CHAPTER VII: MINISTRY OF FINANCE

India Infrastructure Finance Company Limited

7.1 Fund Management and Financing

7.1.1 Introduction

India Infrastructure Finance Company Limited (the Company) was incorporated in January 2006 as a wholly-owned company of the Government of India under the Companies Act, 1956 to provide long term finance to viable infrastructure projects under 'Scheme for Financing Viable Infrastructure Projects through a Special Purpose Vehicle called India Infrastructure Finance Company Limited (SIFTI)'. It extends financial assistance to the sectors included in the harmonized list of infrastructure sub-sectors approved by the Cabinet Committee on Infrastructure on 1st March 2012 viz. transport, energy, *etc* mainly for projects under Public Private Partnership.

7.1.2 Financial highlights

Details of fund mobilization and disbursement by the Company during the three years ended March 2014 are summarized below:

(₹ in crore)

Mobilisation	2011-12	2012-13	2013-14
Bonds	0	5041.32	7176.21
Bilateral/ Multilateral borrowings	1033.74	1079.57	907.45
Domestic Loan	0	1000	0
Total mobilisation	**1033.74**	**7120.89**	**8083.66**
Disbursements			
Direct Lending	4191.00	5138.00	3774.00
Refinance	668.00	250.00	1838.00
Takeout Finance Scheme	560.00	2018.00	893.00
Total disbursements	**5419.00**	**7406.00**	**6505.00**

7.1.3 Audit objectives

Audit was carried out to assess:

- Whether funds were raised after proper financial planning commensurate with the business requirement;
- Whether due diligence was ensured before borrowing;
- Whether controls relating to sanction and disbursement of loans were sound, effective and adequate to cover the risk of lending;
- Whether adequate monitoring mechanism existed to ensure timely recovery of dues; and

- Effectiveness and efficiency in utilization of funds.

7.1.4 Audit criteria

The performance of the Company was assessed against the following audit criteria:

- Scheme for Financing Viable Infrastructure Projects through a Special Purpose Vehicle called India Infrastructure Finance Company Limited (SIFTI);
- The internal guidelines/policies/procedures of the Company relating to mobilization of fund, sanction of projects, disbursement and recovery;
- Agenda & Minutes of the meetings of Board of Directors, Audit Committee and other Internal Committees of the Company;
- Best practices followed in the Industry; and
- Resource plan and Memorandum of Understanding (MOU)/Statement of Intent (SOI) targets of the Company.

7.1.5 Scope of Audit and sample

Audit examined the system of fund mobilization and disbursement followed by the Company during the period 2011-12 to 2013-14. The audit sample was selected based on Stratified Random Sampling Method using IDEA package from the total funds raised and disbursements made as indicated below:

Number of total borrowings during 2011-12 to 2013-14 and sample selected for audit					
Amount raised	₹1000 crore or more	₹500-1000 crore	₹100-500 crore	Less than ₹100 crore	Total
Bonds (Number of cases)	3	7	15	14	39
Bilateral/ Multilateral borrowings (Number of tranches)	0	0	7	127	134
Domestic loan (Number of cases)	1	-	-	-	1
Total (Number of cases)	4	7	22	141	174
Percentage selection	100	50	40	0	
No. of cases in sample	**4**	**4**	**9**	**0**	**17**
Overall selection percentage out of total population					10

Number of total projects sanctioned during 2011-12 to 2013-14 and sample selected for audit						
Particulars	₹1000 crore or more	₹500-1000 crore	₹200-500 crore	₹100-200 crore	Less than ₹100 crore	Total
Direct lending (Number of Projects)	0	1	19	26	58	104
Refinance Scheme (Number of Projects)	1	2	2	0	0	5
Takeout Finance Scheme (Number of Projects)	0	3	7	9	13	32

Total (Number of Projects)	**1**	**6**	**28**	**35**	**71**	**141**
*percent*age selection	100	50	35	25	15	
No. of cases in sample	**1**	**3**	**10**	**9**	**11**	**34**
Overall selection percentage of total population						24

7.1.6 Audit findings

7.1.6.1 Achievement of targets as per Statement of Intent (SOI) set by Ministry of Finance

Based on the inputs from the Company, annual targets for resource mobilization and disbursement by the Company are approved by the Ministry of Finance (Ministry) in the form of Statement of Intent (SOI). Actual performance of the Company as against the targets approved by the Ministry during 2011-14 was as under:

(₹ in crore)

