Significant Risk Events in Indian Banks in the Recent Past

There have been three clear instances where Indian Banks have seen materialization of risks in recent months.

Bank	Risk materialization	Risk management failure
Indian Overseas Bank	Steep decline in credit quality within a quarter Adverse regulatory action Steep fall in market capitalization	Poor credit origination
Bank of Baroda	Illegal transactions performed by employees in a single branch Raids on branch and arrest of bank staff members Steep fall in market capitalization	Poor operational control Failure to detect abnormal transactions early
Axis Bank	Large loss on two big power sector exposures sold to Asset Reconstruction Companies Steep fall in market capitalization	Poor credit origination Significant exposure to stressed segments

Below, we take a look at these.

1. **Indian Overseas Bank**

The Reserve Bank of India (RBI) initiated prompt corrective action (PCA) against Indian Overseas Bank (IOB) in October 2015. RBI invokes PCA against a Bank if it feels that the bank's problems have reached a critical level and its governance and management structures require regulatory directions to protect the solvency of the bank. PCA is triggered if there is a risk of a bank's – CRAR, net NPA or ROA, getting lower than that prescribed by the RBI.

The financial daily, Mint, reported on 6 October 2015, "In the case of IOB, the bank reported a surge in bad loans in the June ended quarter which led to a slump in profits. As of 30 June, the bank's gross non-performing assets (NPAs) stood at Rs.16,451 crore, up nearly 60% from Rs.10,350 crore reported in the year-ago period. As a ratio of total loans, gross NPAs stood at 9.4% at the end of the April-June quarter as compared with 5.84% in the same quarter a year ago."[1]

The directions given by RBI were for improving the internal control of the Bank and for the purpose of consolidation of the activities of the Bank.

[1] http://www.livemint.com/Industry/jsqCHYvxWOR7NGyWvhgyUI/RBI-initiates-prompt-correction-action-against-Indian-Overse.html

Consequently, bonds issued by IOB were downgraded by credit rating agencies[2]. The bank's stock also plunged 15.57 per cent to Rs 29.55, its 52-week low, on Bombay Stock Exchange (BSE) on 2 November 2015. This was after the bank reported a net loss of Rs 551 crore in the second quarter as compared to a loss of Rs 245.51 crore in the corresponding period a year ago.

2. Bank of Baroda

Bank of Baroda (BOB) faced the materialization of serious operational risk between August 2014 and July 2015, as its Ashok Vihar branch in New Delhi witnessed abnormally high levels of foreign exchange remittances which violated FEMA rules. In a statement to the stock exchanges in October 2015, the bank said, around Rs.3,500 crore was remitted through 38 accounts to nearly 400 entities in Hong Kong and the UAE. The irregularity was unearthed by Internal Audit probe of the bank. However, given the magnitude and nature of the irregularity, both the ED and CBI launched investigations and arrested bank officials[3]. The shares of BOB fell by 8% on 12 October 2015.

A report appearing in the financial daily, Mint, on 13 October 2015 that discusses lapses at the bank is presented below[4]:

All transactions were kept below the $100,000 limit so as to not attract attention, although, according to the internal report, the same entity made four or five remittances to the same exporter in a single day. The amounts transferred were supposedly advance payments for imports. Interestingly, almost all the accounts were opened just before the transactions began.

And, the internal report mentions that "heavy cash receipts were observed" in these.

The beneficiary accounts overseas were in the names of Victoroxx International Ltd, Great Asian Exports, King Winner International Ltd and Star Exim Ltd, among others. The Indian companies that made the remittances include AK Enterprises, Vandana Impex, Seagull Traders, Dabang Marketing and Trading and Bankey Bihari Tradelinks, among others.

A CBI official, who spoke on condition of anonymity, said that the agency was questioning some bank officials. "Our initial investigation shows that individuals and companies in whose names remittances were done are mostly untraceable as the address provided are fake," added the CBI official.

