: Yes, Axis and Indusind. Pertinently, government banks with considerable corporate loan exposure, such as State Bank of India, Bank of Baroda, Bank of India and Union Bank of India, did not report divergence, which shows the credibility of their accounts.

The domestic media and analysts publicly responded to the divergence in Axis Bank in 2QFY2018 by saying it was an industry-wide problem, as the bulk of the bankers in the 9 corporate accounts (industry outstanding of around Rs 400 bn) classified the accounts as standard. However, such a view cannot exonerate Axis Bank or any of the other bankers who had classified the accounts as standard. As Andy Mukerjee, the *Bloomberg* columnist scathingly remarked, "Even now all Axis has to say in its defense is that it's not the only one lying..."

These accounts were obviously of suspect quality, as some bankers had classified them as non-performing. Some financial intermediaries have made 'evergreening' of corporate accounts into an art, and it is possible the RBI decided to make an example of these 9 accounts. More clarity may emerge of the other banks involved in these accounts when they publish their 2QFY2018 results.

Jairam Sridharan, Axis CFO, whose main responsibility is the integrity of accounts, has not only been found wanting but is either ignorant of the asset quality or is misleading investors. In 1QFY2018, when the bank reported an annualised credit cost of 195 bhps, he gave a guidance of 175-225 bhps for FY2018 (p. 12 analyst 1QFY2018 results conference call); in 2QFY2018, annualized credit cost shot up to 316 bhps and he gave a revised guidance for FY2018 of 220-260 bhps (p. 17 2QFY2018 results conference call). It is amazing how the board tolerates such competence.

Axis Bank is a prominent new private sector bank with majority foreign ownership (foreign institutional ownership at 46.3% plus GDR at 5.8%) and is audited by S.R. Batliboi & Co, a member firm of Ernst & Young. The bank's senior management are given handsome remuneration, bonuses, stock options and annual pay hikes. Yet when the bank is found by the regulator to be mis-reporting its numbers for two consecutive years and no action is taken by the board or by the regulator against the senior management, it shows there is no accountability and corporate governance is merely a façade.

Axis Shareholders' Silent Prayer to Bain: Stick Around to Clean Up the Mess

NOVEMBER 1, 2017.

Is Bain Capital investing in Axis Bank in order to turn around the troubled lender, or is it merely a passive speculator, picking up a stake when prices are down? If the latter, existing shareholders will be disappointed, for they have been suffering silently as the Axis management has made huge blunders and tried to cover them up again and again – even as the Axis board and the regulators have idly watched. Shareholders would be hoping rather that Bain would play an active role, asking hard questions at the board meetings and driving the revival of a bank which once had a reputation for integrity, efficiency and profitability.

Axis Bank's share prices surged on October 31, 2017 in the wake of media reports that Bain Capital, a private equity fund, is in advanced talks with the bank to invest between US$ 750 mn – US$ 1 bn. The reports say this will be done through a preferential allotment which will allow the fund to own 5% of the bank. This was a welcome relief to Axis's shareholders, who have seen its share prices beaten down in recent days.

Axis Bank did not deny the story and in a stock exchange filing said,

> "The bank in the ordinary course of its business, continues to explore various means of raising capital/funds through issuance of securities in order to meet its business/regulatory requirements, subject to compliance with prescribed procedures and receipt of statutory/regulatory approvals."

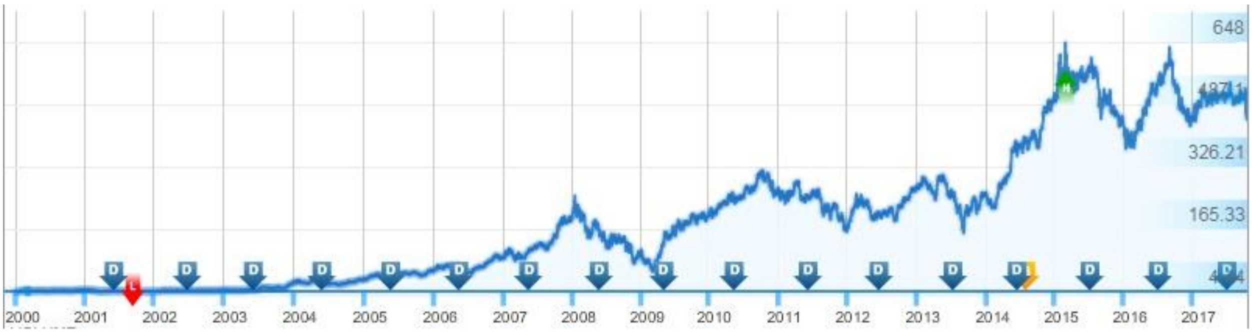
On reported disclosures, Axis Bank's capital adequacy does not pose any issues with CET1 of 10.95% as on September 30, 2017 but it appears the loss in confidence in the bank required an entry of a prominent and respected institutional shareholder to enhance the share price. Alternatively, it could also be the bank expects a huge surge in bad debt provisions to erode its existing capital and hence the existing high capital may be irrelevant.

Axis Bank's Capital Adequacy

%	FY17	1QFY18	2QFY18
CET1	11.13	11.15	10.95
Tier-1	11.87	12.6	12.36
Tier-2	3.08	4.03	3.96
Total Capital - Basle 3	14.95	16.63	16.32

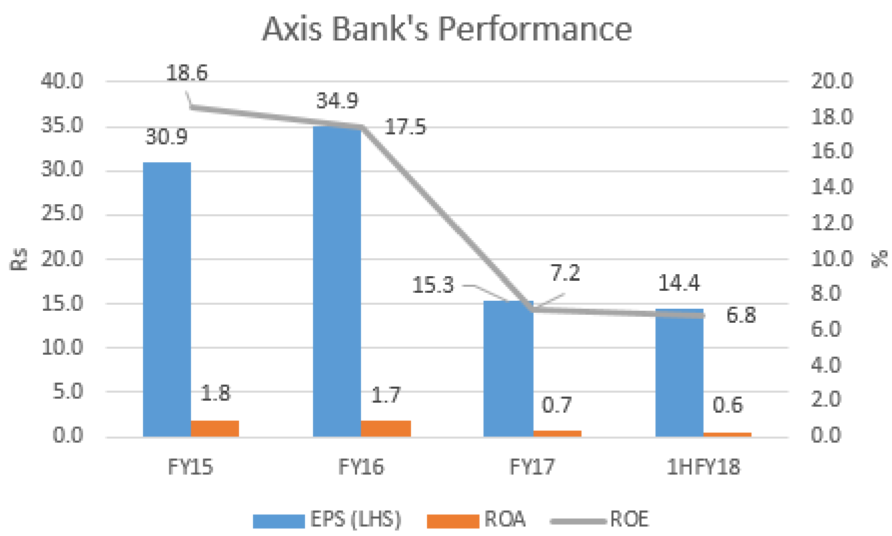
Source: Axis Bank

Axis Bank's Share Price Performance in Rupees



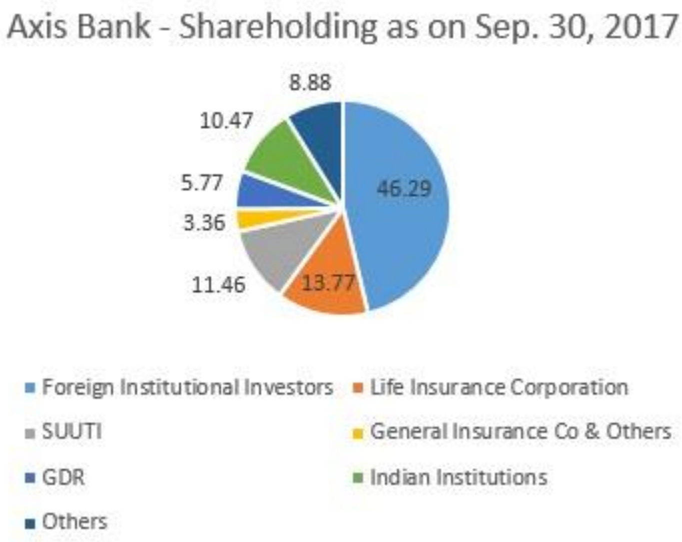
Source: Moneycontrol

Since hitting a high of Rs 648 on March 2, 2015, Axis Bank has disappointed its shareholders as the bank was beset with problems of mismanagement. The industrial downturn resulted in large corporate loans turning bad, in the process exposing poor credit appraisal and monitoring skills; staff were arrested during demonetisation (November 8-December 31, 2016) revealing inadequate operational risk management; and two consecutive years of mis-reporting annual financial statements raised doubts about the integrity of the accounts. Even as the very edifice of the bank was being eroded at its foundations, the board of directors continued to repose faith in the executive management which had contributed to the current dismal state of affairs.



1H18 is annualized
Source: Axis Bank

The market responded to the news of Bain's possible entry with a 9.2% surge in the share price to Rs 529 on October 31, 2017, the highest daily percentage increase since May 16, 2014. Although state-owned entities own stakes in Axis Bank (the Life Insurance Corporation owns 13.77%, Specified Undertaking of the Unit Trust of India owns 11.46%, and other general insurance companies owns a further 3.36%), the market does not believe that these state-owned entities can compel the bank management to focus on improving shareholder value. Hence the possible entry of a prominent PE fund appears to be the white knight coming to the rescue of the shareholders.



Source: Axis Bank

The Economic Times article which broke the Bain Capital story also said that the PE fund may acquire a further 5% stake from other shareholders, taking its total stake to 10%. According to The Mint news story, Singapore's sovereign wealth fund GIC Pte. Ltd and Canada Pension Plan Investment Board (CPPIB) are in talks to co-invest with private equity firm Bain Capital and the three entities will invest about $1.9-2 billion to acquire the 10% stake. If Bain and the other entities are able to appoint one director on the Axis Bank board, it is possible that some pressure maybe applied on the executive management to improve shareholder returns. Such an event maybe reminiscent of the period December 2001 to January 2002, when the Commonwealth Development Corporation (CDC) Capital Partners, a PE fund, took a 26% stake in the then UTI Bank (renamed later as Axis Bank) at a price of Rs 34 pre-split (post-split Rs 6.8) per share. At that time capital and asset quality was a major constraint for the bank, as its promoter, Unit Trust of India, was experiencing a crisis. Non-executive board directors on the bank were also not taking a proactive interest and as a former senior Axis Bank official informed this writer,

> "We referred to the promoter directors as absentee landlords who did not bother to even read board papers while the independent directors were called mushrooms, to be kept in the dark and occasionally fed rubbish."

With the entry of CDC and its appointment of two directors with global banking experience, Paul Fletcher and Donald Peck, the board environment became challenging and senior bank officials were forced to come prepared for board meetings. Many a time proposals to the board were sent back to the drawing board to be overhauled. The heads of retail, corporate and human resources were reviewed by the independent human resources agency, Korn Ferry, and the internal candidates were benchmarked with external candidates. A new post of head risk management was created and an outside candidate was hired. The shareholders agreement drawn up with CDC entailed their right to intervene in the appointment of senior officials such as presidents and above and the CEO. The then senior officials at Axis Bank valued the strategic counsel and oversight of CDC's two directors, who contributed to the growth of the bank and in delivering shareholder value during that period till CDC exited at end-December 2003. The foundations laid at that time served as a platform for future prudent growth till the appointment of Shikha Sharma as CEO on June 1, 2009.

More than a decade later since CDC's exit, shareholders of Axis Bank are confronted with major issues and an impotent board of directors which refuses to take action against the senior executive management despite serious transgressions. Even the foreign institutional investors with their collective shareholding of 46.3% appear to be bystanders. The possible entry of Bain Capital on the board of directors and on the critical credit, audit and nominations committees may be the welcome shake-up required to turn around Axis Bank, as the present board has shown its incapability to do the job.

Axis Bank Results Leak: Round Up the Usual Suspects - Yet Again?

JANUARY 2, 2018

One has to hand it to Axis Bank for demonstrating such consistency. On December 27, the capital market regulator ordered the bank to conduct an internal investigation into the leak of its results prior to their public release. This follows a series of misadventures by Axis Bank: its staff getting arrested on charges of money laundering; a collapse in profitability; two consecutive years of fudging of accounts; and a huge deterioration in corporate asset quality. One consistent theme after all these self-induced calamities is that senior management are completely absolved, and blame falls instead on lower level staff and the external environment. Whether the investigation of the latest fiasco blames it on external factors once again, or the usual junior staff are made sacrificial lambs, remains to be seen. Till then, the public and investors can but marvel at this consistent performance by Axis Bank.

On November 16, 2017, Reuters broke a story regarding 'prescient' Whatsapp messages revealing the results of Indian companies prior to their official release. The unpublished price-sensitive information (UPSI) pertained to 12 companies, of which 9 belonged to the NIFTY-50, the benchmark index of the National Stock Exchange and three were from the financial sector: Axis Bank, Bajaj Finance and HDFC Bank.

The disclosure of UPSI via SMS, telephone and email is widespread in India and social forums like Whatsapp have made it easier. In the case of Axis Bank, the disclosure of key indicators of results prior to their official release was prevalent for many years. Yet leaks continued at this large private bank. The Securities and Exchange Board of India (SEBI), the capital markets regulator, belatedly reacted to this issue, and only after Reuters, a foreign news agency, broke the story, did it launch its own investigation.

On December 27, 2017, SEBI issued a direction to Axis Bank, ordering the bank to

> "conduct an internal inquiry into the leakage of unpublished price sensitive information relating to its financial results and take appropriate action against those responsible for the same,"

SEBI's investigation into the Axis Bank's leaked UPSI on Whatsapp revealed that the gross non-performing assets (GNPA), net non-performing assets (NNPA), net interest margin (NIM) were exact to even two decimal places, while the write-off amount and current and saving deposit ratio (CASA) were very close to the actuals (however, there was a huge gap between the two figures for NPA slippage). The precision of such leaked sensitive information raises serious questions about the Axis Bank senior management and/or its auditors, as such information is in the exclusive domain of the bank and its auditor.

UPSI on Axis Bank's 1QFY2018 Results Leaked on Whatsapp

- The message in circulation in WhatsApp Group was with respect to quarterly financial results of Axis Bank for the quarter ended June 30, 2017, prior to the official announcement by Axis Bank. The actual results of Axis Bank were announced at Stock Exchanges on July 25, 2017 at 16:23 hours.
- As per media report, the message was in circulation on July 25, 2017 since 9:12 AM.
- It was observed that the figures that were in circulation in WhatsApp groups about Axis Bank were either matching in totality or were close to the actual announcements except figures for "slippage" as can be seen in the following table:

Particulars	Whatsapp Post	Actual Results
GNPA	5.03%	5.03%
NNPA	2.30%	2.30%
NIM	3.63%	3.63%
Slippage	*8,000 cr	**3,519 cr
Write off	2,300 cr	2,341.93 cr
CASA	48.33%	49%

** As per WhatsApp message "Slippage will be mostly from outside the watch list"*

*** As per actual results Slippage was Rs 3,519 cr (majority were from outside watch list)*

Source: SEBI

In a severe indictment of Axis Bank, SEBI's direction stated,

> "It is observed that at this stage, the source / origin of the leakage of UPSI cannot be ascertained. However, it can prima facie be inferred on the basis of the afore - discussed facts and circumstances that the UPSI relating to financials of Axis Bank was leaked. **Such leakage is prima facie attributable to the inadequacy of the processes / controls / systems that Axis bank as a listed company had put in place** [bold ours]."