Sl. No.	**Parameters**	**2011-12**		**2012-13**		**2013-14**	
		Targets	**Achievements**	**Targets**	**Achievements**	**Targets**	**Achievements**
1	Resources[1]	6500.00	3297.00	11635.00	8803.00	Not fixed	Not fixed
2	Share of resources raised without sovereign guarantee	Not fixed	Not fixed	Not fixed	Not fixed	62 *per cent*	77 *per cent*
3	Disbursements under:						
(a)	Refinance	0.00	668.00	2000.00	250.00	2500.00	1838.00
(b)	Takeout	5400.00	560.00	4000.00	2018.00	3500.00	893.00
(c)	Direct Lending	6100.00	4191.00	6800.00	5138.00	5500.00	3774.00
4	Net Profit[2]	462.00	547.00	725.00	787.00	1050.00	646.00
5	Return on Average Assets (ROA)	1.27	1.90 *per cent*	1.90 *per cent*	2.18 *per cent*	2.80 *per cent*	1.48 *per cent*

It was noticed that:

- targets for resource mobilisation remained under-achieved during 2011-12 and 2012-13.
- disbursements made under different schemes also fell short of the given targets ranging between 42.14 *per cent* to 52.88 *per cent*.
- both Net profit and Return on Average Assets exhibited significant decline during 2013-14 over the targets for the year.

[1] ***Targets for resources for 2011-12 & 2012-13 were defined in terms of amount excluding capital, whereas the same for 2013-14 were as a percentage of resources raised without government guarantee to total resources raised.***

[2] ***Net Profit and corresponding ROA target till 2012-13 was for Net Profit available for Distribution and subsequently for 2013-14 these were for Net Profit (after Taxes).***

Reasons for downfall in the performance of the Company have been elaborated in the following paragraphs.

7.1.6.2 Deficient Fund Planning

The Company formulated its Annual Resource Raising Plan (ARRP) to estimate the requirement of funds mainly based on the following:

(i) Cumulative amount of sanctions and disbursements as at the end of the respective previous years,

(ii) Expected amount of loan to be disbursed under different schemes of the Company,

(iii) Funds available at the beginning of the year,

(iv) Funds to be kept liquid,

(v) Funds to be borrowed / raised and

(vi) Loan repayment and servicing

However, an examination of the system of estimation of projected fund requirements by the Company disclosed the following inadequacies:

(i) Detailed workings of fund requirements on account of expected loans to be disbursed under different schemes of the Company and funds expected to be raised through borrowings were not found in records of the Company and the same were also not provided to Audit despite specific request (19 March 2015). Accordingly, Audit made an attempt to assess the effectiveness of the projections made by the Company with reference to actual results. It was observed that there were significant variations between the amount of actual and projected borrowings and disbursements as shown below:

(₹ in crore)

Particulars	**2011-12**	**2012-13**	**2013-14**
Projected borrowings	7053.00	11700.00	14600.00
Actual borrowings	1033.74	7120.89	8083.66
Projected disbursements	10000.00	10000.00	11900.00
Actual disbursements	4409.22	6229.00	5459.85

(ii) The Company considered net cumulative sanctions at the end of previous year for assessing the fund requirements for 2011-12 whereas gross amount of cumulative sanctions was considered for assessing fund requirements for 2012-13 and 2013-14. Net sanctions represented the amount of loans allocated to Company (in case of consortium finance the amount is finally allocated to each lender by the consortium) related to projects which had achieved financial closure and gross sanctions included amounts sanctioned by the Company even for the projects where financial closure was yet to be achieved. There were significant differences in the amount of net and gross sanctions for 2012-13 and 2013-14 as detailed below:

(₹ in crore)

Year	Amount of cumulative Gross sanctions at the end of previous year	Amount of cumulative net sanctions at the end of previous year
2012-13	40373	32278
2013-14	51887	38841

Due to consideration of gross sanctions instead of net sanctions, the fund requirements assessed by the Company turned out to be higher than the actual requirements and the Company was saddled with surplus funds at the end of the year as shown below:

(₹ in crore)

Particulars	March 2012	March 2013	March 2014
Projected liquidity as assessed by the Company	5000.00	3000.00	4200.00
Actual liquidity represented by Total Fixed Deposits-Total Overdrafts	5370.50	7945.49	11141.55
Difference being excess actual liquidity than planned	370.50	4945.49	6941.55

Thus, due to deficient assessment of fund requirements, the Company landed in a situation of surplus funds compared to actual requirements which progressively increased over the years.

The Company/Ministry stated (January/March 2015) that the Company prepares Annual Resource Raising Plan (ARRP) on the basis of the latest SOI available which was based on information regarding expected disbursement and fund raising for the same considering the liquidity requirements of the Company. Credit Department, Corporate Planning Department and Resource and Treasury Department(s) analyzed past achievements of sanctions, disbursements etc, focus on future business activities and market conditions for projecting disbursements and borrowing required by the Company. It was also mentioned that financial projections though might carry element of subjectivity, were not made arbitrarily. Further, the Company also tries to raise funds at appropriate cost through tax free bonds which requires Government approval and takes time.

