

## Chapter-III : Supervisory Role of NSDF

### 3.1 Supervisory role of NSDF over NSDC

As per the Cabinet approval (November 2008), Board of Trustees of NSDF was to examine and sanction proposed annual work plan submitted by NSDC together with the amount to be released to NSDC against the work plan. NSDF was also to play a supervisory role over functioning of NSDC, which was enshrined in the NSDF trust deed also. However, modalities of performance of the supervisory role were not clearly defined. On the contrary, at various instances, NSDC did not agree on the supervisory role of NSDF. Details are as follows:

#### 3.1.1 Review of NSDC's activities

An Investment Management Agreement (IMA) was entered into between NSDF and NSDC in March 2009. IMA was the only contractual document entered into between NSDF and NSDC and it governed the release and utilisation of funds from NSDF to NSDC. However, no provision for supervisory role of NSDF over NSDC functions was included in the IMA.

It was observed that in a NSDF trust meeting held on 8 June 2012, on the issue of review of work plan of NSDC, Chairman, NSDC stated that, *“it was not the role of NSDF to review the working of NSDC, as it was only a pass-through vehicle. By proposing to undertake a review of the activities of NSDC, the NSDF was interfering in the operations of NSDC.”*

During the 31<sup>st</sup> Board meeting of NSDC (6 July 2012), following amendments to the provision of IMA was proposed by the DEA, *“Provided that trust shall review the activities of NSDC from time to time to fulfil the objectives of Trust as contained in clause 2.4 of Deed of Public Trust”*. However, all the board members from private sector were against inclusion of this provision. The Chairman, who was a Government nominee but from the private sector, also opposed its inclusion. One Government nominee stated that *“it was not the intention of Government to interfere in day to day functioning of the Company.....but as NSDC is entirely dependent on Government funds for its activities, accountability demands that there should be review by NSDF.”*

But, finally the board did not approve inclusion of this clause in IMA citing autonomy of NSDC.

These events clearly brought out that responsibility of NSDF for monitoring the activities of NSDC was not even institutionalised in the IMA and NSDC kept dictating the terms governing its relationship with NSDF.

MSDE in its reply (April 2015) stated that at present, there was no conflict on the overseeing role of NSDF and relationship between NSDF and NSDC.

Reply of MSDE about absence of conflict was not borne out by the facts as detailed in the preceding paragraphs.

### 3.1.2 Release of Funds by NSDF

The Board of Trustees of NSDF was supposed to examine the proposed work plan of NSDC in accordance with the IMA and sanction such amount out of its corpus as it may, find proper and justifiable. Details of fund provided by NSDF to NSDC and its status were as follows:

**Table 2: Status of Funds at NSDC**

(₹ in crore)

Year	Opening Balance	Funds Received	Interest earned	Total funds available	Funds utilised <sup>3</sup>	Closing balance	Per cent utilisation
2008-09	---	200.00	-----	200.00	0.25	199.75	0.12
2009-10	199.75	----	4.40	204.15	11.53	192.62	5.65
2010-11	192.62	----	9.55	202.17	59.59	142.58	29.47
2011-12	142.58	104.95	12.57	260.10	147.61	112.49	56.75
2012-13	112.49	289.00	21.04	422.52	154.11	268.41	36.47
2013-14	268.41	1,073.99	52.16	1,394.56	376.90	1,017.66	27.03
2014-15	1,017.66	690.06	122.82	1,830.54	1,011.30	819.24	55.25
Total	--	2,358.00	222.54	--	1,761.29	--	68.25
		2,580.54					

Audit noticed from the scrutiny of NSDF board meeting minutes and correspondence with NSDC that there were delays in submission of work plan by NSDC.

<sup>3</sup> Utilisation includes operating and admin expenses, Grants in Aid paid, Loan disbursed to Institutions, Long term investments made, Monetary awards, NSDC FLDG Funds.

Audit query for providing details of year wise budget requirements/proposals submitted by NSDC remained unanswered from NSDF. From the records made available to audit, it could not be ascertained whether the Board of Trustees examined the work plans, which were submitted. In fact, it was noticed from records of the Ministry that till February 2013, no review of any project was undertaken by NSDF due to paucity of time and requisite manpower. It was also noticed that in February 2013, for the first time the details of two projects were submitted to NSDF on a sample basis for approval of format.

NSDC utilised only 68.25 *per cent* of the total funds received from NSDF since inception upto 2014-15. As can be seen from table no. 2 above, NSDF released grants to NSDC during the year 2011-15 without adjusting the balances lying with NSDC and without analysing the future requirement of funds. In fact, release of ₹ 690.06 crore by NSDF in 2014-15 was unwarranted as NSDC already had a large unspent balance of ₹ 1,017.66 crore in the beginning of 2014-15. NSDF could have insisted on utilisation of previous balance before releasing further funds to NSDC.