SEBI has instructed Axis Bank to conduct an inquiry within a period of 3 months and

> "strengthen its processes/systems/controls forthwith to ensure that such instances of leakage of unpublished price sensitive information do not recur in future…The scope of such inquiry shall include and not be limited to determination of the possible role of following persons in relation to the aforesaid leakage of UPSI."

Axis Bank has been ordered to submit the results of the enquiry to SEBI within 7 days from its completion.

In a bank, while individual departments may have their respective data, the consolidation at the all-bank level is undertaken by the finance and accounts department, and normally only a few senior individuals in the department will know the critical data. Once the accounts and finance department collates the information it goes to the Audit Committee of the board which has a discussion with the auditor and thereafter to the board of directors, where it is approved and certified by the auditor. The investor relations team also prepares the presentations prior to the announcement of the results. In Axis Bank, the chief financial officer (CFO), Jairam Sridharan, is responsible for the accounts, finance and investor relations department. The leaks can therefore only come from departments led by the CFO, the company secretariat which prepares the board agenda, the board of directors and/or the auditor.

The leaks could either emanate from the senior staff (including the board of directors) at Axis Bank/auditor, or from the junior staff doing the critical data entry of the results. Normally, in a bank, junior employees do not get access to such price sensitive information. From the number of companies where these leaks apparently regularly happen, it appears that there maybe a cabal of stock operators who specialize in a few highly traded companies who have created a network of insiders within the companies they trade on to achieve an early price advantage.

When a company conducts, or is ordered to conduct, an internal investigation into irregularities, senior managers are routinely absolved of any responsibility, and instead juniors are deemed accountable. However, if such a decision emerges from Axis Bank's investigation, senior managers and the CEO cannot be absolved of the blame:

i. It suggests that the internal systems handling price-sensitive information are so poor that juniors can easily access them.
ii. If the few juniors authorized to handle such information have leaked them, it shows poor judgment of character by the seniors who approved and delegated such authority to the junior staff.
iii. One cannot rule out the possibility that senior staff have leaked the information, deliberately allowing the system to be porous and ensuring that price-sensitive information is more widely dispersed to cover-up their own actions.

The problem with Axis Bank is that there has been a series of serious lapses in 2017, and in none of them have senior management and the CEO accepted any responsibility: the arrest of junior staff by authorities on money laundering charges during demonetisation, significant deterioration in corporate asset quality, two consecutive years of misreporting of its accounts, and finally a major leak of confidential price sensitive information. All these events cannot be attributed to coincidence, and in each and every one of these incidents senior management have to accept responsibility.

In 3 months' time, the regulator will be aware of the findings of Axis Bank's internal investigation, but investors and the public may continue to remain in the dark as to how such accurate information on the bank's results were leaked. Given the previous track record, it is unlikely that the senior management will be indicted, and it remains to be seen how the regulator responds to the report.

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DISCLOSURE & CERTIFICATION

I, Hemindra Hazari, am a registered Research Analyst with the Securities and Exchange Board of India (Registration No. INH000000594) I have no exposure to Axis Bank referenced in this Insight. Views expressed in this Insight accurately reflect my personal opinion about the referenced securities and issuers and/or other subject matter as appropriate. This Insight does not contain and is not based on any non-public, material information. To the best of my knowledge, the views expressed in this Insight comply with Indian law as well as applicable law in the country from which it is posted. I have not been commissioned to write this Insight or hold any specific opinion on the securities referenced therein. This Insight is for informational purposes only and is not intended to provide financial, investment or other professional advice. It should not be construed as an offer to sell, a solicitation of an offer to buy, or a recommendation for any security.

Axis Bank's IT Chief Departs under a Cloud

FEBRUARY 26, 2018.

Amit Sethi, Axis Bank's Chief Information Officer (CIO), an individual perceived to be close to CEO Shikha Sharma, has been asked to resign, allegedly under a cloud. According to an *Economic Times* report, his resignation followed a complaint from a whistle-blower regarding his conduct in the functioning of the information technology (IT) department, and is "believed to contain allegations of irregularities and inappropriate deals." In a bank which prides itself on being digital, such a calamity in its critical IT department reveals serious fault lines of a possible compromise of standards. Unfortunately, this incident is part of a series of management mishaps on the watch of the present CEO, and shareholders and depositors are forced to remain mere spectators as the board steadfastly backs such performance.

Responding to a questionnaire sent by this writer on the allegations that led to Amit Sethi's resignation Axis Bank's official spokesperson said on February 12, 2018,

> "Mr. Amit Sethi is no longer in the services of the Bank, and the appropriate communication has been sent by the Bank to relevant authorities. Issues that require further enquiries will be taken up in accordance with the Bank's policies and procedures…The Bank has seasoned professionals running the IT infrastructure and processes. Movement of specific individuals has no impact on the day to day operations. Further, IT security is handled by a separate team of professionals, independent of the CIO."

A Whatsapp message sent by this writer to Amit Sethi on February 11, 2018 regarding the reasons behind his resignation remained unanswered.

For the head of information technology of a bank to have been asked to resign on alleged grounds of impropriety is a matter of grave concern. It is also possible that when a head of an important division exits in such a fashion other senior officials in the division may be also under investigation. The CIO in a bank would be regularly approving large IT acquisition orders, and hence any malfeasance is a loss to not just shareholders but also to the public funds the bank is responsible towards. It is therefore extremely important for the senior management in a bank, especially the CIO, to have an unblemished reputation.

Unfortunately, the feedback received by this writer in interacting with serving and former Axis Bank staff is that there were numerous concerns regarding Amit Sethi when he was General Manager and Head Business Technology Group at ICICI Bank from April 2011 to May 2012. Thereafter he was the Senior President and CIO, Yes Bank from June 2012 to May 2013. Despite these concerns, Axis Bank selected Amit Sethi to be CIO, but also specifically created the post of Executive Vice-President in Axis Bank to accommodate him.

Prior to Sethi's appointment, in the Axis Bank organisational structure, individuals moved from Senior Vice-President to the post of President. Since his appointment, the new post of Executive Vice-President was institutionalized in Axis Bank's organizational structure. In July 2015, Amit Sethi was promoted to President and CIO of Axis Bank. Although officially Sethi reported to V Srinivasan, the deputy managing director, Sethi was considered close to Shikha Sharma.

The *Economic Times* article dated February 23, 2018 which broke the news of Sethi's resignation concluded with,

> "This is a rare instance of an Indian bank acting against a senior executive on the basis of a complaint by a whistleblower."

Indeed, it is unusual for Axis Bank to have responded and taken action on a whistle-blower's complaint especially when the accused was a member of senior management and considered to be a favourite of the CEO. Axis Bank's past track record of responding to whistle-blowers' complaints was not inspiring as it has shown itself to subdue conscientious whistle-blowers who expose regulatory lapses by firing them using the draconian clause 3.5 of the bank's 'Staff Rules'. This clause enables the bank to terminate the services of an employee without assigning any reason for the termination. It is possible the action taken on Amit Sethi was on account of serious misconduct by him and/or a fallout of internal politics at the top of the hierarchy.

In a bank which prides itself on being digital, IT is extremely critical. When a bank's CIO is compelled to resign under such a dark cloud, huge issues arise which the bank has to further investigate. All IT purchases (hardware, software, integration of systems, outsourcing) authorized by the CIO have to be reexamined, as the bank is unsure whether standards have been compromised. Historically, in India, banking was focused towards credit risk, but the recent Punjab National Bank-Nirav Modi fraud has highlighted the importance of operational risk, in which IT plays a major role.

RBI has instructed banks that when fraud is detected by them, the regulator (the RBI) has to be informed and the state police. A loss to the bank on account of a criminal breach of trust by bank employees should be reported to the police and a First Information Report (FIR) filed. In government banks frauds above Rs 30 mn are also reported to the Central Bureau of Investigation. In private sector banks, the practice has been that when frauds are detected the regulator is belatedly informed, and only in rare cases is a FIR filed with the police, as these banks are sensitive to any negative publicity. In this case Axis Bank has declined to reply to this writer whether the RBI has been informed, and whether the bank has filed an FIR with the police. As the matter is now public, Axis Bank, for the sake of transparency, and given the seriousness of the issue and the seniority of the individual, needs to issue a statement to the public on the reasons for Amit Sethi's resignation, whether there was any malfeasance involved; if so, a police complaint has to be filed.

For an individual, ushered in by amending the organizational structure at the top, and thereafter considered close to the CEO, to resign under such unsavory circumstances does not cast a favourable light on Axis Bank. But as past history suggests, the board of directors and the regulator are oblivious to the numerous management disasters at Axis Bank under Shikha Sharma's watch: staff arrested for money laundering, huge corporate non-performing loans, collapse in profits yet rewarding senior management, fudging of accounts, leak of results prior to their announcement – the list is long. For such a track record, the board has rewarded Shikha Sharma with another term, and shareholders and the public can only be mute spectators.

DI*SCLOSURE & CERTIFICATION*

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Can Willful Mis-reporters Be Made Guests of the State?

MARCH 6, 2018.

The Reserve Bank of India (RBI), the banking supervisor, has fined Axis Bank Rs 30 mn for fudging its accounts and, in particular, under-reporting its non-performing loans for the year ended March 31, 2016. The fine amount is paltry, but the regulator's objective in publicizing penalties is to name and shame the bank. How the board of directors of Axis Bank can allow Shikha Sharma, Chief Executive Officer (CEO), Jairam Sridharan, Chief Financial Officer (CFO), V. Srinivasan, Deputy Managing Director and Head-Corporate Credit and Viren H Mehta, auditor and partner S.R Batliboi & Co, a member firm of Ernst & Young to continue in their assignments post this announcement remains to be seen. What is relatively unknown is that under the Banking Regulation Act (BRA), 1949, mis-statements in accounts can be punishable with imprisonment, as the Indian Penal Code, 1860, is applicable. However, the RBI quietly adopts a far less stringent provision to penalize banks for mis-reporting of accounts. To date, the 'naming and shaming' has not had any impact: in fact, the board of directors has not only rewarded the senior executive management with hikes, bonus and stock options, but has given Shikha Sharma another term as CEO, despite this and other serious transgressions.

Mis-reporting of Accounts by Axis Bank

Rs mn	**FY2016**	**FY2017**
Gross NPAs Reported	60,876	212,805
Gross NPAs as assessed by RBI	155,655	269,133
Divergence in Gross NPA	**94,779**	**56,328**
Net NPAs Reported	25,221	86,267
Net NPAs as assessed by RBI	96,852	129,437
Divergence in Net NPAs	**71,631**	**43,170**
Provisions for NPAs	33,934	122,057
Provisions for NPAs as assessed by RBI	57,082	135,214
Divergence in Provisions	**23,148**	**13,157**
Reported Net Profits	82,237	36,793
Net Profits as assessed by RBI	66,878	27,940
Divergence in Net Profits	**-15,359**	**-8,853**
Divergence (%)		
Gross NPA	**155.7**	**26.5**
Net NPA	**284.0**	**50.0**
Provisions	68.2	10.8
Net Profits/Losses	-18.7	-24.1

Source: Axis Bank

On the evening of March 5, 2018, the RBI informed the public that it had imposed a fine of Rs 30 mn on Axis Bank on February 27, 2018 for, "violations of various regulations issued by RBI in the assessment of

Non-Performing Assets (NPAs)," for the year ended March 31, 2016 (FY2016). Pertinently, Axis Bank had disclosed that it had mis-reported its accounts by under-stating its NPAs in both FY2016 and FY2017, and hence there exists a possibility of the bank being fined for mis-reporting FY2017 accounts as well at a later date.

While RBI has justified the penalty under the provisions of Section 47A (1)(c) read with Section 46(4)(i) of the Banking Regulation Act, 1949, these provisions are extremely mild as compared with Section 46 (1) of the BRA when it comes to punishment for willfully filing false statements by banks.

Section 46, Banking Regulation Act, 1949, which deals with penalties, states:

> (1) Whoever in any return, balance-sheet or other document *1*[or in any information required or furnished] by or under or for the purposes of any provision of this Act, wilfully makes a statement which is false in any material particular, knowing it to be false, or wilfully omits to make a material statement, shall be punishable with imprisonment for a term which may extend to three years *2* [or with fine, which may extend to one crore rupees or with both].

According to the BRA, CEOs and auditors of government and private sector banks are deemed to be public servants for the purpose of the Indian Penal Code (IPC), 1860 and the Supreme Court of India upheld this section in a judgement in 2016.

Section 46A of BRA states,

> 1[46A. Chairman, Director, etc., to be public servants for the purposes of Chapter IX of the Indian Penal Code 2[Every Chairman who is appointed on a whole-time basis, Managing Director, Director, auditor] liquidator, manager and any other employee of a banking company shall be deemed to be a public servant for the purposes of Chapter IX of the Indian Penal Code (45 of 1860).]

Section 167, of Chapter IX of the Indian Penal Code, 1860 states,

> 167. Public servant framing an incorrect document with intent to cause injury.—Whoever, being a public servant, and being, as 2 [such public servant, charged with the preparation or translation of any document or electronic record, frames, prepares or translates that document or electronic record] in a manner which he knows or believes to be incorrect, intending thereby to cause or knowing it to be likely that he may thereby cause injury to any person, shall be punished with imprisonment of either description for a term which may extend to three years, or with fine, or with both.

As the law considers willful mis-statements of accounts to be criminal acts, attracting a punishment of imprisonment, the RBI penalty of Rs 30 mn is not even a rap on Axis Bank's knuckles. The CEO, CFO and auditors are directly accountable for the accounts, and since the under-statement of NPAs pertains to corporate accounts, the head of corporate credit – V. Srinivasan is also responsible. The banking supervisor has not even demanded the heads of Shikha Sharma, CEO, Jairam Sridharan, CFO and Viren H Mehta, the auditor and partner, S. R. Batliboi (a member firm of Ernst and Young), for endorsing two consecutive years of fudged accounts.

Taking a cue from the RBI's relaxed attitude toward the serious charge of mis-reporting of accounts, the board of directors at Axis Bank has continued to reward the CEO, CFO and V Srinivasan, deputy managing director and head (corporate credit) with increments, bonus and stock options; in the case of Shikha Sharma, they have even appointed her for another term.

On Sharma's watch, Axis Bank has had repeated management led-failures, its staff have been arrested for money laundering on account of stringent sales targets, fudging of accounts, huge corporate NPAs, leak of results prior to their public announcement and abrupt resignation of the Chief Information Officer on account of alleged mal-practices.

This is the real state of corporate governance in the Indian private corporate sector – banks can report fudged accounts, the regulator uses diluted provisions to fine banks only nominally, and the concerned individuals not only get away scot free but are rewarded for such performance.