The fact remains that the Company was not maintaining detailed workings of expected disbursements and borrowings with their tentative time schedule based on past experience and was not consistent in considering net sanctions instead of gross sanctions for assessing fund requirements resulting in a situation where it found itself with progressively increasing surplus resources.

7.1.6.3 Management of Fund

(a) Holding excess unutilised funds

As indicated in the paragraph 7.1.6.2 above, the Company was having progressively increasing funds over the years due to inadequacies in the assessment of fund requirements. The surplus available funds were parked in fixed deposits (FDs) which

extended for a period upto one year. For meeting its temporary fund requirements, it was taking overdraft against such FDs as and when the need arose. Outstanding balance of FDs and overdraft against FDs as on 31 March 2012, 2013 and 2014 were as under:

(₹ in crore)

As on	**Balance of total FDs**	**Balance of overdraft raised against FDs**
31 March 2012	8114.18	2743.69
31 March 2013	9429.34	1483.86
31 March 2014	13225.47	2083.92

As seen from the above, the Company borrowed funds in excess of requirements and parked the same under fixed deposits against the spirit of the main objective of the Company to channelize funds in infrastructure projects. The Company availed overdraft against fixed deposits for all purposes including disbursements.

The Company/Ministry stated (August 2014/January 2015/March 2015) that actual timing and quantum of disbursement in infra sector is highly unpredictable due to long gestation period and unexpected delay which might happen during the course of the project. Sixty projects funded by the Company had suffered average delay of 15 months from COD proposed at the time of appraisal. Hence the resources raised by the Company till the time of disbursement were parked in FDs with PSU banks as bank provided a risk free investment with high security, at yield higher than other investment opportunities available to the Company like Government Securities (G Sec.) etc. Further, the Company would not want to get into compelling situation to raise funds at prohibitive costs. Therefore, it borrowed for longer tenures to meet requirement of funds, for long term infrastructure projects, while meeting short term requirement of funds from overdraft of bank deposits.

The replies are to be viewed against the fact that parking of funds in FDs was not the core business of the Company. The Company needs to put in place a well documented system and standard operating procedure after considering the requirements of stakeholders to assess the requirements of funds and to channelize them in the infrastructure as per its main objective.

7.1.6.4 Borrowings

Examination of the selected cases of borrowings revealed the following instances of borrowing at cost that was higher than the prevailing rates or other options available to the Company:

(a) Issue of Taxable Bonds

The Company decided (4 July 2012) to raise ₹ 2000 crore through long term bonds in tranches for tenors[♣] of 15, 20, 25 and 30 years during 2012-13. Since the available amount of credit rating was ₹ 1109.04 crore only, the Company invited (11 July 2012) bids for a bond issue of ₹ 1100 crore from top 15 arrangers for 20, 25 and 30 years' tenor

[♣] ***Implies tenure or period of loan or bond as used by the Company in its records.***

bonds. In response to the above, 12 arrangers submitted their bids (10 for 25 years' bonds and 11 for 30 years' bonds), which were opened on 17 July 2012. Audit observed that:

(i) Board of Directors (Board) had passed the resolution to raise the fund for tenor of 15, 20, 25 and 30 years; however, the Company did not call for the bids for 15 year tenor bonds without recording any reasons therefor. G-Sec rates (semi-annualized) prevailing as on coupon fixation date *(i.e.* 20 July 2012) for a tenor of 15 years was 0.2385 *per cent* lower (i.e., 8.5369 minus 8.2984) than that for the 25 years' tenor. In such a scenario, raising fund through bonds with 15 years' tenor was more advantageous. Thus, not raising bonds for 15 years as per the decision of Board, saddled the Company with an avoidable burden of extra interest cost to the tune of ₹ 37.56 crore in 15 years @ ₹ 2.5043 crore p.a.

(ii) The Company without recording any reasons, did not raise fund through 20 years' tenor bonds though it had called for and received bids for a total sum of ₹ 1100 crore. The semi-annualised G-Sec rates and the quoted spread, taken together for 20 years tenor bonds, was 0.0905 *per cent* lower than that for 25 years' tenor bonds. The Company could have raised fund for 20 years' tenor instead of 25 years and avoided the extra interest cost amounting to ₹ 19.01 crore (*i.e.,* 0.0905 *per cent* p.a. x ₹1,050 crore x 20 years).

The Company stated (January 2015) that they were in the business of financing long term infrastructure projects for which long term funds are required. Further, DFS♠ had advised (March 2012) the Company to raise resources for a longer tenor of 15-20 years and above so that the development of bond market takes place. Since, there were many 15 year bonds already in the market; a benchmark (with actively traded bonds) for 15 year tenor already existed. By issuing these bonds, a benchmark for 25 and 30 years was created for future long tenor bond issuances by the Company and other Corporates and a benefit of this shall be reaped by the entire country in the future. This effort by the Company was also praised by the Ministry. Considering the Company's long term funds requirement and DFS' advice, preference was given to raise funds with a longer tenor i.e. 30 years, 25 years and 20 years. Accordingly, at the time of book-building, first the bids for longer tenor bonds were allotted and the entire issue size/ rating limit of ₹ 1,100 crore was exhausted by 25 year tenor bonds. Also, it is not possible to ascertain the coupon rates based just on the benchmark G-Sec yield as the final coupon depends upon the spread over the G-Sec yield which is arrived at after the book-building process.