MSDE stated (April 2015) that the inefficiency in funding mechanism pointed out by Audit have been noted to make systematic improvements. NSDF has appointed IL&FS Trust as Monitoring Agent appointed for monitoring NSDC's activity. MSDE stated (October 2015) that NSDC would be further directed to submit annual work plans in proper format to the Ministry/NSDF and their performance would be reviewed periodically.

Appointment of a third party monitor by NSDF does not address the need for review of work plan of NSDC and release of funds accordingly.

## **3.2 Regulatory oversight over NSDC**

### **3.2.1 Applicability of NBFC Regulations**

Reserve Bank of India (RBI) is the regulator of Non-Banking Financial Companies (NBFC)<sup>4</sup> in India. The regulatory and supervisory objectives of regulation of NBFCs are to ensure that these companies function as a part of the financial system of the

---

<sup>4</sup> Non-banking financial companies (NBFCs) are financial institutions that provide banking services in the nature of providing loans, accepting deposits etc but do not hold a banking license.

country within the policy framework, in such manner that their existence and functioning do not lead to systematic aberration. The regulatory framework laid down by RBI had prescribed various prudential norms to be followed by NBFCs, which dealt with systemic risks. These prudential norms provided for requirement of maintaining minimum Capital to Risk Weighted Assets Ratio, norms for classification of assets as Non-Performing Assets (NPA), provisioning requirements for assets, credit/investment concentration norms, adoption of good corporate governance practices etc. among others. The regulatory framework also prescribed various returns and disclosures tools. These were important parts of accountability mechanism in ensuring the robustness of functioning of the NBFC. These returns and disclosures tools help the regulator to check whether the prescribed prudence norms were being followed.

NSDC is covered under the definition of NBFC due to its activities relating to disbursing of loans. The legal counsel of NSDC also advised (December 2009) that the activities of disbursing funds through loans and equity participation would squarely fall within the definition of NBFC activities and therefore required registration under RBI Act before disbursement of funds. Nevertheless, NSDC requested (February 2010) DEA to facilitate in getting a provisional exemption from the appropriate authority, pending final approval of exemption from RBI from registration formalities and other compliances. DEA accepted NSDC's contention and informed (February 2010) RBI that regulatory oversight to NSDC was being provided through the Board of Trustees of NSDF, headed by Secretary, DEA and additional regulatory oversight by the RBI, therefore, did not appear necessary.

On DEA's persuasion, RBI agreed and informed (June 2010) DEA about exempting NSDC in view of the fact that NSDC had been registered as a non-profit Company under Section 25 of the Companies Act, 1956 and regulatory oversight was being provided through the Board of Trustees of NSDF. Audit was unable to find merit in DEA's decision to take NSDC out of RBI's prudential supervision. RBI is the apex regulator of NBFCs and its regulatory supervision would have instilled discipline and helped NSDC in its financing activities.

It was apparent from the conditions that the exemption was granted on the assumption that regulatory oversight would be provided through the Board of Trustees of NSDF.

### 3.2.2 Regulatory oversight role by NSDF

Audit noticed that though the exemption from RBI was taken for the regulatory supervision by NSDF, no corresponding system was created in NSDF to provide the regulatory oversight. Audit examination of the regulatory oversight role played by NSDF revealed the following:

- DEA requested (June/July 2013) RBI well after three years of getting exemption from RBI, to suggest the framework/guidelines for oversight by NSDF over NSDC in line with the RBI norms for non-deposit taking NBFCs.
- RBI informed (December 2013) that as on 31 March 2013 the asset size of NSDC was ₹ 548 crore and under the extant regulations, NBFCs with assets size of ₹ 100 crore and above were termed as systemically important NBFCs and were subject to regulations relating to prudential norms. RBI also emphasized upon the fact that it was important that there was data availability on the company, in terms of its size, leverage, financials and others in light of the concerns on shadow banking in the wake of 2008 economic crisis and the attempts at both national and international levels, in bringing shadow banks under surveillance.
- DEA decided (March 2014) that there was need for a regulatory entity like a trustee company to be given the mandate for independent monitoring of the projects funded by the NSDC and for appropriate micro-prudential regulatory oversight of NSDC. Accordingly, IL&FS Trust Company Limited was appointed (November 2014) for monitoring the activities of NSDC and providing micro-prudential regulation.

Analysis of these events clearly demonstrate that since its inception and especially since getting the exemption from RBI in June 2010, there had been no prudential regulatory oversight by NSDF over the functioning of NSDC despite having activities similar to an NBFC. Despite DEA's assurance to RBI that NSDF would be the regulator, DEA initiated enquiries about the details of NBFC framework/guidelines applicable to NSDC only in June 2013. Further, though pointed out by RBI in December 2013 that NSDC met the criteria of systemically important NBFCs bringing out the concerns on shadow banking in the wake of 2008 economic crisis, no concrete action over its supervision were taken till November 2014. Reply of MSDE

(April 2015) confirmed absence of this regulation over NSDC for more than five years since its inception.