Is the Axis Bank Board Competent to Choose a CEO?

APRIL 6, 2018.

According to an *Economic Times* report, the Reserve Bank of India (RBI) has asked the Axis Bank board of directors to reconsider the fourth three-year term the board gave Shikha Sharma (Chief Executive Officer) last year. Her term was to come to an end in June 2018, but nearly a year earlier, when media reports suggested she was leaving to join another firm, the board hurriedly and prematurely recommended her for a fourth term. The recommendation by the board was surprising on account of the repeated management failures at the bank. The RBI's decision has undermined the credibility of the Axis Bank's board of directors in the critical task of CEO selection. By rejecting her reappointment, the RBI has exposed the board's inability to evaluate the recent performance of the bank and hold Shikha Sharma accountable for this performance. This raises broader questions about the competence of the board. The RBI's action throws light on how certain private sector bank boards function as handmaidens of the CEO, instead of safeguarding shareholder and depositor interests. Under such circumstances, when the RBI has rejected the candidate chosen by the board, can the board be trusted to select another CEO?

The *Economic Times* article which broke the story of RBI's rejection of the board's decision to reappoint Shikha Sharma said,

> "The regulator addressed the letter to Axis Bank chairman Sanjiv Misra and gave its reasons for urging a review [of Shikha Sharma's fourth term],...These included the bank's performance and its deteriorating asset quality…"

Axis Bank did not deny the story and informed the stock exchanges

> "In this connection, we wish to inform you that the Bank's Board follows a standard process with regard to senior appointments, and forwards its recommendations· to the regulator (to the extent required). This process is currently in progress."

While the RBI rejection and Axis Bank's subsequent public comment were carried widely in the media, far-reaching implications regarding the board's competence in recommending her have not been examined.

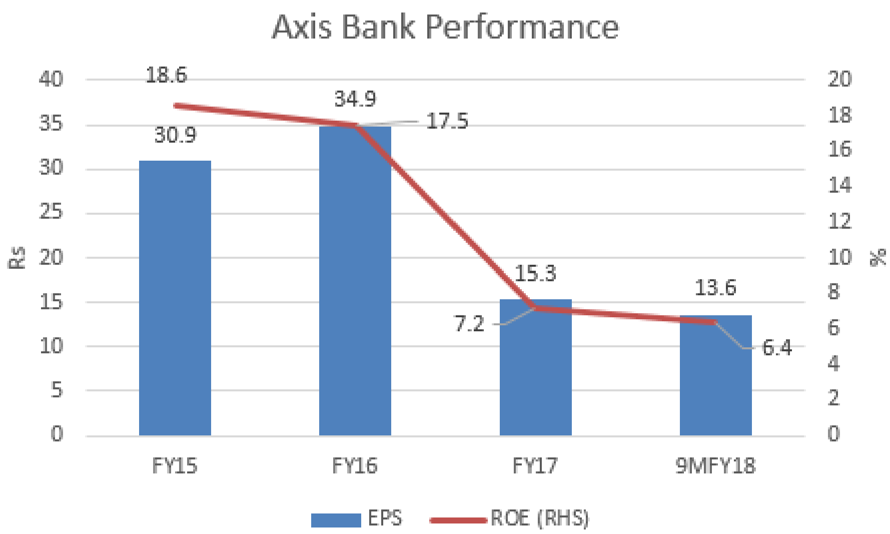
In the past two years, Axis Bank has been regularly in the news for all the wrong reasons: in end April 2016, it released a watch-list of poor quality corporate loans which had not been classified as non-performing; at the same time, instead of strengthening the critical risk management division, Shikha Sharma attempted to sideline the position of the Chief Risk Officer by making the post to also report to the Chief Financial Officer, widely perceived to be her blue-eyed boy. Subsequently, the RBI had to specifically issue a circular which compelled Axis Bank to reverse this reporting structure. During demonetisation (November 8, 2016 – end December 2016), staff of the bank were arrested for money laundering, exposing the lacunae in the operational risk management at the bank. In May 2017, the bank disclosed that it had fudged its financial accounts for the year ended March, 2016 by under-reporting non-performing loans and over-stating profits.

Despite the massaging of accounts, the drop in profits, and the sharp deterioration in asset quality for the year ended March 31, 2017, the board rewarded the senior management through higher increments, bonus and stock options. In October 2017, the bank reported that it had fudged its accounts for the year ended March 31, 2017, the second year in succession. On the eve of 2018, the capital markets regulator ordered the bank to conduct an investigation into repeated leaks of its results prior to the public announcement. Come February 2018, news broke that Amit Sethi, the Chief Information Officer, an individual perceived to be close to Shikha Sharma, was made to resign under dubious circumstances.

Thus Axis Bank under the leadership of Shikha Sharma is a case study in mismanagement. Any responsible board of directors would have held her accountable and replaced her, but instead, in an astounding decision, the board prematurely announced a fourth term for her, nearly a year in advance. Fortunately for shareholders and the public, where the board of Axis Bank clearly failed in holding her accountable, the banking regulator stepped in and rejected her extension as CEO.

Axis Bank 2 Year Share Price (in Rs) Performance

Source: Moneycontrol



Source: Axis Bank. 9MFY18 is annualised

When a board plans to continue with an existing CEO, a consensus view is taken by the board; it is then formalized through the nominations committee, and thereafter accepted by the board. In Axis Bank's case it appears that the entire board was so satisfied with Shikha Sharma's past 2 years performance of declining profits, profitability and stagnant share price that it decided to retain her for another term. One wonders what performance matrix the board used to arrive at such a conclusion in the face of the recent self-inflicted calamities the bank experienced.

However, when a new candidate is to be considered as CEO, the process is more extensive and the nominations committee plays a key role. Normally, an external agency is hired to short-list candidates. The Nominations Committee of the Board reviews the candidates and selects the individual. Then the selection goes to the entire board, where the selection is approved. However, for the selection of a new CEO, the RBI requires 3 names to be submitted for its approval, with the first name being the board's primary recommendation.

Nominations & Remuneration Committee of Axis Bank

Prasad R Menon	Chairman, Nomination & Remuneration Committee
Rohit Bhagat	Independent Director
Rakesh Makhija	Independent Director

Source: Axis Bank

The rejection by the RBI of the board's decision to extend the tenure of Shikha Sharma is a severe indictment of the Axis Bank board of directors (includes directors representing, Life Insurance Corporation of India, SUUTI and Bain Capital). When the regulator gives a vote of no confidence against a serving CEO applying for a further term, the board has to take it extremely seriously, and it has to understand the reasons for the lack of confidence. Despite the public embarrassments to the bank, the board kept rewarding Shikha Sharma with increments, bonus and stock options and even with a further three year extension. And while Shikha Sharma enjoys their confidence, she no longer enjoys the confidence of the regulator. More worrying is the board's inability to analyse the series of management-induced mishaps in the last 2 years and fix accountability on the CEO. If a board is incapable of such a basic function of performance appraisal of the bank and its CEO, the board itself becomes dysfunctional. Can such a board be trusted to select another CEO?

Even RBI Has Finally Woken Up, But Not the Axis Bank Board

APRIL 10, 2018.

After the Reserve Bank of India (RBI) made clear to the board of Axis Bank that it should reconsider its decision to grant the present Chief Executive Officer (CEO) a fourth term, one would have expected the board to have seen the light. But no, shockingly, the board has written to the RBI asking for her to be given a reduced fourth term of seven months, till December 2018. When the RBI does not consider Shikha Sharma to be a fit and proper CEO to continue for 3 more years, why should it agree for her to continue for an additional 7 months? It is actions like this that make investors lose confidence in the Axis board, which appears more interested in salvaging a CEO's poor reputation than in improving performance for shareholders.

In a humiliating rebuke to the board of Axis Bank, the RBI had reportedly rejected the candidature of Shikha Sharma for a fourth term (to end in May 2021). The RBI rebuke should not have come as a surprise, as, under her leadership, Axis Bank experienced a collapse in performance, deterioration in asset quality, poor operational risk management and 2 consecutive years of fudging of accounts. That a board of directors could even recommend a further term of 3 years for such a CEO should enlighten investors on the competence of the Axis Bank board.

Now, in order to soften the RBI's sharp rebuke of its CEO and to salvage her reputation, Axis Bank stated,

> "Shikha Sharma, Managing Director & CEO of the Bank has requested the Board to reconsider the period of her re-appointment as the Managing Director & CEO of the Bank be revised from 1st June 2018 up to 31st December 2018,"

The wording of the bank's filing to the stock exchanges indicates that it is Shikha Sharma who voluntarily wants to cut short her fourth term. Her current request is a far cry from the exuberance she exhibited during an interview with *CNBC TV18* when the board recommended her for a fourth term in end July 2017. Responding to a question on the opportunity given to her by the board, she replied,

> "I am excited. I am grateful to the board for having given me this extended opportunity. I think we are living right now in one of the most exciting times for India, for the Indian financial system with the amount of stuff that is changing. So you have to exercise every bit of your IQ, EQ. So it is absolutely fantastic and I feel very honoured to have this opportunity."

Despite the "exciting times for India" and the honour bestowed on her by an ever grateful board what has made her change her mind in less than a year?

The board and Shikha Sharma feign total ignorance of the *Economic Times* headline article which stated that the RBI had rejected her candidature for a fourth term. **The central issue remains: if the RBI has lost confidence in Shikha Sharma and no longer considers her fit and proper to be given a fourth term as CEO, why should it consider her competent to be given a 7 month extension as CEO?**

A possible explanation in the media is of succession, since her third term ends on May 30, 2018, it is too short a period to find her successor; there were reports that V. Srinivasan, her second-in-command had earlier submitted his resignation. However, what the media and possibly the Axis Bank board conveniently forget is that Shikha Sharma herself was identified as Axis Bank CEO by the nominations committee of the board in a short span of 2 months, and completely against the wishes of the then chairman and CEO, P. J Nayak, who resigned once the board finalized her candidature as his successor. Hence if the board in 2009 could take such a decision at short notice, the board more than nearly a decade later can also repeat such a performance.

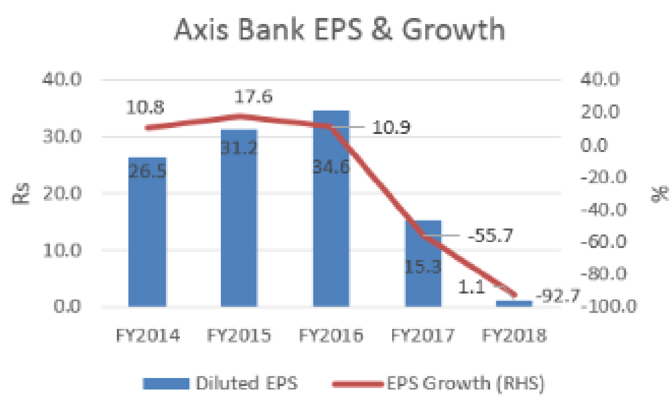
The Axis Bank's board's decision to persist with Shikha Sharma despite her poor track record, and even when the banking regulator disapproves of her continuing, speaks volumes for the independence of the board and of the sorry state of corporate governance in the private sector. Private sector boards in the capital market are supposed to be focused on rewarding merit and performance and penalizing under par performance. But the Axis Bank board during Shikha Sharma's tenure as CEO has rewarded failure and wants to persist with such a CEO for as long as possible. What is even more surprising is that Axis Bank has a board director from Bain Capital, a private equity firm which is known to focus on superior returns. Axis also has considerable foreign and institutional investors, who are similarly focused on performance. Their silence on this entire episode of rewarding non-performance is shocking and a telling reminder of how supposedly free and efficient markets operate in the real world.

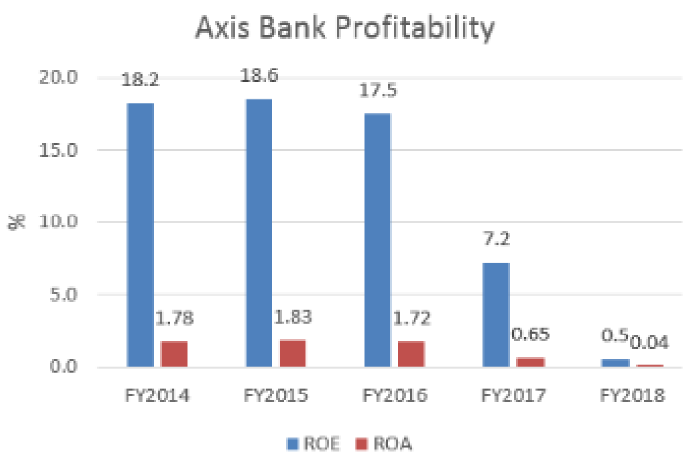
Rewarding Epic Mismanagement with Pay Hikes, Yet Again

JULY 6, 2018

Axis Bank is back in the spotlight for rewarding senior management for a disastrous performance. It was a year in which profits and profitability collapsed with the souring of corporate loans, the regulator penalised the bank for fudged accounts, the share price stagnated and no dividend was declared. Yet the board of directors hiked the salaries of Shikha Sharma, the CEO, and V Srinivasan, the deputy managing director with overall responsibility for corporate credit. Jairam Sridharan, the Chief Financial Officer (CFO), got a huge salary increase for the second year in succession. Such largesse for individuals responsible for the debacle, and a particularly handsome reward for an individual directly responsible for two consecutive years of mis-reported accounts, indicate the dysfunctional nature of the Axis Bank board of directors and the complete lack of accountability of its senior management. Instead of being focused on shareholders' interest, this board is more interested in rewarding an incompetent management. It is shocking that despite the induction of significant capital and a nominee director by Bain Capital, a prominent private equity firm, geared towards shareholder returns, salary hikes to senior management have been approved. Such a board needs to be completely overhauled, and since the majority institutional shareholders do not find such conduct objectionable, the banking regulator should step in and replace all the directors.

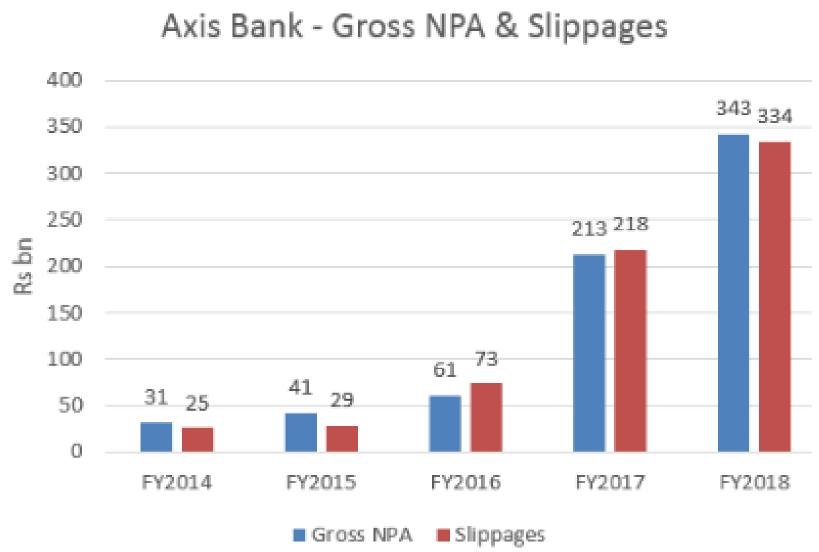
For the second consecutive year, Axis Bank reported disastrous results, as profits and profitability collapsed, resulting in the bank not declaring a dividend. In the year ended March 31, 2018 (FY2018), the bank's EPS fell by 93%, following a year when the EPS had fallen by 56% and the bank's ROE was reduced to a single positive decimal point.