The fact, however, remains that:

(i) The Company, did not adhere to the approval of the Board and directions of the Ministry, and did not invite bids for 15 years' tenor bonds to explore the expected coupon rates. Further, comparison of G-Sec rates for 15 years' tenor bonds and 25 years' tenor bonds reflected an extra burden towards interest cost of ₹ 37.56 crore over 15 years. Further, comparison of spread for 15 years bonds was not possible as the Company did not invite the bids for these bonds.

♠ ***Department of Financial Services, Ministry of Finance***

(ii) Out of bids received for ₹ 690 crore for 30 years' tenor, the Company issued bonds for only ₹ 50 crore. Therefore, even the stated criteria of first priority to long tenor bonds was also not followed by the Company.

(b) Raising loan from LIC

The Company requested (24 February 2012) Life Insurance Corporation of India (LIC) to provide indicative term sheet for ₹ 1000 crore debt/bond for a tenor of 15 years fully backed by Government of India.

Though the Company had a balance of ₹ 8114.25 crore in FDs as of 21 March 2012, it requested (21 March 2012) LIC to provide long term debt of ₹ 1000 crore backed by GoI guarantee for 15 years' period taking the plea that the funds were required within the same financial year urgently for onward lending to infrastructure projects. LIC agreed (29 March 2012) to grant the Company a Rupee Term Loan of ₹1000 crore. The loan agreement was signed on 30 March 2012 and the loan was drawn on 28 May 2012.

Having entered into an agreement with LIC the Company had no other option but to draw the loan at an interest rate of 9.36 *per cent* p.a. plus guarantee fee to GOI @ 0.25 *per cent* p.a. i.e. making the effective cost of the borrowing as 9.61 *per cent* against the then prevailing AAA rates of 9.45 *per cent* for 15 years as per Reuters screen as on 28 May 2012. Even after considering the likely bond issue expenses of approximately 0.24 *per cent*[•], the extra avoidable cost of the borrowing from LIC at higher rate of 0.16 *per cent* (*i.e.* 9.61 *per cent* less 9.45 *per cent*), worked out to ₹ 21.57 crore (i.e., ₹ 1000 crore x 15 years x 0.16/100 less bond issue expenses of ₹ 2.43 crore). Moreover, though the borrowing was planned to be made within 2011-12 on an urgent basis, the same was deferred till end of May 2012 without recording any reasons therefor.

The Company/Ministry stated (August 2014/January 2015/March 2015) that keeping in view the high volatile conditions of the bonds market, the Company deferred the drawl of loan till May 2012, but since turbulent market conditions were not observed to cease in near term, and GOI guarantee was approved for the same, the Company raised the fund from LIC at the appropriate time as per the then market conditions. The Company also indicated the instances of bond issues at similar rates by Power Finance Corporation Limited (in April 2011 for 10 years @ 9.18 *per cent*), Indian Railway Finance Corporation Limited (in May 2011 for 20 years @ 9.47 *per cent*) and Rural Electrification Corporation Limited (in June 2012 for 10 years @ 9.35 *per cent i.e.85 basis points over G-Sec rates*).

The replies substantiated the fact that the funds were borrowed without assessing actual requirements and at rates higher than prevailing rates. As regards bond issues by other CPSEs quoted by the Company, the same were not comparable as the bonds of Power Finance Corporation Limited and Indian Railway Finance Corporation Limited were of 10 year and 20 year tenors, and were issued more than one year ago, whereas, the replies of the Company/Ministry in respect of the bond issue of Rural Electrification Corporation

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[•] ***Based on the bond issue expenses of ₹ 12.52 crore incurred by the Company on issue of secured and unsecured bonds aggregating ₹ 5142.28 crore during 2012-13 which works out to 0.24 per cent.***

Limited supports the audit observation as the same was raised at a rate of interest lower by 0.26 *per cent* than the rate at which the Company had borrowed the funds from LIC (i.e., 9.61 *per cent* effective rate).

7.1.6.5 Analysis of lending schemes of Company

The Company has been providing finance to different infrastructure projects under four different schemes viz. SIFTI, refinance, take out finance and credit enhancement scheme. The audit findings in respect of these lending schemes were as under:

(a) SIFTI

As already indicated in paragraph 7.1.1, the Company was incorporated to provide long term finance to viable projects under SIFTI. However, Ministry conveyed (24 October 2011) that the Company might be brought under the regulatory oversight of RBI by registering it as a Non-Banking Financial Company – Infrastructure Finance Company (NBFC-IFC). The Company was registered with RBI in September 2013. Accordingly, the Company after September 2013 was required to follow two set of guidelines *viz.* SIFTI and RBI guidelines.