### 3.2.3 Appointment of Monitor and Micro Prudential Regulator

Audit analysed the documents related to appointment of IL&FS Trust Company Limited as the monitor and micro-prudential regulator for NSDC. It was noticed that Expression of Interest (EoI) was called from interested parties in July 2014 by DEA. Pre-bid meeting was organised in August 2014 in which two organisations participated and sought clarifications. Only one bid, from IL&FS Trust Company Limited, was finally received till the last date (5 September 2014) for submission of bids. Technical bid was opened by the technical committee constituted for this purpose and the bid was found by the committee to be qualifying. Thereafter the financial bid was opened and negotiations was carried out with the bidder. Contract was awarded to IL&FS Trust Company Limited in November 2014 by the Department of Skill Development and Entrepreneurship. The assignment of IL&FS Trust Company Limited commenced from 1 December 2014.

Audit analysis of the appointment process revealed the following:

- i. A pre-qualification criteria *“Bidder should have experience of at least three projects involving project management/monitoring for a Central Government department or State Government or World Bank each for more than ₹ five crore”* was proposed on file. However, this criteria was revised to *“Bidder should have experience of fund administration/trusteeship involving administration of funds up to ₹ 5,000 crore with minimum number of funds being administered being 50”*. This change was not commensurate with the size of the entity to be regulated i.e. NSDC, whose total funds under disposal were ₹ 1,677.94 crore in five years since inception. Further, the criteria of *“minimum number of funds being administered being 50”* also did not correspond to the scope of work as NSDC was not engaged in fund management activities and its funds were invested in term deposits and other banks accounts. This coupled with the fact that only one bidder submitted its bid indicated that the pre-qualification criteria was made highly restrictive.
- ii. A Technical Evaluation Criteria was laid down which was a scaled formula having maximum score of 100, made of individual scores for eight different sub-criteria. It was observed that the parameters of experience of administering SEBI registered pooling funds (investment funds/venture capital funds) and existing systems and procedures for operational management of pooled funds were

assigned individual scores of 25 each, whereas important parameters of experience in handling diversified trusteeship products in fiduciary space, enforcement of third party fiduciary space and presence of qualified team of legal and financial experts were assigned individual scores of five each only, which were very significant for the envisaged role of micro-prudential regulation.

- iii. A nominee from NSDC, which itself was going to be monitored and regulated by the agency, was appointed as a member of the technical evaluation committee, which involved conflict of interest.
- iv. Only one bid was received after EOI was invited by DEA. The technical committee initially recommended that the entire bidding process should be carried out again as only one bid was received. Thereafter the matter was deliberated in DEA and a provision of Manual of policies & procedures for purchase of goods issued by Department of Expenditure in 2006 was referred to stated, *“if after scrutiny it is found that all such aspects were fully taken care of and in spite of that the purchaser ends up with one responsive tender only, then the contract may be placed on the tenderer, provided the quoted price is reasonable”*. Thereafter, the technical committee opened the bid and carried out further steps. In audit opinion, accepting the single bid was not proper in view of the following :
  - Rule 169 of the General Financial Rules 2005 (GFR 2005), under the chapter on procurement of services, prescribed that number of short listed candidates should not be less than three.
  - Clause 11.7.4 of the manual quoted above and used in this case, first provided that *“A situation may also arise where, **after analysing the tenders, the purchase organisation ends up with one responsive tenderer. In such situations, the purchase organisation is first to check whether, while floating/issuing the tender enquiry, all necessary requirements like standard tender enquiry conditions, industry friendly specification, wide publicity, sufficient time for formulation of tenders, etc. were fulfilled. If not, the tender is to be re-issued/re-floated after rectifying the deficiencies. However, if after scrutiny it is found that all such aspects were fully taken care of and in spite of that the purchaser ends up with one responsive tender only, then contract may be placed on that tenderer provided the quoted price is reasonable.**”* In this case, DEA did not end up to the situation of one responsive tender after analysing all the tenders received and rather only one tender was received.