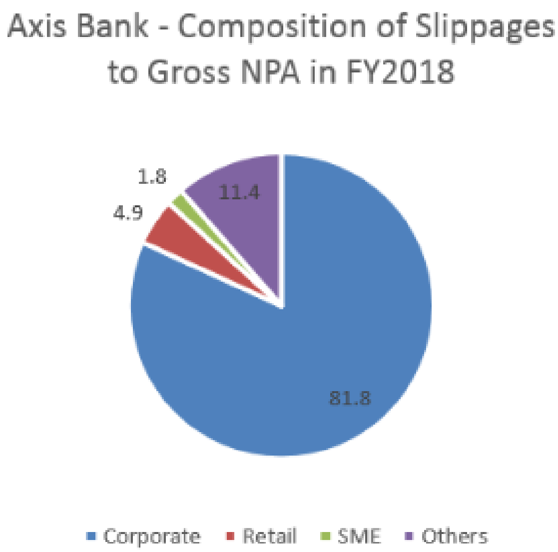




Source: Axis Bank

The disastrous performance was on account of corporate loans going bad. Under the leadership of Shikha Sharma and V Srinivasan, deputy managing director and in-charge of corporate credit since his appointment in 2009, the bank had focused on large ticket corporate and infrastructure loans to boost asset size. In FY2018, 82% (85% in FY2017) of the slippages to gross NPAs was on account of corporate loans. Gross NPAs in the bank's industrial portfolio shot up from 10.7% in FY2017 to 17.2% in FY2018, and in infrastructure it went from 8% to 29.6% in the same period. The state of its corporate loan book reveals the poor credit appraisal and monitoring systems at the bank under the direct leadership of Shikha Sharma and V Srinivasan.





Source: Axis Bank

For shareholders, the poor fundamental performance of the bank under the present management was also reflected in its share price, which has been unable to cross Rs 636 since September 6, 2016.

Axis Bank 2-Year Share Price History

Source: Moneycontrol

For shareholders, the poor performance was compounded by unreliable accounts. For two years in succession (FY2016 and FY2017), the bank was guilty of fudging its books, as the RBI detected significant under-reporting of non-performing loans and inflating of profits. The reliability of the bank's FY2018 accounts will only be known later, when the regulator completes its onsite inspection of the bank. On March 7, 2018, the Reserve Bank of India (RBI) imposed a penalty of Rs 30 mn on the bank for inflating its profits and under-stating its non-performing loans. Pertinently, there is no discussion in the annual report on fixing accountability for such a serious offense. The primary responsibility of Jairam Sridharan, the CFO appointed since October 2015, is the integrity of accounts, and hence he is the individual, along with the CEO, to be held accountable for the two consecutive years of mis-reported accounts.

Mis-reported Accounts in FY2016 & FY2017

Rsmn	FY2016	FY2017
Gross NPAs Reported	60,876	212,805
Gross NPAs as assessed by RBI	155,655	269,133
Divergence in Gross NPA	**94,779**	**56,328**
Net NPAs Reported	25,221	86,267
Net NPAs as assessed by RBI	96,852	129,437
Divergence in Net NPAs	**71,631**	**43,170**
Provisions for NPAs	33,934	122,057
Provisions for NPAs as assessed by RBI	57,082	135,214
Divergence in Provisions	**23,148**	**13,157**
Reported Net Profits	82,237	36,793
Net Profits as assessed by RBI	66,878	27,940
Divergence in Net Profits	**-15,359**	**-8,853**
Divergence (%)		
Gross NPA	**155.7**	**26.5**
Net NPA	**284.0**	**50.0**
Provisions	**68.2**	**10.8**
Net Profits	**-18.7**	**-24.1**

Source: Axis Bank

With such a pathetic track record of performance, shareholder returns and unreliable accounts, a professional board would have removed the CEO and individuals responsible for these management-created calamities. Not only were the concerned individuals not removed, the board of directors rewarded them with hikes in their remuneration. All the executive directors (including the CEO) received minimum hikes in FY2018 of 7.5% per annum, with Jairam Sridharan, the architect of the unreliable accounts receiving a substantial hike of 17.5%. In FY2017, the board also rewarded him with a 19.2% increase.

Increase in Remuneration for the Senior Management at Axis Bank

%	FY2015	FY2016	FY2017	FY2018
Shikha Sharma, Managing Director, CEO	**15.0**	**12.9**	**6.5**	**7.5**
V Srinivasan, Deputy Managing Director	**14.0**	**13.5**	**10.0**	**7.5**
Rajiv Anand, ED Retail Banking	NA	NA	15.0	7.5
Rajesh Dahiya, ED Corporate Centre	NA	NA	19.3	15.0
Jairam Sridharan, Chief Financial Officer	**NA**	**NA**	**19.2**	**17.5**
Girish Koliyote, Company Secretary	NA	NA	9.5	11.8
Median remuneration of employees	**6.16**	**6.45**	**9.27**	**7.57**
Average remuneration non-managerial staff	8.00	8.20	9.70	8.61
Average remuneration managerial staff	**15.00**	**15.40**	**11.00**	**8.73**

Source: Axis Bank, NA Not Applicable

In the FY2018 annual report, the board has not provided any specific explanation of why the CEO and the executive directors were entitled to salary hikes in a year of such a disastrous performance. The only comment on the subject is

> "Remuneration increase is dependent on the Bank's performance as a whole, individual performance level and also benchmarks. (p. 119 of annual report)"

Going by this statement, it appears that the only rationale for giving hikes to Shikha Sharma, V. Srinivasan, Jairam Sridharan and the others was that the market benchmarks were so high that the board was compelled to disregard the pathetic overall performance of the bank and their own individual performance of huge corporate NPAs and unreliable accounts.

Bain Capital, a prominent global private equity firm committed around US$ 1.2 bn as capital in Axis Bank in end 2017 and inducted a nominee director. Private equity firms are solely focused on shareholder returns and play an important role in management and hence it is shocking for an active institutional investor to approve managerial rewards which are decoupled from performance.

By presiding over such poor performance and rewarding the senior management, the board of Axis Bank has clearly demonstrated that it is not 'fit and proper' to manage the affairs of the bank. And as the major shareholders, such as the Life Insurance Corporation of India, Specified Undertaking of the Unit Trust of India (SUUTI) and Bain Capital, who have their nominee directors on the board, are endorsing and rewarding such performance, it is time the banking regulator stepped in and restructured the board before further calamities are inflicted by this management.

DISCLOSURE & CERTIFICATION

I, Hemindra Hazari, am a registered Research Analyst with the Securities and Exchange Board of India (Registration No. INH000000594) I have no exposure to Axis Bank referenced in this Insight. Views expressed in this Insight accurately reflect my personal opinion about the referenced securities and issuers and/or other subject matter as appropriate. This Insight does not contain and is not based on any non-public, material information. To the best of my knowledge, the views expressed in this Insight comply with Indian law as well as applicable law in the country from which it is posted. I have not been commissioned to write this Insight or hold any specific opinion on the securities referenced therein. This Insight is for informational purposes only and is not intended to provide financial, investment or other professional advice. It should not be construed as an offer to sell, a solicitation of an offer to buy, or a recommendation for any security.

Augean Stables Await the New Appointee at Axis Bank

SEPTEMBER 10, 2018.

Finally, putting speculation to rest, in the evening of September 8, 2018, Axis Bank announced that the Reserve Bank of India, had approved Amitabh Chaudhry, the Chief Executive Officer (CEO) of HDFC Standard Life as the CEO of Axis Bank for a three-year term from January 1, 2019 till December 31, 2021. To address the critical issues of mismanagement at Axis Bank, it was critical that the new CEO have two attributes. One was to be an outsider, as the senior executive management under Shikha Sharma, the current CEO, had lost credibility. The second was that the new CEO should be a seasoned commercial banker with considerable exposure to managing corporate and retail credit risk and operational risk management. Unfortunately, Amitabh Chaudhry only satisfies the attribute of being an outsider, as he has not been a banker since 2003. It remains a mystery why the Axis Bank board appointed, and the RBI approved, such an individual. His only exposure to commercial banking was early in his career, prior to moving on to investment banking, information technology and finally life insurance. Such an individual will have to either depend on consultants or hire experienced senior and mid-level bankers and directly monitor credit and operational risk. It is these soon to be inducted individuals, working under Chaudhry's instructions who will have to turn around affairs at Axis, and restore confidence in the bank.

At a time when Axis Bank is confronted with serious issues of corporate asset quality, lack of competent commercial banking leadership and poor operational risk management, the board and the regulator have decided to select an individual with limited commercial banking experience, but who has successfully delivered on the initial public listing (IPO) of HDFC Standard Life Insurance. It is an uphill task for Amitabh Chaudhry, the CEO of HDFC Life Insurance. It is reminiscent of the time when P.J. Nayak, a former bureaucrat with a lack of commercial banking, took charge at the then UTI Bank (later renamed Axis Bank) in January 2000. At the time, the bank was facing severe asset quality and capital adequacy issues, but Nayak was able to successfully turn around the bank.

For Amitabh Chaudhry to be successful, he has to totally revamp the bank and restructure the executive management, especially the entire corporate credit team and operational risk management, which had been exposed for failing to follow Know Your Customer (KYC) regulations, leading to money laundering. Accounting transparency and integrity has also to be improved, as the bank has been found by the regulator to have mis-reported two consecutive years of accounts (FY2016 and FY2017). To restore confidence, the heads which immediately have to roll are those of V. Srinivasan, the deputy managing director and in-charge of corporate credit since 2009, and Jairam Sridharan, the Chief Financial Officer (CFO).

Since Amitabh Chaudhry has limited commercial banking experience, he needs to urgently induct experienced commercial bankers on the board of directors and in senior and mid-level management. The present board of directors has only a single former commercial banker, S. Visvanathan, the former managing director of State Bank of India (SBI). None of the executive directors, including Shikha Sharma and the deputy managing director, had ever worked in a bank branch or in core commercial banking activities prior to joining Axis Bank. There lies the severe lack of commercial banking expertise in the senior management of Axis Bank, and the induction of Amitabh Chaudhry is unlikely to change it.

Not only will Chaudhry have to deal with the huge and poor quality corporate exposures taken by the bank under the leadership of Shikha Sharma, which are likely to erode the bank's capital base (Tier-1 capital of Rs 700 bn and net NPAs of Rs 149 bn in 1QFY2019), but he has also to instil systems and install experienced bankers to prevent any future recurrence. The turn-around, if successful, will take a while, and the bank will need to add quality assets to compensate for the high provisioning required for its poor corporate asset quality. Moreover, the high growth in retail assets also requires careful monitoring, as it is taking place in an environment of poor employment growth with layoffs in the information technology and telecommunication sectors. If the retail asset quality starts rapidly deteriorating, Chaudhry will have a full blown crisis on his hands.

A far more difficult task for Chaudhry will be to drastically change and improve the culture introduced by Shikha Sharma in the bank, which focused on meeting asset and revenue targets while negating the importance of KYC, credit appraisal and monitoring and compliance -- the very backbone of commercial banking. The management style has to be more participative, more co-operative with constant and regular interaction with the 3,799 branches and less top-down with less stringent revenue targets.

Work Experience of Amitabh Chaudhry

Mr. Amitabh Chaudhry, age 54 years, is the Managing Director & CEO of HDFC Standard Life Insurance Company Ltd ("HDFC Life"). He has been associated with HDFC Life since January 2010.

Mr. Chaudhry started his career in the Corporate Banking with Bank of America in 1987, where he worked in diverse roles ranging from Country Finance Officer, Head of Wholesale and GCMG Finance in Asia Division and thereafter as Managing Director and Head Technology Investment Banking, Asia. Mr. Chaudhry was also associated with CALYON Bank (formerly Credit Lyonnais Securities Asia (CLSA), as its Managing Director, Head South East Asian Investment Banking and Head Technology Investment Banking.

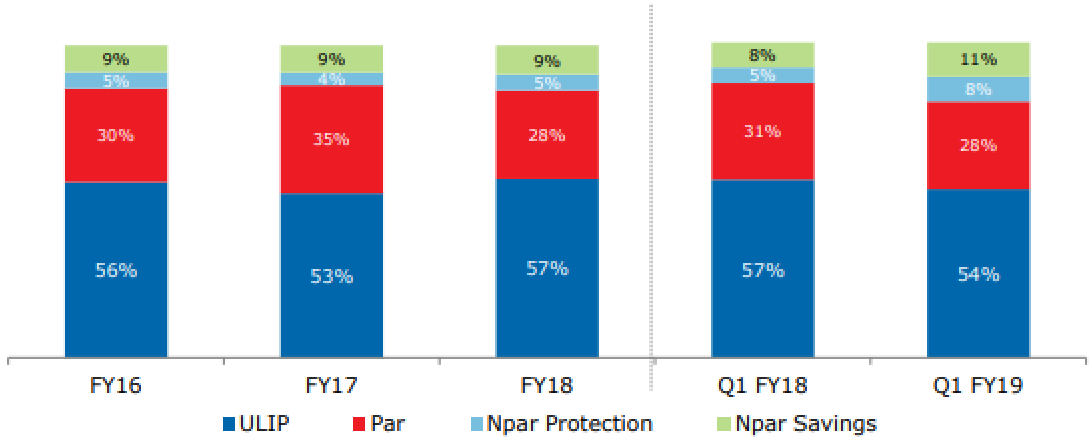
Prior to joining HDFC Life, he joined Infosys BPO Ltd. in 2003 and was elevated as its Managing Director & CEO in 2006. He was also Head - Independent Validation & Testing Unit (IVS) of Infosys Technologies Ltd

Mr. Chaudhry is a B. Tech in (Electronic & Electricals) from the Birla Institute of Technology & Science, Pilani and is an alumnus of Indian Institute of Management, Ahmedabad

Source: Axis Bank

It would have been better if the Axis Bank board of directors had selected a contemporary and seasoned commercial banker with considerable experience in corporate credit, bad debt recovery and overall risk management. Amitabh Chaudhry's experience with commercial banking was early in his career, that too in a foreign bank which has limited banking operations in India as compared with the full-fledged operations of Axis Bank. He then moved onto investment banking and financial technology prior to taking charge at HDFC Standard Life Insurance. His success at HDFC Standard Life and its IPO was with a strategy of focusing on Unit-linked Insurance Plan (ULIP), which is more of a mutual fund product with negligible life insurance. Such a strategy supported by a favourable capital market resulted in rapid business growth, resulting in the current valuation of the company. In 2009, the Axis Bank board, contrary to P J Nayak's recommendation, selected Shikha Sharma, the then CEO on ICICI Prudential Life Insurance as Axis Bank CEO. In hindsight, the selection of an individual with a complete lack of commercial banking experience resulted in the present crisis at the bank.