Requirements of SIFTI restricted the Company from sanctioning the loans:

- To borrowers other than through a consortium,
- Beyond 20 *per cent* of total project cost,
- having average maturity lesser than 10 years, and
- to projects falling under sectors not covered in SIFTI.

Audit came across nine instances where projects involving proposed loan amount of ₹ 3098.36 crore were not approved by the Company on account of above restrictive clauses of SIFTI. The Company stated (January 2015) that they had taken up the matter regarding limitation of provisions of SIFTI with the Ministry.

The Ministry stated (March 2015) that they had approved (4 March 2015) modifications in SIFTI enabling the Company to lend:

- Under multiple banking arrangement instead of consortium;
- Upto 40 *per cent* of the total project cost; and
- To projects having average maturity of less than 10 years in case of flexible structuring.

Audit appreciates the action taken by the Ministry. However, the modifications only partially address the restrictive clauses because:

- The Company would still not be able to finance projects as a sole lender and beyond 40 *per cent* cap in otherwise eligible cases; and
- The scope of SIFTI was not reviewed to examine the possibility of inclusion of other sectors to make it broadbased and attractive.

(i) Non-compliance of SIFTI guidelines in respect of loan sanctioned for KMP Expressway

The project for construction of 135 km stretch of access controlled and elevated Kundli-Manesar-Palwal Expressway was awarded (31 January 2006) by Haryana State Industrial and Infrastructure Development Corporation Limited (HSIIDC), the Concessioning Authority, to KMP Expressways Limited (KMP) for a concession period of 23 years and 9 months. The scheduled commercial operation date of the project was 1 July 2009.

Due to change in the composition of KMP, writ petitions were filed (May 2006) by the initial constituents of KMP *viz*. Madhucon Projects Limited and Gammon India Limited for quashing the award of project. After dismissal (March/April 2008) of the petitions, an appeal and a special leave petition filed by Madhucon Projects Limited and Gammon India Limited with the Supreme Court of India, were also dismissed in May 2008 and June 2008 respectively.

Without waiting for the final outcome of the above disputes, a loan of ₹ 380 crore was approved (11 December 2006) by the Company, part financing the project having the total project cost of ₹ 1915 crore.

Audit observed that the loan was sanctioned despite the fact that the stipulated conditions of the then prevailing SIFTI guidelines of the Company were not fully complied with *viz.,* (i) the appraisal was not done by the lead bank (Para 6.1 of SIFTI) and (ii) no guarantee from lead bank was obtained for recovery of loan (Para 7.6 of SIFTI).

As the developer had failed to execute the project, the substitution clause of the agreement was invoked, the earlier developer was removed and the efforts were made by Consessioning authority for locating a new developer (April 2014).

Thus, the Company compromised on compliance of SIFTI guidelines and failed to protect its own financial interests. The loan of ₹ 135.25 crore (outstanding amount as on April 2014) extended to the borrower ultimately became a non-performing asset for the Company.

The Company stated (August 2014) that all the decisions had been taken in line with the Lead and other Lenders in the Consortium as per the SIFTI and added that the Information Memorandum was prepared and circulated by SBI Caps and all the participating Lenders had sanctioned loan on that basis. Further, in infrastructure loans, lead lender also take care of the recovery on behalf of all the participating Lenders in the Consortium.

The Ministry added (March 2015) that the project was being re-tendered without taking into consideration lenders' dues and in view of this lenders had filed intervener application in the Supreme Court for protecting their interests.

The reply is to be viewed against the fact that IDBI Bank was the lead lender in this consortium and appraisal was required to be done by them and not by SBI Caps as per SIFTI guidelines. Further IDBI Bank did not guarantee recovery of loan through them in this case.

(ii) Term loan assistance to Srinivasa Gayithri Resource Recovery Limited.

Srinivasa Gayithri Resource Recovery Limited, the concessionaire, was awarded a ‘waste to energy project’ by Bruhat Bengaluru Mahanagara Palike, the Concessioning Authority, on Public Private Partnership (PPP) basis. For part financing the project, the Company, sanctioned (May 2007) a term loan assistance of ₹ 14 crore to Srinivasa Gayithri Resource Recovery Limited, the borrower, in consortium with Indian Bank (Lead Bank) and Oriental Bank of Commerce (OBC) on the basis of the appraisal done by the lead bank. The scheduled Commercial Operation Date (COD) was March 2010 which was rescheduled multiple times, for the first time upto December 2010 and latest upto March 2013.