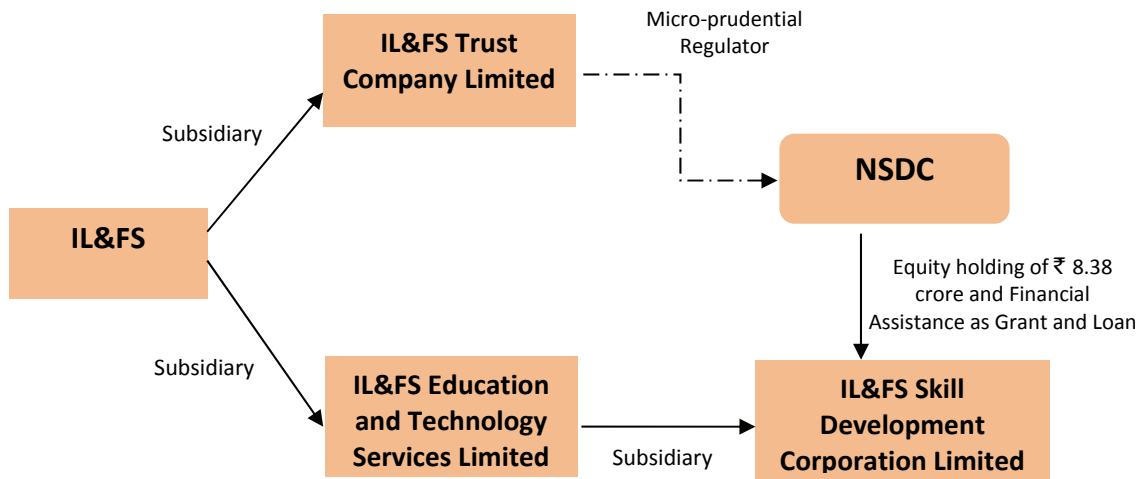


- Rule 167 of the GFR 2005 prescribed that Ministry proposing to engage consultants should estimate reasonable expenditure for the same by ascertaining prevalent market conditions and consulting other organisations engaged in similar activities. This was not carried out before inviting the bids.
  - NSDF carried out negotiations with the bidder and the work was finally awarded at ₹ 1.65 crore per annum whereas the initial financial bid was of ₹ 4.25 crore per annum. This reduction was achieved by excluding '*design, development and implementation*' of analytical tools and '*cost after contract period was over*', from the items of Financial Proposal. This removal of two out of three items from the financial proposal was clearly done at a later stage, during negotiations with the only bidder.
- v. Absence of conflict of interest was an important pre-qualification criteria which stated that a self-declaration was to be furnished by the bidder. In this respect, it was observed that IL&FS Trust Company Limited was part of the IL&FS group. Scrutiny of the list of NSDC funded partners revealed that another group company of the same group i.e. IL&FS Skill Development Corporation Limited (ISDC) was sanctioned with funding of ₹ 159 crore in 2010-11 and disbursed ₹ 89.97 crore upto March 2015 (₹ 8.38 crore as equity, ₹ 34.10 crore as grant and ₹ 47.49 crore as loan). ISDC was a subsidiary of IL&FS Education and Technology Services Limited (IETS) and also a joint venture between IETS, IL&FS Cluster Development Initiative Limited (ICDI) and NSDC. The possibility of conflict of interest was brought to the notice of the technical committee. Despite that, IL&FS Trust Company Limited was declared as technically qualified by the technical committee on the ground that members in the two board of directors were not same, shareholders of the two were different and IL&FS Trust Company Limited had filed a declaration that they did not have any conflict of interest due to any existing or forthcoming association with NSDC.

The contention of the technical committee needs to be viewed in light of the fact that ISDC was a subsidiary company of IETS, which itself was a subsidiary company of Infrastructure Leasing and Financial Services Limited (IL&FS). IL&FS Trust Company Limited was also a subsidiary company of IL&FS.



The organisational linkages have been indicated in the chart below:



As per Section 2 (87) of the Companies Act, 2013, subsidiary company of a subsidiary company is also termed as subsidiary company of the holding company. Therefore, relying on the submitted fact of absence of some directors and shareholders on both companies without further examination by the technical committee led to compromise with a very critical criterion of absence of conflict of interest.

In view of the above, appointment of IL&FS Trust Company Limited (November 2014) as a third party monitor and micro-prudential regulator was not regular. Further, carrying out the task of micro-prudential regulation was an important regulatory function which inherently included enforcement mechanism. Appointment of a private agency for carrying out this regulatory task, on the lines of the one performed by RBI, after taking it out of RBI's purview lacked justification.

MSDE stated (October 2015) that the Ministry has not contracted out the regulatory function but has appointed IL&FS Trust Company for professional advice since there is no in-house professional expertise within NSDF. The monitoring agencies would merely submit its report to the NSDF who in turn would provide oversight. The term of IL&FS Trust as monitoring agent of NSDF is ending in November 2015. The observations of audit would be given due consideration while initiating the process for deciding renewed/fresh appointment of monitoring agent.

Reply of the Ministry may be viewed in the light of the fact that the RFP document specifically listed various monitoring functions and the letter of award dated 28 November 2014 clearly stated that *“NSDF proposes to appoint IL&FS Trust Company Limited as an independent monitoring agency for NSDC’s activities and for performing micro-prudential oversight on its functioning”*.