HDFC Standard Life Product Mix – Annual Premium Equivalent



Source: [HDFC Standard Life Insurance]()

Despite his relative lack of experience in commercial banking, if Amitabh Chaudhry is able to remove the coterie appointed by Shikha Sharma, inducts seasoned commercial bankers on the board and in the senior and mid-level management, and adopts a hands-on approach towards credit and operational risk management, then, like P.J. Nayak, he may be successful in turning around Axis Bank during this tumultuous phase. Shareholders are perhaps fortunate that the board did not select an insider, and they can only hope for better times under the leadership of Amitabh Chaudhry.

Axis Bank Board's Motto: Trust Only in Strangers

APRIL 11, 2019.

The Reserve Bank of India's (RBI) approval of the selection of Amitabh Chaudhry, the then HDFC Standard Life Insurance Chief Executive Officer (CEO), as the Axis Bank CEO on August 8, 2018, and his taking charge on January 1, 2019, were celebrated by the market. Analysts and the media were also favourably inclined towards his lateral new hires in the senior management, all of whom had spent many years in HDFC Bank. Unfortunately, these developments actually revealed a strategic fault line in the organisation. The Axis Bank board in its quarter century of existence has not only failed to groom internal candidates for the top-most job, but also recently has been unable to nurture or to trust internal candidates being appointed as executive directors and other critical posts (exception of Chief Risk Officer) in senior management. Recently, it has announced a voluntary retirement scheme which is virtually devoid of benefits to the retiring personnel; over 50 senior management personnel are being eased out at the end of April 2019 with little more than Mediclaim and unexercised stock options to show for their years of service. Such a step is likely to send demoralising tremors down the entire organisation. When the board of Axis Bank believes that only outsiders can be trusted in critical posts in senior management, and these posts are denied to the in-house cadre, how can the bank achieve the present CEO's performance objectives of a sustainable ROE of 18% and doubling the market capitalisation?

When Axis Bank (then called UTI Bank) commenced operations on April 2, 1994, the first CEO was Supriya Gupta, the former deputy managing director of State Bank of India (SBI). In his prior assignment, he was the CEO of the then State Bank of Bikaner and Jaipur (SBBJ) (since merged with SBI), so most of the officers he brought in came from either that bank or from the SBI group. When he retired on December 31, 1999, the bank was under stress from poor asset quality and capital adequacy (in FY2000 the bank reported net NPA of 4.7% and tier-1 capital of 7.99%), and the board decided to select P.J. Nayak, a non-banker who was then serving as the Executive Trustee with the founder, Unit Trust of India, as the chairman and CEO of the bank. Prior to that Nayak was a civil servant with the Indian Administrative Service (IAS). It was apparent that in the first 6 years of its existence, the bank had either not groomed an internal candidate to succeed Gupta or the board did not find anyone suitable for the job.

Nine years later, the time had come for Nayak to step down, but by that time the bank was on a far stronger footing (FY2009 net NPAs at 0.4% and tier-1 capital of 9.3%). However, in a stormy board meeting, the board did not agree to Nayak's choice of an internal candidate to succeed him, and instead it selected Shikha Sharma, the then CEO of ICICI Prudential Life Insurance, who had negligible commercial banking experience, as his successor. Here again Axis Bank failed to place trust in a cadre of senior leaders to hold the reins of executive management.

Executive Board Directors, CFOs & CRO Axis Bank Since FY2009

	FY2009	FY2010	FY2011	FY2012	FY2013	FY2014	FY2015	FY2016	FY2017	FY2018	FY2019
Executive Board Members											
CEO	P J Nayak	Shikha Sharma	Shikha Sharma	Shikha Sharma	Shikha Sharma	Shikha Sharma	Shikha Sharma	Shikha Sharma	Shikha Sharma	Shikha Sharma	Amitabh Chaudhry
Executive Director	-	-	-	-	V Srinivasan	V Srinivasan	V Srinivasan	V Srinivasan	V Srinivasan	V Srinivasan	-
Executive Director	-	M M Aggrawal	S K Chakrabarti	-	Somnath Sengupta	Somnath Sengupta	Somnath Sengupta	Rajesh Dahiya	Rajesh Dahiya	Rajesh Dahiya	Rajesh Dahiya
Executive Director	-	-	-	-	-	-	-	Rajiv Anand	Rajiv Anand	Rajiv Anand	Rajiv Anand
Non-Board Members											
Chief Financial Officer	Somnath Sengupta	Somnath Sengupta	Somnath Sengupta	Somnath Sengupta	Sanjeev K Gupta	Sanjeev K Gupta	Sanjeev K Gupta	Jairam Sridharan	Jairam Sridharan	Jairam Sridharan	Jairam Sridharan
Chief Risk Officer	-	Bapi Munshi	Bapi Munshi	Bapi Munshi	Bapi Munshi	Bapi Munshi	Bapi Munshi	Cyril Anand	Cyril Anand	Cyril Anand	Cyril Anand

Highlighted in blue are long-serving individuals in Axis Bank cadre
Source: Axis Bank.

Unlike Nayak, who selectively inducted specialised expertise from outside, but generally relied on the internal cadre of officers for leadership positions, Sharma brought in outsiders. Some were former associates of hers from ICICI Bank like V. Srinivasan (in-charge of corporate credit), Jairam Sridharan (retail credit & subsequently CFO) and Rajesh Dahiya (human resources) from the Tata corporate group. Pertinently, since Sanjeev Gupta resigned after a brief stint on the board sometime in FY2016, Axis Bank has not elevated any long serving Axis Bank cadre officer to the board. During Sharma's leadership, outside appointees like Srinivasan, Dahiya and Anand (who had joined Axis Bank just prior to her appointment) were elevated as executive directors to the board. All the executive directors on the board post the resignation of Somnath Sengupta and Sanjeev Gupta, including Shikha Sharma, had never worked in a bank branch and had negligible commercial banking experience. It was therefore no surprise that under her reign, corporate credit, operational risk management and corporate governance sharply deteriorated. When the regulator declined to renew her term as CEO in April 2018, the board again chose an outsider and rejected individuals in her coterie to succeed her.

Outsiders Recruited in Senior Management of Axis Bank

Name	Designation on Joining Axis Bank/Group	Joined in	From
P J Nayak	Chairman & CEO	Jan 2000	UTI, IAS
Shikha Sharma	CEO	June 2009	ICICI Prudential Life, ICICI Bank
V Srinivasan	ED - Corporate Banking	FY2010	JP Morgan, ICICI Bank
Rajesh Dahiya	President - Human Resources	FY2011	Tata Sons
Rajiv Anand	CEO Axis Asset Mgt.	FY2010	Standard Chartered Bank
Jairam Sridharan	Senior Vice President	Jun 2010	Capital One, ICICI Bank
Amitabh Chaudhry	CEO	Jan 2019	HDFC Standard Life Insurance
Deepak Maheshwari	Group Executive - Chief Credit Officer	Jan 2019	Federal Bank, HDFC Bank
Ravi Narayanan	President - Head Branch Banking	Feb 2019	HDFC Bank
Ganesh Sankaran	Group Executive - Wholesale Banking	Mar 2019	Federal Bank, HDFC Bank
Pralay Mondal	Group Executive - Retail Banking	Apr 2019	Yes Bank, HDFC Bank

Source: Axis Bank

The arrival of Chaudhry as CEO is a "déjà vu all over again" moment for the bank, as his first major act was to induct outside individuals in senior management who have had a long prior association with HDFC Bank. While Sharma preferred to induct outsiders from ICICI Bank, Chaudhry has a preference for HDFC Bank. Both of them, with the endorsement of the board, had little faith in selecting Axis Bank's long serving internal officer cadre for critical posts (exception of Chief Risk Officer) in the bank, as a stepping stone for executive board slots and for future succession planning.

The second major act of Chaudhry was to undertake a restructuring and coerce around 50-70+ senior management staff (executive vice presidents, senior vice presidents and vice-presidents) to take early retirement, without providing them any benefits. Shikha Sharma had also done a similar exercise , but that was some years after taking charge.

The inability of the board in 25 years of existence to select internal candidates as CEOs, or even groom them as executive directors, is a strategic failure in succession planning and management. Either the new CEOs since 2009 prefer to recruit outsiders without first evaluating the potential of the in-house senior management, or the in-house cadre of senior managers at Axis Bank is inherently of doubtful quality, which reflects extremely poorly on the management and human resource training.

Whatever may be the reason, the fact is that Axis Bank is a commercial bank, and not an investment bank, which requires a considerable number of its 60,000+ staff to be motivated to deliver on performance. Furthermore, the forced early retirement scheme, without any benefits to some of the senior management being shifted out, is likely to further lower the morale of the rank and file. If the officer cadre believes, based on the past 25 years of existence and recent announcements, that they can neither aspire for the CEO's post nor for an executive director's post nor for any other important post in the bank, and these will be reserved for outsiders, how can they be motivated to improve the performance of the bank and achieve the current CEO's objective of doubling the market capitalisation and attaining a sustainable ROE of 18%?

Exclusive: RBI's Risk Assessment Reports on Axis Bank: Missing the Forest for the Trees

JULY 9, 2019

This article was originally published in Moneylife.

On 26 June 2019, confronted with a contempt petition filed in the Supreme Court of India by Right to Information Act, 2005 (RTI) activist, Girish Mittal, the Reserve Bank of India (RBI) finally disclosed the hitherto confidential annual inspection reports, called risk assessment reports (RARs), of select banks for the years FY2013, FY2014 and FY2015.

These are State Bank of India, Axis Bank, ICICI Bank and HDFC Bank.

The RAR, conducted by the RBI after the end of the financial year, is a comprehensive document about its assessment of the bank for that year. T**he RBI grades every bank with a rating from 1 to 4, with 4 being the worst and 1 the best.**

The RBI collects considerable material from banks, which is fed into a model that is weighted, and calculates a risk number. Neither the weightage nor the detailed calculation is disclosed to the banks. After discussing the draft report with senior management prior to its finalisation, the RBI has the final word and the bank has to show signs of improvement in the subsequent year on the weaknesses highlighted in the report. In this article we evaluate the RBI's RAR of Axis Bank in FY2013, FY2014 and FY2015.

Axis Bank: RBI Risk Assessment Report

	FY2013	FY2014	FY2015
Risk Category			
Board	2.200	1.650	1.732
Senior Management	2.289	1.924	1.984
Risk Governance	2.380	2.489	2.021
Internal Audit	1.993	1.560	1.902
Credit Risk	2.360	2.346	2.377
Market Risk	2.553	2.168	2.062
Liquidity	2.147	2.475	2.190
Operational (non-IT) Risk	2.423	2.072	2.283
Operational (IT) Risk	2.187	1.917	1.748
Other Pillar II Risk	1.610	1.566	1.449
Business Risk	-	-	2.194
Bank Level Aggregate Risk	**2.301**	2.175	2.151
RBI Comment	**High Risk**	-	-
Note: Colour code not in original RBI RAR			

Note: RBI sourced via RTI

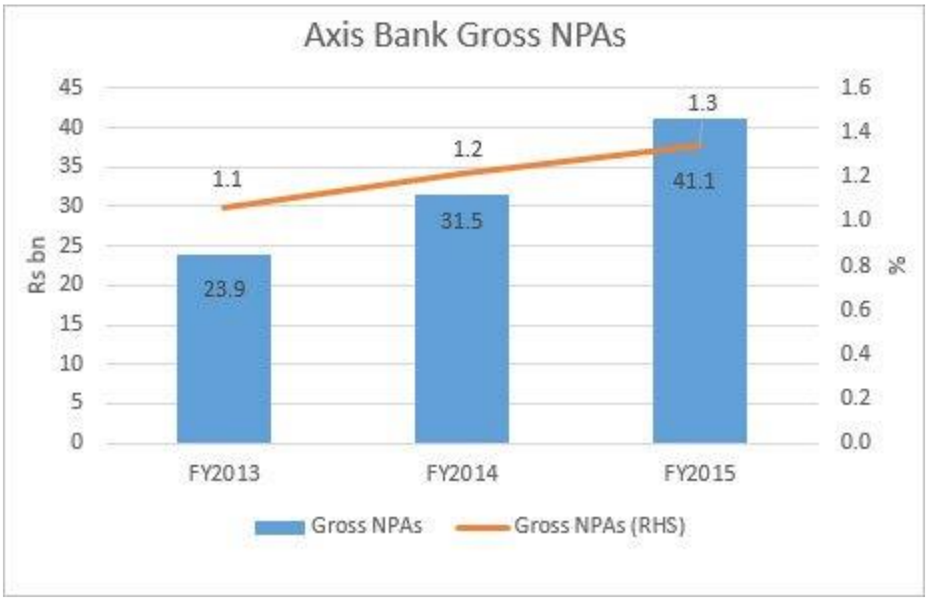
The RBI's RAR of Axis Bank for FY2013 presents a poor portrayal of the bank's governance, leadership and banking ability. The core skill of managing a bank is risk management, and the banking supervisor was of the view that this critical area needed to be "toned up". According to the RBI, the business and control heads were working in segregated silos and "did not ensure that issues were brought before the relevant committees" for intensive examination and for guidance.

The RBI's rating for risk governance, at 2.38, was even higher than the already high risk rating of 2.301 for the overall aggregate risk for the bank, which indicates how poor risk governance was at Axis Bank. Credit risk, at 2.36, was marginally better than risk governance, but nevertheless still higher than aggregate risk. The RBI found "major weakness in the quality of credit appraisal," as there was a shortfall in the valuation of securities at the time of settlement, as compared to valuation at the time of sanction and origination, which pointed to lax collateral management.

The division which had the highest risk in the bank was market/treasury, at a very alarming 2.553. This division appears to have been mis-managed, as it had incurred operating losses on a standalone basis for 4 of the previous 5 years, and the bank's internal systems did not separately identify income from treasury and from the bank's internal customers through transfer pricing. There was also no independent verification of achievement of targets by treasury dealers. The bank did not maintain or monitor individual profit and loss for individual dealers. Worse, no disciplinary track record was incorporated in dealers' performance appraisal in terms of breaches in risk limits.

A bank's treasury is an extremely sensitive, sanitised and restrictive area, but Axis Bank's treasury was apparently porous. The dealers extensively used Reuters Messenger (RM) which had "no audit trail and no oversight", and the bank did not have a policy for its use.