The lead bank informed (9 April 2014) the Company that it had assigned its share in the project to one M/s Edelweiss Asset Reconstruction Company Limited (EARCL). The Company requested (21 April 2014/ 25 August 2014) the Indian Bank (the erstwhile lead bank) to hold a Joint Lenders Meeting and to inform the terms and conditions of the transfer of their stake to EARCL. Meanwhile, the Concessioning Authority, informed (16 August 2014) the Company that since the concessionaire had not been able to operationalize the project and neither had taken any convincing steps to remedy the default as per the concession agreement, they were considering terminating the said agreement.

Finally, the consortium meeting was held on 10 September 2014, which was attended only by the Indian Bank and the Company wherein the latter learnt that the other member of the consortium i.e., OBC had also sold its stake to EARCL. A copy of the Assignment Agreement entered into with EARCL was circulated in the meeting which revealed that for a consideration of ₹ 18.50 crore, the share of Indian Bank against the overdue amount of ₹ 29.45 crore was transferred to EARCL resulting into sacrifice @ 37.18 *per cent*. The Indian Bank also informed that since the asset had been assigned to EARCL, no conclusive decision could be taken in that meeting and they had no role to play and further action if any, could be taken by EARCL and the Company only. Lately, the Company also requested (17 September 2014) EARCL for taking over of its share of loan (totalling to ₹ 21.80 crore as on August 2014) on similar lines as of the other consortium members.

Audit observed that:

- Common Loan Agreement did not contain any clause prohibiting the consortium members from quitting / assigning their stake to a third party. There was no standard operating procedure in the Company to ensure continued commitment of lead lender through insertion of such clause in the common loan agreement.
- The Company was left with the option of either continuing with the existing project which was not progressing or to transfer its share to EARCL bearing a loss of ₹ 8.11 crore (i.e. ₹ 21.80 x 37.18 *per cent*).

The Company/Ministry stated (January/March 2015) that they had already informed Department of Financial Services vide their letters 30 September 2014 and 23 December 2014 of the unilateral action taken by the Lead Bank under Consortium Arrangement and highlighted that to protect the spirit of consortium it was desirable that Lead

Bank/Syndicator maintained their share in the debt and did not exit the consortium. The Company added that the possibility of incorporating a 'tag-along' clause in future agreements to safeguard the interest of the Company was being explored. The Company is also parallely exploring other options to maximize recovery and exit from the account.

The replies substantiate absence of standard operating procedures in the Company to safeguard its interests against quitting of lead/other lenders of the consortium.

(iii) Non-funding of cost overrun

On examination of the records relating to selected cases of restructured loans, it was seen that the Company had been declining to fund cost overrun in the projects of direct lending taking different pleas viz., (i) the Company was not authorized to fund cost overrun under SIFTI, or (ii) the internal guidelines of the Company did not permit funding of cost overrun.

As per the credit policy of the Company, restructuring of loan account is done after establishing the financial viability and reasonable certainty of repayment from the borrower as per the terms of restructuring package. While the projects are assessed viable by the Company in terms of the restructuring packages approved by it, the Company did not find it appropriate to finance the cost overruns on such restructured packages without any recorded reasons. The system needs to be examined so that the business opportunities for financing do not get lost in case of restructured projects which are otherwise viable. Audit observed that while restructuring the loans, the Company did not agree to finance cost overruns without any documented reasons in 13 cases involving a business opportunity of ₹ 1064.94 crore.

The Company stated (January 2015) that they generally had not been financing cost overrun in the projects. SIFTI, however, has not barred the Company from funding cost overrun. The matter was discussed at the MIC meeting held on 22nd September 2014. It was observed that most of the infrastructure projects were currently facing cost overrun. It was also observed that such cost overruns were funded invariably by existing lenders on pro-rata basis. Non-participation by the Company in which it was a member of consortium might result in non-release of funds by other lenders, putting the project in jeopardy. This also went against the spirit of consortium lending and had already resulted in bitter complaints from other lenders. DFS (Department of Finance Services), Ministry of Finance vide letter dated 3rd November, 2014, had urged the Company to participate in cost overrun and sanction additional funding/ priority loan, which would resurrect the infrastructure projects facing difficulties. The Company should also participate in the CDR[♠] forum by becoming regular member and sanction re-structuring packages in line with members of banks, involving revision in interest rate, additional funding, re-structuring of existing liabilities and repayment period. In view of the foregoing, the Company had reviewed the matter at its MIC meeting held on December 16, 2014 and decided to participate in the cost-overruns, wherever necessary.

The Company/Ministry (January/March 2015) accepted the audit observation.