Under Reserve Bank of India (RBI) rules, an entity can transfer up to $100,000 as pre-payment for imports without a so-called "bill of entry"."The advance payment provision is generally a privilege given to importers to make advance payments and is used on a case-by-case basis. The authorized dealer is bound by rules to ensure that adequate documents are received within a stipulated period of time to ensure that the actual import has taken place," said K.N. Dey, executive director at Mecklai Financial. Dey added that the provision is not something that is commonly or loosely used.

[2] http://economictimes.indiatimes.com/markets/bonds/icra-lowers-rating-of-bonds-issued-by-iob/articleshow/49572399.cms
[3] http://timesofindia.indiatimes.com/india/CBI-ED-arrest-6-persons-in-BoB-money-laundering-case/articleshow/49345412.cms
[4] http://www.livemint.com/Companies/5RTuIN8Opm9qayotBOq1iK/Bank-of-Baroda-black-money-transfers-case-gets-murkier.html

A former Bank of Baroda official pointed out that the bank is still required to seek documentation to show that the imports have indeed taken place. A bank can also seek information from the bank receiving the payments if required.

"There appear to be lapses at the bank's end on many counts including on account of due diligence required under know-your-customer (KYC) norms, the generation of exceptional transaction reports (ETR) and suspicious transaction reports (STRs)," said the former official, adding that he has no access to direct information on this case.

Some of the other irregularities that were observed in the report include not generating docket numbers for each remittance, not obtaining credit reports of the suppliers despite heavy advance payment for imports being made to the same entity, bill of entry of imports not being obtained before making further remittances to the same supplier and no effort being made by the branch to obtain it; in many cases, mode, date and place of shipment were not mentioned.

The report also mentioned that the office account of a branch should be nil at the end of the day through system-generated transactions. But the Ashok Vihar branch's account was "never nil with transactions of system-generated entries and there was debit/credit balance at the end of the day", the report said. These amounts were then manually transferred to various general ledger accounts to close the day's business.

3. Axis Bank

The share price of Axis Bank plunged by 7% on 28 October 2015. This was apparently because of the news that Axis Bank had to offload assets worth Rs 1,820 crore to Asset Reconstruction Companies (ARCs), for Rs 550 crore in security receipt and Rs 100 crore in cash, thus taking a hit of Rs 1,170 crore.

According to a Business Standard report on the day[5]:

Axis Bank results have spooked the markets, not because of its numbers which were in line with analyst expectation but more on account of a sharp increase in impairments. What has perturbed some analysts is that details of impairments were not provided in the profit and loss (P&L) account posted on the stock exchanges. Instead, a link in the auditor note was given to the bank's website where the details were mentioned.

There is nothing wrong in what Axis Bank did; it did not try to hide the numbers and made the entries well within the prescribed norms, providing for the residual provisioning in the P&L account. But analysts seem to be taken aback by the disclosure.

The impairments in question are two power sector accounts worth Rs 1,820 crore, which Axis Bank's management pointed out in the conference call that they had to sell it as they did not see a near-term solution to revive the assets.

[5] http://www.business-standard.com/article/markets/why-axis-bank-shares-fell-over-7-today-115102800722_1.html

Axis Bank sold the assets to Asset Reconstruction Companies (ARC) for Rs 550 crore in security receipt and Rs 100 crore in cash, thus taking a hit of Rs 1,170 crore. It provided Rs 336 crore as NPA (non-performing asset) provision and utilised Rs 800 crore of floating assets to settle the remaining.

However, concerns remain. SBI Cap Securities pointed out that the bank's asset quality is not out of the woods. The report points out that given Axis Bank's exposure to stressed segments like infrastructure iron and steel, it is susceptible to corporate delinquencies. While headline gross NPA remained steady at 1.6 per cent of advances, including the asset sold to ARCs, annualised slippages during the quarter increased sharply to 4.1 per cent. This is as high as those of some of the public sector banks. So, why should the bank deserve a high valuation?