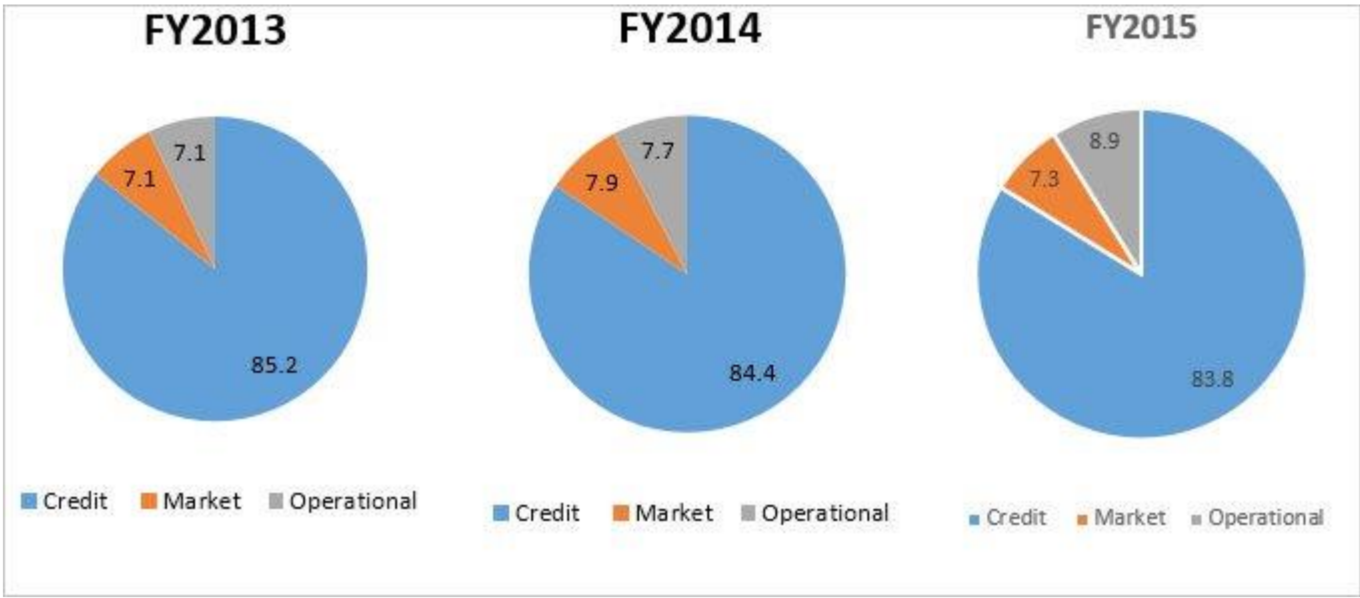
In a violation of RBI policies, it was used as a primary means of communication with external customers in negotiations for pricing of deals. In both the derivatives and foreign exchange treasuries, there was no separate inter-bank desk and customers' desk, resulting in "inter-bank dealers communicating directly with external customers". The trading book and derivatives book were also headed by the same individual.



Source: Axis Bank

Despite Axis Bank reporting low gross NPAs, between 1.1%-1.3%, in the FY2013-FY2015 period, RBI's RAR reveals that it was concerned with the credit risk at the bank. What is peculiar in the RBI RAR for Axis Bank over the 3 years is that, while the aggregate bank rating improved from 2.301 in FY2013 to 2.175 in FY2014 and to 2.151 in FY2015, the all-important credit risk rating only marginally improved from 2.36 in FY2013 to 2.346 in FY2014, and then deteriorated to 2.377 in FY2015. To grasp the significance of this, we need to note that in Indian banks, credit risk is the major risk, indeed it constitutes the overwhelming majority of risk weighted assets. In Axis Bank for FY2013, FY2014 and FY2015 credit risk assets were 85.2%, 84.4% and 83.8% respectively of total risk weighted assets. With the credit risk rating persistently remaining above 2.3, which the RBI considers high-risk, and credit forming the overwhelming bulk of risk weighted assets, it is puzzling for the aggregate risk rating of Axis Bank to have improved.

Axis Bank: Composition of Risk Weighted Assets



Source: Axis Bank Annual Reports

What is even more unusual is that it is the responsibility of senior management and the board of directors to monitor credit risk. Hence the credit rating risk score should be mirrored in the score given to the board and to the senior management. However, while credit risk remains poor, there is a significant improvement in the risk rating of the board and the senior management in FY2014 as compared with FY2013, prior to deteriorating in FY2015. While the credit risk score in FY2015 is worse than in FY2013, the score given to the board and senior management in FY2015 is significantly better than in FY2013.

The public and the stock market are now well aware from events post-FY2015 that it was the major mismanagement in the bank's corporate loans which impacted the bank performance and along with other issues of operational risk and integrity of accounts contributed to the truncating of the fourth term of former managing director and CEO, Shikha Sharma.

There is therefore an obvious flaw in the RBI's rating of the board and the senior management in its RAR, as it appears to be delinked from the credit risk score. One hopes that the RBI has corrected this from

FY2016 onwards. Another critical shortfall in RBI's RAR of Axis Bank for these years is its inability to comment on and rectify the strategic weakness in the Axis Bank board, which contributed to its poor performance and finally to the removal of its CEO, Shikha Sharma, by the banking regulator.

In all 3 years of Axis Bank inspection reports, while commenting on certain issues of the board pertaining to nominees of SUUTI (Special Undertaking Unit Trust of India) and Life Insurance Corporation (LIC) and certain other issues, the banking supervisor failed to highlight the elephant in the boardroom, namely the negligible commercial banking and corporate credit expertise on the board of directors of a prominent private sector commercial bank.

Nomination & Remuneration Committee of Axis Bank

	FY2013	FY2014	FY2015
Chairman	Prasad R Menon	Prasad R Menon	Prasad R Menon
Member	KN Prithviraj	KN Prithviraj	KN Prithviraj
Member	VR Kaundinya	VR Kaundinya	VR Kaundinya
Member	Samir K Barua	Samir K Barua	Samir K Barua

Note: In FY2013 & FY2014 Nominations Committee was separate, chaired by SB Mathur with Kaundinya & Barua as members. In FY2015 both committees were merged.
Source: Axis Bank

One of the many shortcomings of Ms Sharma and the Nominations and Remuneration Committee (chaired by Prasad R Menon) was their inability to select seasoned commercial bankers, well versed in corporate credit as directors on the board. Axis Bank was practically unique amongst commercial banks in India in that, during FY2013-FY2015, barring Somnath Sengupta (executive director, October 2012 – 2014) and his successor, Sanjeev K Gupta (ED & CFO only in FY2015, as he too, like Mr Sengupta, took early retirement) none of the executive directors had exposure to commercial banking, nor had they managed corporate credit or worked in a bank branch prior to their appointment in Axis Bank.

Ms Sharma, appointed as CEO in June 2009, had a background in life insurance, investment banking and retail finance with the ICICI group. V Srinivasan, prior to his appointment in Axis Bank in 2009, had a background in investment banking, fixed income, treasury and foreign exchange. Debt and treasury management has limited corporate credit exposure, as it deals in highly rated credit instruments requiring negligible credit assessment and credit monitoring skills. In the three years under examination, Axis Bank's board of directors consisted of 13-14 members, and in each of those years, at best the board had only three (two in FY2013 and FY2014) experienced commercial bankers, one of whom was a non-executive director. Apart from the executive directors, the only non-executive directors who had commercial banking experience were KN Prithviraj and V Visvanathan (from FY2015). From FY2016 onwards it got worse, with V. Visvanathan (independent director) being the sole board member having commercial banking and corporate credit expertise; with the early departures of Mr Sengupta and Sanjeev

Gupta the new executive directors such as Rajesh Dahiya (exposure to general corporate management) and Rajiv Anand (background in investment management and treasury) lacked commercial banking and corporate credit expertise.

In the light of recent events in Yes Bank and in many government banks, we can see that, even though the inclusion of experienced commercial bankers on the board of directors is not a foolproof mechanism for prudent credit risk management, a negligible and token presence of such expertise on the board of a bank is a major red flag.

It is apparent, that the RBI did not consider the lack of commercial banking and corporate credit expertise on the board of a prominent private sector bank as a major risk factor which needed to be addressed – this in a bank which had 84% of its risk weighted assets in credit and 45% (FY2015) of total credit in corporate credit. This was all the more important when the RBI had given Axis Bank a high risk credit score exceeding 2.3 in all the 3 years. It appears that the board, especially its NRC, was oblivious to the need to get experienced bankers on the board in order to rectify the high risk credit score that RBI RARs were giving the bank.

Unfortunately for Axis Bank shareholders, the board of directors, and the banking supervisor's inability to address this gaping and visible hole, contributed to the bank's corporate credit quality rapidly deteriorating.

In FY2013, the operational (non-IT) risk was 2.423, which indicates high risk, and the RBI observed the bank had a high turnover of staff, e.g. while the bank recruited 15,217 employees, 9,033 staff quit the bank, and at the entry level, and in the sales and front office, attrition rose significantly. The sales culture has put tremendous pressure on the front office to sell financial products, and in the industry, at the base level, there appears to be high turnover, as staff move to other banks in an attempt to escape the pressure.

The RBI also noted the high and rising incidences of both internal (staff) and external (customers) fraud. It also noted that the bank had deemphasised staff training, as expenditure allocated was low. Although the rating improved over the next 2 years, it became a major issue during demonetisation, when bank staff were arrested for money laundering.

In FY2014, the RBI's RAR scored the bank's liquidity risk at 2.475, as it was concerned with the bank's dependence on short-term funds and volatile CASA (current and saving accounts) deposits; the bank's average cost of term deposits was higher than the median and average rate offered by major banks in the market. The bank's liquidity was also constrained due to its reliance on top depositors for funding short-term 14-day liquidating assets. Since the liquidity risk rating improved to 2.19 in FY2015, it appears the bank addressed the issue. The objective of RBI's RARs of banks is to highlight the weaknesses and improve upon the risk management of the bank. Contrary to capital market expectation, banks are in the business of managing risk and not only to maximise profits.

In the context of the three years of Axis Bank's RAR being made available to the public via the RTI, one should credit RBI with having correctly identified the poor credit risk management of the bank from

FY2013 to FY2015. However, the role of the banking supervisor is to also identify the accountability for the same and monitor its improvement.

In Axis Bank the RBI not only failed to hold the board of directors and the senior management responsible, but gave the board and the senior management a better aggregate risk score in FY2015 as compared with FY2013, while showing a worsening score for credit risk for those years.

Shockingly, the RBI inspectors were also unable to see the strategic risk in the composition of the Axis Bank board of directors and the virtual non-existence of commercial banking and corporate credit expertise at the top. Events since FY2015 have clearly revealed the failure of the Axis Bank board and its senior management in managing credit, operational risk and the integrity of the financial accounts. The RBI too has to accept responsibility for failing to act and to restructure the board at the necessary time. In this sense, then, the RBI RARs of Axis Bank, though interesting for students of banking, misses the forest for the trees.

RBI Confidential Reports Reveal a Gulf between Axis Bank Annual Reports and Reality

JULY 15, 2019.

Under the threat of being pulled up for contempt of court by the Supreme Court of India, the Reserve Bank of India (RBI) finally disclosed the confidential inspection reports, called Risk Assessment Reports, of some banks requested under the Right to Information Act (RTI), 2005. The reports, though dated (from FY2013 till FY2015), provide a valuable insight into the actual working of banks, at times in contrast to the management's commentary to shareholders at that time. In the case of Axis Bank, the divergence of views of the management and the banking supervisor is evident. Many in the sell-side and business media tend to regard management's commentary with reverence, and these supposed sentinels regurgitate the same to their clients and the public without the rigour of critical evaluation. The now public disclosures of the RARs of banks is a rude wake-up call to these watchpersons to thoroughly scrutinize and challenge audited accounts and management commentary. Media reports cite that Axis Bank may be considering a US$ 1.3 bn equity issue, and although a new CEO has taken charge, investors may well want to exercise caution regarding management commentary in light of the RARs that have been made public.

RBI's RAR Scores for Axis Bank

	FY2013	FY2014	FY2015
Risk Category			
Board	2.200	1.650	1.732
Senior Management	2.289	1.924	1.984
Risk Governance	2.380	2.489	2.021
Internal Audit	1.993	1.560	1.902
Credit Risk	2.360	2.346	2.377
Market Risk	2.553	2.168	2.062
Liquidity	2.147	2.475	2.190
Operational (non-IT) Risk	2.423	2.072	2.283
Operational (IT) Risk	2.187	1.917	1.748
Other Pillar II Risk	1.610	1.566	1.449
Business Risk	-	-	2.194
Bank Level Aggregate Risk	2.301	2.175	2.151
RBI Comment	High Risk	-	-
Note: Colour code not in original RBI RAR			

Source: RBI sourced from RTI

The RBI Risk Assessment Reports (RARs) of banks examine the risk that banks have to manage. Voluminous data is provided to the RBI which is fed into a model, which weights it and gives the bank a risk score between 1 to 4 (where 4 is the worst while 1 is the best). The weights and the calculation of the score are not disclosed to the banks.

In an article published on July 9, 2019, this writer had highlighted the consistently high credit risk score that the RBI had given Axis Bank in all the 3 years FY2013 to FY2015. The article pointed out the inability of the bank and the banking supervisor to fix accountability on the board of directors and senior management, and to rectify their inherent weaknesses in corporate credit and commercial banking expertise. In the present insight, this writer compares the RBI's comments on the bank's risk management with what the bank at that point in time conveyed to shareholders.

In Axis Bank's FY2013 annual report, the bank informs shareholders the following regarding the bank's treasury/market risk management,

> "The Bank adopts a comprehensive approach to market risk management for its banking book as well as trading book for both its domestic and overseas operations…Market risk management is guided by well laid policies, guidelines, processes and systems for the identification, measurement, monitoring and reporting of exposures against various risk limits set in accordance with the risk appetite of the Bank." p. 23

> "There is a functional separation between the Treasury Front Office, Risk and Treasury Back Office to undertake derivative transactions. The derivative transactions are originated by Treasury Front Office, which ensures compliance with the trade origination requirements as per the Bank's policy and the RBI guidelines." p. 65

In contrast to the impression of comprehensive, well-organised treasury systems that the management of Axis Bank conveys to shareholders, the RBI made some severe comments regarding the bank's treasury and its internal systems. Indeed, as per the RBI, the bank's treasury/market risk, at 2.553, had the highest risk score in FY2013. The RBI RAR states,

> "Under the current mechanism, it was not possible to separately identify the income generated by Treasury from market and that from internal customers through transfer pricing. There was no independent verification of achievement of targets by Treasury dealers."

> "The bank did not calculate and monitor dealer wise P&L. Since the individual dealers' business targets were not shared with control departments, there was no validation of allocation of incentives to dealers by the Head, Treasury based on the actual performance of individual dealer. Moreover, the bank didn't incorporate the disciplinary record of the dealers in terms of risk limit breaches, etc. into their overall performance evaluation."

> "The dealers widely used, apart from other tools, the Reuters Messenger (RM) which had no audit trail and no independent oversight. The bank didn't have any policy regarding use of RM chat facilities in dealing operations as this represented another mode of communication with external customers for negotiation of pricing, and regarding primary record of the transactions for such facilities, in violation of RBI instructions"

> "There was no separation between inter-bank desk and customer desk in derivatives resulting in inter-bank dealers communicating directly with corporate customers. In FX desk

> as well, the reporting lines for inter-bank desk and corporate desk were the same. Similarly, the trading book and the derivatives book were headed by the same person."