♠ ***Corporate Debt Restructuring***

(b) Refinance Scheme

As per the lending terms of SIFTI, the Company could fund viable infrastructure projects through Refinance to banks and Financial Institutions towards loans granted by them with tenor exceeding 10 years. In February 2009 (*i.e.,* nearly three years after approval of SIFTI), Government of India (GOI) defined the *modus operandi* for refinance by approving the Refinance Scheme and permitted the Company to raise ₹ 10,000 crore through tax free bonds in tranches. The Company adopted the Refinance Scheme in February 2009. Salient features of the Refinance Scheme were as under:

- Refinance would be made available to new projects in road and port sectors only for which bids were submitted on or after 31.01.2009;
- The Company would provide refinance up to 60 *per cent* of the loans provided by the individual banks to infrastructure projects in roads and port sectors; and
- The banks would not charge more than 2.5 *per cent* over and above the rate charged by the Company.

The Company informed (26 October 2009) the Empowered Committee (EC) that the restrictions of the Refinance Scheme *viz.,* providing finance in the projects (a) which pertained to road and port sectors only, and (b) for which bids were submitted on or after 31 January 2009, had collectively constrained the disbursement under the scheme, and the Company could not utilize ₹10,000 crore raised in January/March 2009 *i.e*. for more than six months. Despite piecemeal relaxations by EC permitting the Company to extend refinance to Public Financial institutions in addition to banks (December 2009), relaxation in the restrictions relating to rate of interest and road and port sectors (March 2011) the Company could utilise only ₹ 6256 crore since inception of scheme in 2009 to March 2014 for the Refinance Scheme.

The Company/Ministry stated (January/March 2015) that though certain covenants have been modified suitably over a period of time to make the Refinance scheme more attractive, the important factor, which determines the attractiveness of the scheme, viz. the Rate of Interest (RoI) offered by the Company under Refinance scheme was not attractive enough to expand the scheme to the desired level. The Company had been raising the funds by issue of bonds or raising resources from multi-lateral/bilateral agencies. The total cost of funds after considering the hedging of foreign currency lines of credit works out to be on-par with the costs of funds of mobilizing resources by issue of bonds. As the other banks, Financial Institutions/NBFCs also had access to the bonds markets, the USP[♣] of Refinance scheme offered by the Company had been blunted.

The replies substantiate the audit observation that the Refinance scheme was largely unsuccessful.

(i) Irregular sanctions under Refinance Scheme

The Company under the Refinance Scheme sanctioned loans to Rural Electrification Corporation Limited (REC), Power Finance Corporation Limited (PFC) and

[♣] ***Unique Selling Proposition***

Infrastructure Development Finance Company Limited (IDFC) in deviation with the terms of the scheme after obtaining approval from the EC (**Annexure-XI**). Audit observed that:

- The Company curtailed the tenor of the loans sanctioned to REC, PFC and IDFC under the refinance Scheme from the stipulated minimum tenor of 10 years to upto 1 year in 9 out of 10 cases against the spirit of the refinance scheme.
- The Company did not fulfill the main objective of Refinance Scheme by linking the date of maturity of such loans with that of the tax free bonds under which funds for the refinance scheme were raised by the Company.
- Due to inclusion of pre-payment clause in deviation of the scheme, the Company had to accept the pre-payment of the loan amounting to ₹ 1195 crore on 10 September 2014 (i.e., interest reset date) from REC.

The Company/Ministry stated (January/March 2015) that the USP of the scheme viz. the Rate of Interest (RoI) offered by the Company under Re-finance Scheme was not attractive enough to expand the scheme to the desired level. As the other banks, FIs/NBFCs also had access to cheaper sources of funds like deposits, the bonds markets, etc., the USP of re-finance scheme offered by the Company has been blunted. Further, the interest rate was to be reset every year. It was normal commercial practice to stipulate Annual Reset for longer tenor loans. REC had chosen to repay the loan on the reset date, as it could mobilize the funds at more competitive rates than that offered by the Company.

(c) Takeout Finance Scheme

With the objectives to boost the availability of longer tenor debt finance for infrastructure projects and to address the sectoral/ group / entity exposure issues and asset-liability mismatch concerns of lenders, the Company submitted the Takeout Finance Scheme before the EC for its approval, which was approved by EC in January 2010 (10th meeting). The scheme was implemented from 16 April 2010. The salient features of the Scheme were as follows:

- The eligible entities were the scheduled commercial banks or any other participating entities who had extended loans under the Common Loan Agreement to the Borrower.
- The projects should have achieved financial closure and have a residual debt tenor of at least 6 years.
- The extent of takeout finance on the outstanding amount of loan of a lender from whom the loan is to be taken over on the scheduled date of occurrence of takeout was 75 *per cent*. However, the total takeout amount could not exceed 50 *per cent* of the total residual loan of the infrastructure project.