With regard to the training and well-being of the staff, the management conveys in its FY2013 annual report a professional culture, on account of the human resources practices adopted.

> "The Bank has built a learning infrastructure to ensure availability of skilled and empowered workforce." p.27
>
> "A young workforce with an average age of 29 years and the Bank's policy of being an equal opportunity employer continues to significantly contribute towards emergence of the Axis Bank brand. The Bank inspires everyone to excel and contribute to, irrespective of gender, race or age, and this echoes in all HR initiatives undertaken." p. 28

The RBI RAR highlights the high turnover of staff, particularly at the entry level, and at the sales and front office. These the management does not highlight, nor even comment on.

> "5.1.2 While the bank recruited 15,217 employees on one hand, 9,033 employees had also quit bank. The turnover at base level was high. The attrition rate of the Sales and Front Officers increased significantly during FY-2013.
>
> 5.1.3 The employee training expenditure vis-à-vis total operating expenditure was very low and it declined during FY-13."

The fact that the staff training expenditure was extremely low, and that as a percentage of operating expenditure it declined in FY2013, were worrying developments for a bank. Such practices can contribute to high operational risk, and reflect the extent of management commitment to setting up infrastructure of a skilled work force.

The RBI's RAR states that there was no defined policy for rotation of employees posted in sensitive desks. In banks, such a policy is mandatory to prevent fraud.

> "5.2.4 There was no defined policy for rotation of employees posted in sensitive desks at the corporate office. There were 2,727 employees eligible for rotation but continuing in the same role for more than 3 years including 455 employees for more than 5 years. There were 8,020 employees who had not availed mandatory leave."

In the bank's FY2014 annual report, liquidity is not considered to be a concern:

> "Bank is in a position to meet its daily liquidity obligations as well as to withstand a period of liquidity stress from, bank-wide factors, market-wide factors or a combination of both." p 25

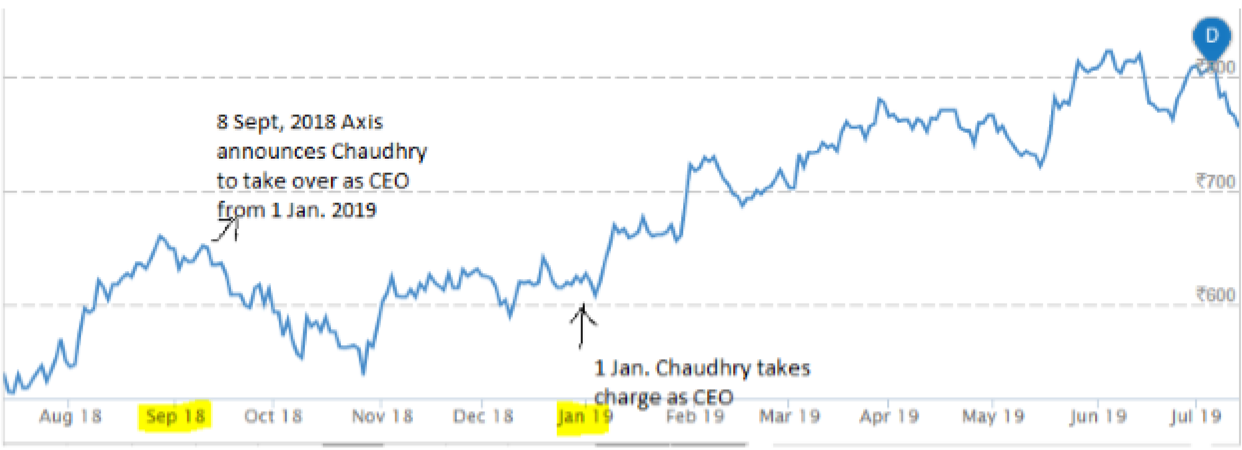
However, the RBI's RAR had considered the bank's liquidity management to be high risk, with a score of 2.475.

> "4.1.2 (a) The bank used a high proportion of short term funding as indicated by its volatile CASA component. (b) The bank was exposed to higher liquidity risk on account of higher proportion of short-term, interest sensitive funds. (c) The bank had high reliance on bulk deposits. (d) The bank's average cost of term deposits was higher than the median rate as well as average rate offered by major banks in the market. The bank's liquidity position was weakened due to reliance on top depositors for funding short term assets that could be liquidated within 14 days. The liquidity available to the bank through unencumbered G-secs was limited and it was hampered due to higher proportion of loans other than demand loans."

As Axis Bank is considering a US$ 1.3 bn equity issue under the new CEO, no doubt aggressive sales targets will have been given to the front office and branches, with the CEO emphasizing his target ROE. What is to be noted is that the Indian economy is dramatically slowing down, and in such an environment growing the balance sheet of a bank may not be the most prudent strategy. What the RBI RAR reports highlight, apart from the major credit risk, is that operational risk management needs considerable improvement.

In the private sector banks there is tremendous pressure on the front office staff to achieve ambitious targets, and that is why there is a high turnover of staff in the industry. However, the new management needs to tighten not only the bank's weak credit risk management, but also the critical operational risk management pertaining to mis-selling of financial products, Know Your Customer (KYC) and Anti-Money Laundering (AML) systems. Otherwise it may suddenly explode, as it did during demonetization, when Axis Bank staff were arrested for money laundering.

Axis Bank 1 Year Share Price History



Source: Moneycontrol

Since Amitabh Chaudhry took charge as Axis Bank's CEO on January 1, 2019, the share price has been up 20%, as compared with a mere 3% increase in the NIFTY-50 index, as the market expects considerable improvement in the bank's future performance. Investors, though, need to take the new management's optimistic outlook with liberal helpings of salt, and critically evaluate the commentary and disclosures. The RBI's RARs provide ample evidence of what may lurk beneath the rosy surface.

Shikha Sharma Rewarded with Prominent Directorships for Mismanagement at Axis Bank

JUNE 18, 2019

On June 14, 2019, Tech Mahindra joined the ranks of Tata Global Beverages, Ambuja Cement and Dr Reddy's in appointing Shikha Sharma as an independent director. Private equity firm KKR had also appointed Sharma as an adviser for their alternative investments. The irony of publicly-owned and listed blue-chip companies eagerly seeking Sharma for the prestigious position of independent director on their boards is that she had a poor track record and an unceremonious exit as chief executive officer (CEO) of Axis Bank. On her watch in Axis Bank, senior management personnel were rewarded for epic mismanagement, poor operational risk controls led to staff being arrested for money laundering, whistle-blowers were persecuted, and accounts for two consecutive years were fudged, which finally led to the banking regulator effectively removing her out as CEO. Any one of these issues should have disqualified her for any prominent position in publicly-owned and listed companies. Indeed, with such an embarrassing exit, the private corporate sector should have boycotted her, but instead she has been welcomed with open arms to join their boards of directors. Her appointments on prestigious boards lays bare how corporate governance is actually practised in India, where a candidate with such a dismal track record is eagerly sought after to grace boards.

On June 14, 2019, Tech Mahindra announced the appointment of Shikha Sharma as an independent director on its board. This followed blue chip companies like Tata Global Beverages, Ambuja Cement and Dr Reddy's appointing her as independent director on their board of directors. Global private equity giant KKR also appointed her as an adviser for their alternative investments. The Reserve Bank of India (RBI), the banking regulator, had over-ruled the Axis Bank board and truncated her fourth term as CEO and her tenure at the bank ended on December 31, 2018, but that did not stop private corporate sector firms in selecting her to join their board of directors.

Indeed, in the notices given to the stock exchanges, no mention is made of how the banking regulator over-ruled the Axis Bank board of directors and effectively removed her as CEO with a truncated fourth term. Instead, Tech Mahindra's notice to the stock exchanges glorified her tenure at Axis Bank and said,

> "She has a rich experience in banking, insurance and has an excellent track record and led the Bank on a transformational journey from being primarily a corporate lender to a bank with a strong retail deposit franchise and a balanced lending book."

Brief Profile of Ms. Shikha Sharma

Ms. Shikha Sharma age 60 years is a B.A (Hons.) in Economics, PGD in Software Technology and PGD from IIM, Ahmedabad. She has rich experience in banking, insurance and has an excellent track record and led the Bank on a transformation journey from being primarily a corporate lender to a bank with a strong retail deposit franchise and a balanced lending book.

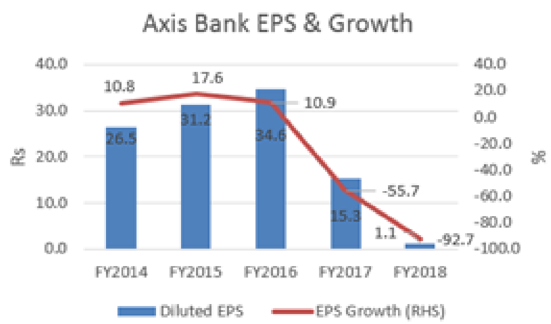
She began her career with ICICI Bank in 1980. She was a MD and CEO of ICICI Personal Financial Services from May 1998 to December 2000. Thereafter, she was Managing Director and CEO of ICICI Prudential Life Insurance Company from December 2000 to June 2009. Later she was appointed as Managing Director and CEO of Axis Bank from June 2009 till December 2018.

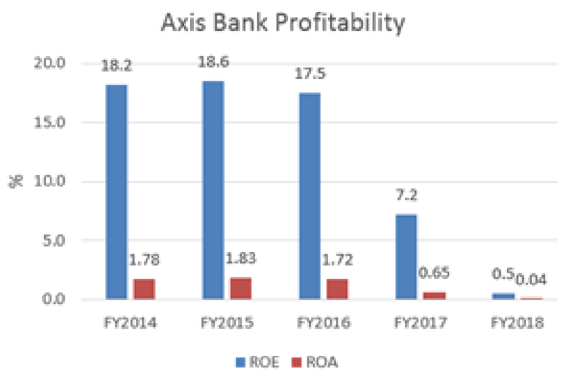
Ms. Sharma has won many awards including Outstanding Businesswoman of the year- CNBC TV18, AIMA JRD TATA Corporate Leadership, Banker of the Year – Business Standard and has been recognised Top 20 Women in Finance by Finance Asia and 50 most powerful women in business by Fortune. She is on the board of directors of public listed companies' viz. TATA Global Beverages Limited, Ambuja Cements Limited and Dr. Reddy's Laboratories Limited. She is also an advisor to KKR & Co. Inc., and a member of Board of Governors of IIM, Lucknow and Advisory Board of Bridgespan.

Ms. Shikha Sharma does not hold shares of the Company.

Tech Mahindra Limited

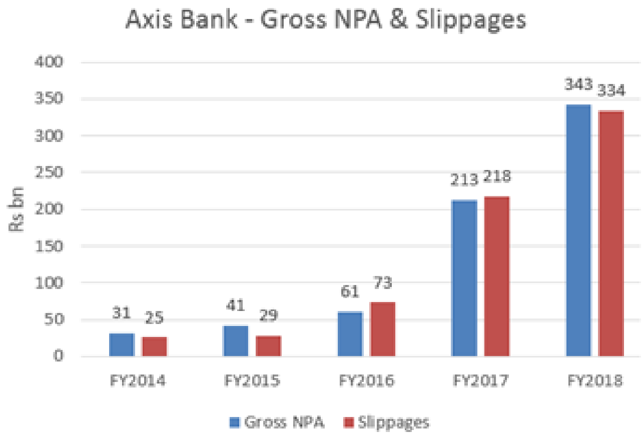
Source: Tech Mahindra

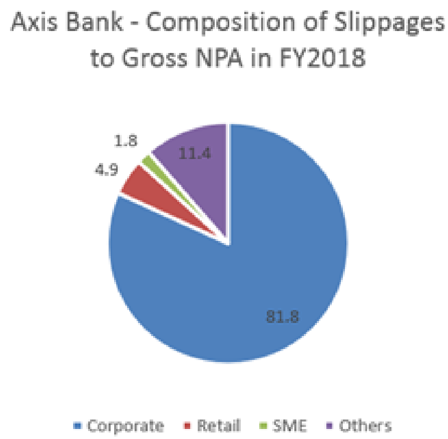




Source: Axis Bank

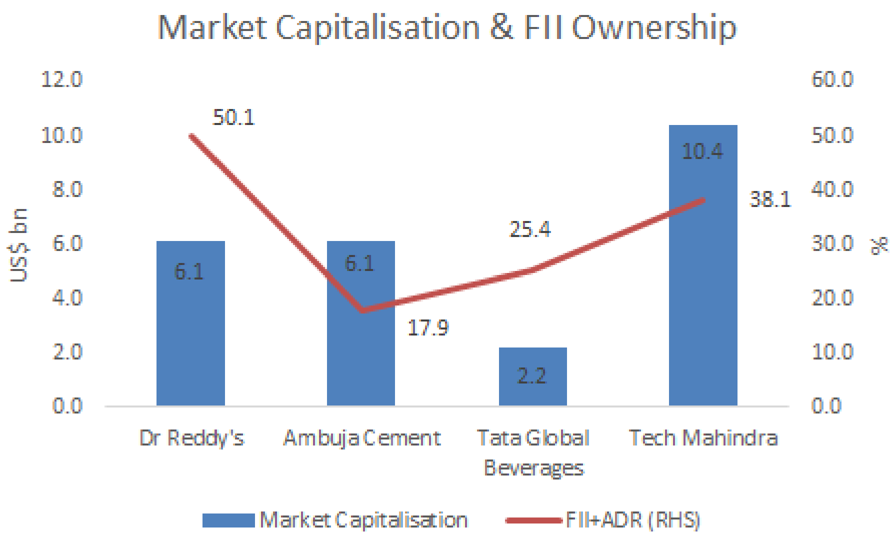
Not only was the performance of Axis Bank pathetic in her final years as CEO, but she was also responsible for a culture which promoted marketing at the cost of poor operational risk controls and lapses in Know Your Customer (KYC) protocols. This resulted in bank staff being arrested for money laundering during demonetisation. Under her leadership, Axis Bank also persecuted whistle-blowers who had attempted to expose such poor practices and fired them using the draconian clause 3.5 of the bank's 'Staff Rules'. This clause enables the bank to terminate the services of an employee without assigning any reason for the termination, thus denying any future employment for the employee in any other entity. Incorporating such harsh measures effectively silences any honest banker from complaining against any regulatory lapses which could disrupt the growth of business.





Source: Axis Bank

If poor financial performance and shortfalls in operational risk management were not bad enough, Axis Bank was hauled up by the regulator for fudging its financial accounts for 2 consecutive years (FY2016 and FY2017) and was even fined by the RBI. Mis-reporting of information is a very serious offence, and as per Section 46(1) of the Banking Regulation Act, 1949 (BRA) wilful mis-reporting by a bank is a criminal offence. The Axis Bank board, instead of sacking a CEO with such a track record of mis-management, rewarded her and the senior management with increments, bonuses and stock options. The board prematurely approved Sharma for a fourth term as CEO, but RBI disallowed it.



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Source: Companies, Moneycontrol

It is an individual with such credentials who is being appointed to publicly-listed companies from prominent business houses like Tata and Mahindra, in firms where foreign institutional ownership is significant. While, in India, elaborate corporate governance practices are adopted, they are followed in form, and not in spirit. However, globally the environmental, social and governance (ESG) movement is gathering steam, and many prominent and large institutional investors closely examine governance practices and institutional investors in these companies may need to re-examine and probe further why these companies selected Shikha Sharma as an independent director.

Non-founder/promoter shareholders holding more than 1%

Dr Reddy's		Ambuja Cement		Tata Global Beverages		Tech Mahindra	
Entity	%	Entity	%	Entity	%	Entity	%
Life Insurance Corporation (LIC)	3.9	LIC	4.9	LIC	1.4	LIC	1.3
First State - Global Emerging Fund	1.4	Govt. of Singapore	1.9	National Pension Trust	1.6	First State - Asia Pac Leaders Fund	4.1
Aditya Birla Sun Life Trustee	2.1	Nomura India Investment Mother Fund	1.2	First State - Global Emerging Fund	2.8	Aditya Birla Sun Life Frontline Equity Fund	1.8
Franklin Templeton Mutual Fund	1.3	Abu Dhabi Investment Authority - Behave	1.0	Mirae Asset	2.7	Government Pension Fund Global	1.5
First State - Asia Pac Leaders Fund	2.9	-	-	Government Pension Fund Global	2.2	ICICI Prudential Balanced Advantage Fund	1.7
-	-	-	-	Reliance Capital Trustee Co Ltd	1.4	Government of Singapore	1.1
-	-	-	-	Sundaram Mutual Fund	1.1	-	-
-	-	-	-	First State - Asia Pac Fund	1.9	-	-
-	-	-	-	First State - Asia Pac Leaders Fund	1.6	-	-
-	-	-	-	Baron Emerging Markets Fund	1.3	-	-

Source: Moneycontrol

	Dr Reddy's	Ambuja Cement	Tata Global Beverages	Tech Mahindra
Promoters/Founders Stake (%)	36	63.5	34.5	35.9
	Nomination & Remuneration Committee of the Board			
Chairman	Anupam Puri	Nasser Munjee	Ranjana Kumar	Ravindra Kulkarni
Member	Kalpana Morparia	N S Sekhsaria	N. Chandrasekaran	Anupam Puri
Member	Bharat N Doshi	Shailesh Haribhakti	V. Leeladhar	Ulhas N. Yargop
Member	Prasad R Menon	Martin Kriegner	Harish Bhat	-
	Shikha Sharma Appointed on the Board			
Date	31 January 2019	01 April 2019	07 May 2019	14 June 2019

Source: Companies

The responsibility for selection of directors is with the Nominations and Remuneration Committee (NRC) of the board, which may be influenced by the promoters/founders of the company. The NRC is one of the most powerful sub-committees of the board, as it evaluates the performance of the executive directors and selects new directors for the board's approval. Interestingly, Dr Reddy's NRC has Kalpana Morparia, CEO, J.P. Morgan India, a former colleague of Shikha Sharma in ICICI Bank, where they both spent the bulk of their careers. Another Dr Reddy's NRC member, Prasad R Menon (a former senior executive of the Tata group), was not only on the board of Axis Bank for many years (he ceased being a director in FY2019) but was also the chairman of Axis Bank's NRC from FY2014, during which period the NRC kept rewarding Shikha Sharma and her senior management team for mismanagement. Prasad R Menon is not the only Tata group connection: Shikha Sharma's husband, Sanjaya Sharma, spent his entire career in the Tata group and retired as a CEO of one of the group companies.

The Indian board room is in reality a club of cronies who recommend one another in companies in which they serve. In the case of Shikha Sharma, despite her pathetic performance as Axis Bank CEO, and even with the banking regulator effectively removing her and holding her accountable for the mismanagement at Axis Bank, prominent blue-chip companies flocked to select her for a board position on their boards. It is time institutional investors concerned with corporate governance best practices wake up and take notice.

DISCLOSURE & CERTIFICATION

I, Hemindra Hazari, am a registered Research Analyst with the Securities and Exchange Board of India (Registration No. INH000000594). I have no position in any of the securities referenced in this note. Views expressed in this note accurately reflect my personal opinion about the referenced securities and issuers and/or other subject matter as appropriate. This note does not contain and is not based on any non-public, material information. To the best of my knowledge, the views expressed in this note comply with Indian law as well as applicable law in the country from which it is posted. I have not been commissioned to write this note or hold any specific opinion on the securities referenced therein. This note is for informational purposes only and is not intended to provide financial, investment or other professional advice. It should not be construed as an offer to sell, a solicitation of an offer to buy, or a recommendation for any security.

Sell-side Selects Serial Misreporter of Axis Bank as 'Best CFO' for Banks in 2019

SEPTEMBER 6, 2019.

The prestigious Institutional Investor 2019 All-Asia ex-Japan Executive Team Awards have been announced. Remarkably, sell-side analysts selected Jairam Sridharan (Axis Bank) as the 'Best CFO [Chief Financial Officer]' in the banking category. This should be deeply troubling to the capital market. In effect, these highly experienced analysts are loudly and proudly proclaiming that a CFO who has a history of certifying two consecutive years of fudged accounts (in FY2016 and FY2017) should be rewarded with the best CFO award. One would expect that when the regulator has exposed a bank's accounts as misleading, not once, but twice under the same CFO, the sell-side would have collectively bayed for his blood. They ought to have demanded his immediate dismissal, as he had misled them. Hence their future estimates, based on their discussions with him, were useless, as were their price targets. But that would be asking for too much from a profession which primarily engages in corporate public relations and corporate access in the guise of research. Fortunately for the capital market, the buy-side were more discerning, and as a result in the overall 'Best CFO' category, Jairam Sridharan did not make it to the top 3.

Institutional Investor 2019 All-Asia ex-Japan Executive Team Awards

OVERALL		BUY-SIDE		SELL-SIDE	
RANK	BEST CEO	RANK	BEST CEO	RANK	BEST CEO
1	**Huiyu Tian,** China Merchants Bank Co.	1	**Mingjian Bi,** China International Capital Corp. (CICC)	1	**Amitabh Chaudhry,** Axis Bank
2	**Mingjian Bi,** China International Capital Corp. (CICC)	2	**Huiyu Tian,** China Merchants Bank Co.	2	**Aditya Puri,** HDFC Bank
3	**Aditya Puri,** HDFC Bank	3	**Aditya Puri,** HDFC Bank	3	**Huiyu Tian,** China Merchants Bank Co.
RANK	BEST CFO	RANK	BEST CFO	RANK	BEST CFO
1	**Hao Li,** China Merchants Bank Co.	1	**King Fung (William) Wong,** China International Capital Corp. (CICC)	1	**Jairam Sridharan,** Axis Bank
2	**King Fung (William) Wong,** China International Capital Corp. (CICC)	2	**Hao Li,** China Merchants Bank Co.	2	**D Arul Selvan,** Cholamandalam Investment and Finance Co.
3	**Sashidhar Jagdishan,** HDFC Bank	3	**Eugene Galbraith,** Bank Central Asia	3	**Hao Li,** China Merchants Bank Co.* **Sashidhar Jagdishan,** HDFC Bank*
RANK	BEST IR PROFESSIONAL	RANK	BEST IR PROFESSIONAL	RANK	BEST IR PROFESSIONAL
1	**Yu Lai,** China Merchants Bank Co.	1	**Yu Lai,** China Merchants Bank Co.	1	**Wenqing Diao,** China Merchants Bank Co.* **Yu Lai,** China Merchants Bank Co.*
2	**Wenqing Diao,** China Merchants Bank Co.	2	**Wenqing Diao,** China Merchants Bank Co.	-	-
3	**Bhavin Lakhpatwala,** HDFC Bank	3	**Rudy Budiardja,** Bank Central Asia	3	**Jini P K,** Cholamandalam Investment and Finance Co.
RANK	BEST INVESTOR RELATIONS PROGRAM	RANK	BEST INVESTOR RELATIONS PROGRAM	RANK	BEST INVESTOR RELATIONS PROGRAM
1	**China Merchants Bank Co.**	1	**China Merchants Bank Co.**	1	**Axis Bank**
2	**HDFC Bank**	2	**China International Capital Corp. (CICC)**	2	**China Merchants Bank Co.**
3	**China International Capital Corp. (CICC)**	3	**HDFC Bank**	3	**Kasikornbank**

Source: *[Institutional Investor Sourced from LinkedIn]*

In this selection, the conduct of the sell-side is telling. In a free market, they are supposed to be the sentinels, warning and punishing errant companies and indicting senior officials for misbehaviour, and especially for fraudulent accounts. More so in India, where the Banking Regulation Act, 1949 considers wilful mis-reporting of information by banks to be a criminal offence punishable with a jail term for the

indicted officials. Sadly, in reality, the sell-side are lapdogs and as this example lucidly illustrates, the sell-side not only fails to bark when it is supposed to but also conveniently suffers from collective amnesia when it comes to garlanding an individual with the 'Best CFO' award.

In two consecutive years of FY2016 and FY2017, when Jairam Sridharan was the CFO, Axis Bank was hauled up by the banking regulator for fudged accounts of under-reporting bad loans and inflating profits. Misreported accounts for any listed company on the stock exchanges is a very serious offence, as the entity's market valuation is primarily dependent on the audited accounts that it reports. Senior management remuneration of increments, bonus and stock options is also based on the reported financial performance.

Axis Bank's Mis-reported Accounts in FY2016 & FY2017

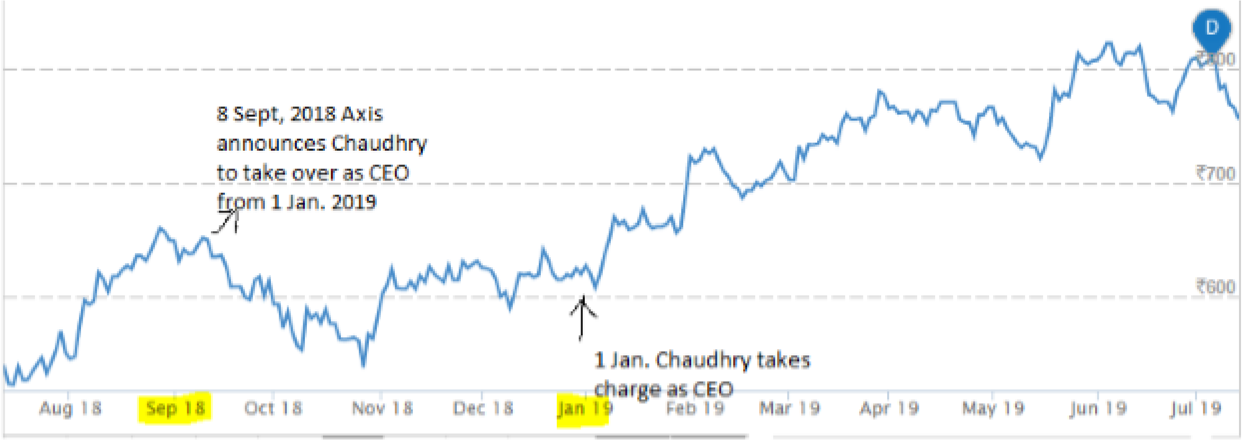
Rsmn	**FY2016**	**FY2017**
Gross NPAs Reported	60,876	212,805
Gross NPAs as assessed by RBI	155,655	269,133
Divergence in Gross NPA	**94,779**	**56,328**
Net NPAs Reported	25,221	86,267
Net NPAs as assessed by RBI	96,852	129,437
Divergence in Net NPAs	**71,631**	**43,170**
Provisions for NPAs	33,934	122,057
Provisions for NPAs as assessed by RBI	57,082	135,214
Divergence in Provisions	**23,148**	**13,157**
Reported Net Profits	82,237	36,793
Net Profits as assessed by RBI	66,878	27,940
Divergence in Net Profits	**-15,359**	**-8,853**
Divergence (%)		
Gross NPA	**155.7**	**26.5**
Net NPA	**284.0**	**50.0**
Provisions	68.2	10.8
Net Profits	-18.7	-24.1

Source: Axis Bank

The Banking Regulation Act, 1949 (BRA) takes mis-reported information provided by banks even more seriously, as Section 46(1) treats wilful mis-information by a bank as a criminal offense, punishable with a jail term. Moreover, the primary responsibility of a CFO is the integrity of the accounts. When the banking regulator after due process has detected and publicized that a bank's accounts are fudged, it is the duty of the board of directors to take stringent action against the CEO, CFO, head of the audit committee and the auditor, to restore the credibility of the institution. But the Axis Bank board of directors rewarded the senior management for such practices, Jairam Sridharan even received an increment in FY2017, and the then CEO, Shikha Sharma, was hastily given another term as CEO. Fortunately, it was the RBI which effectively removed the latter by refusing to give its approval for her full-term extension.

When the Axis Bank board of directors refused to take action, it was the role of the sell-side to highlight the lack of credibility of the concerned individuals and demand their removal. In the normal course of interaction with a company, sell-side analysts have maximum exposure with the CFO, and their own future estimates are based on the published audited accounts and discussions with the CFO. When the banking regulator has determined that, not one, but two successive years of financial accounts of Axis Bank were fudged, it would have required a complete reassessment of the sell-side's estimates, price targets and most importantly their valuation of the bank. But at that time the sell-side remained quiet, and this writer was probably the only analyst to publicly demand the removal of the concerned officials.

Axis Bank Share Price History July 2018 – July 2019



Source: Moneycontrol

Instead, a mere 2 years later after the mis-reported accounts were disclosed, and probably on account of the surge in Axis Bank's share price following the selection of Amitabh Chaudhury as CEO of the bank, the sell-side unanimously decided to award the 'Best CEO', 'Best CFO', and 'Best Investor Relations programme' award to Axis Bank in 2019. Fortunately for the capital market, the buy-side's selection of the 'Best CFO' was more discerning, and Jairam Sridharan did not make it in their top 3 selections thereby maintaining the credibility of the market. In theory, the sell-side plays an important role in the capital market, but, unfortunately, their business model has evolved to be the cheerleaders for the companies they cover, instead of being the capital market's sentinels. Corporate access and corporate public relations have replaced critical analysis of companies, and holding senior officials to account for poor and fraudulent performance is virtually nonexistent in their published research. The sell-side's selection of Jairam Sridharan as 'Best CFO' in the banking category for 2019 takes their tottering credibility to even lower depths, but nobody cares to call them out.

DISCLOSURE & CERTIFICATION

I, HemindraHazari, am a registered Research Analyst with the Securities and Exchange Board of India (Registration No. INH000000594). I have no position in any of the securities referenced in this note. Views expressed in this note accurately reflect my personal opinion about the referenced securities and issuers and/or other subject matter as appropriate. This note does not contain and is not based on any non-public, material information. To the best of my knowledge, the views expressed in this note comply with Indian law as well as applicable law in the country from which it is posted. I have not been commissioned to write this note or hold any specific opinion on the securities referenced therein. This note is for informational purposes only and is not intended to provide financial, investment or other professional advice. It should not be construed as an offer to sell, a solicitation of an offer to buy, or a recommendation for any security

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