Despite multiple modifications having been made in various clauses of the Scheme to make it more attractive business growth under the scheme was not good as seen from the following:

- Since introduction of Takeout Finance Scheme in 2010, the Company sanctioned 61 projects amounting to ₹ 11,348.21 crore till March 2014 out of which 28

projects (45.90 *per cent*) wherein total amount sanctioned of ₹ 4864.35 crore (42.86 *per cent*) was involved were cancelled subsequently.

- Out of remaining 33 projects, disbursement of ₹ 3870.76 crore was made in 23 projects against sanctioned amount of ₹ 4120.30 crore, and in 10 projects, wherein loan of ₹ 2363.56 crore was sanctioned upto March 2014, no disbursement was made (June 2014).

The Company stated (January 2015) that major reason for cancellation of sanctions made under Takeout Finance Scheme was refusals on the part of existing lenders to furnish NOC for takeout finance. Further, in certain cases, the existing lenders themselves had come forward to reduce the rate of interest in line with the interest rates offered under takeout finance by the Company, which discouraged the borrowers to avail takeout financing from the Company. Though the Company's rate of interest under Takeout Finance Scheme and Re-finance scheme are generally lower than the interest rates offered under direct finance scheme, the impediments to the Takeout Finance Scheme were being created by the existing lenders with a view to retain projects which have become operational thereby overcome major risk viz. the implementation risks. The Ministry further informed (March 2015) that ₹ 1851.98 crore had since been disbursed in six cases and in balance four cases, the Company was continuously pursuing with borrowers.

(d) Credit Enhancement Scheme

The Company approved (18 August 2011) the 'Outline – Credit Enhancement Scheme' for viable infrastructure projects. Under the scheme, the Company was required to extend the credit enhancement in the form of guarantee to commercially viable infrastructure projects up to ₹ 4000 crore, wherein the projects had minimum rating of BBB any credit rating agency, and had achieved the Commercial operation date.

Audit observed that though the first pilot project had been approved by the Ministry of Finance in September 2012, the Company had not funded any project up to September 2014 under this scheme.

The Company stated (January 2015) that while they had given in-principle approval to a few transactions under this pilot scheme, no bond issue availing the Company guarantee had taken place mainly due to the prevailing market conditions. The Ministry added (March 2015) that Regular Credit Enhancement Scheme had since been approved in March 2015.

The replies to paras 7.1.6.5 (b) (i), 7.1.6.5 (c) and 7.1.6.5 (d) need to be viewed against the fact that not a single bond issue had taken place under Credit Enhancement Scheme even after lapse of more than three years since the scheme was launched. The results of Regular Credit Enhancement Scheme of March 2015, in terms of its attractiveness, popularity and performance, can only be known after a reasonable period of time. Refinance and Takeout Finance Schemes also remained largely unsuccessful. Therefore, there is a need for the Company to critically revisit the two schemes mentioned above considering the market trends, prevailing rate of interest, publicity requirements and other financial terms to make them attractive to borrowers.

7.1.7 Monitoring

7.1.7.1 Non-adherence to the directions of BOD

Review of the agenda and minutes of the meetings of the Board of Directors revealed the following:

(i) The Company noticed (23 October 2012) that as per audited standalone financials for the quarter ended 30 June 2012, the Company had suffered diminution in the Net Present Value of restructured assets by ₹ 4.42 crore. The Board of Directors advised that valuable lessons should be learnt from experiences gained from problems/impediments/issues leading to restructuring of accounts and the same should be incorporated as checklist points for future reference and guidance.

In the same meeting, the Board also desired that cumulative cost overrun in respect of restructured accounts should also be placed before the Board. Audit did not find any such information having been placed before the Board till date (September 2014).

(ii) While approving its Standalone Financial Statements for the Quarter ended 30 June 2013, the issue of restructuring was again deliberated by the BOD (29 July 2013) when it was observed that in most of the restructured accounts, the Company had sanctioned loans without availability of land in road projects and without Fuel Supply Agreement (FSA) and/or Power Purchase Agreement (PPA) in power projects. Consequently, there was inordinate delay in implementation of projects entailing requirement to make huge provisions. The Board also advised the Company to ensure that these critical requirements were not compromised in future.

Audit observed that, even after the direction of the Board, the Company continued to sanction[♦] loans without ascertaining the availability of required land in full and availability of FSA/PPA in violation of the directions of the Board.

The Company stated (January 2015) that the aspects advised by the Board of Directors were meticulously followed during sanction as well as monitoring stages. The position on cumulative cost overrun in respect of restructured accounts would be placed in subsequent meeting of the Board of Directors. It was further submitted that the Company did not carry out original appraisal and adopted the appraisal memorandum prepared by the Lead Bank or FIs. However, stipulating the same as pre-commitment conditions might result in inordinate delay in financial closure and the Company might lose its edge in the market and potential business.

As the Board had taken a well considered decision to ensure availability of land and signed PPA/FSA before sanction of loan by the Company, it was desirable for the Company to present to the Board the problems being faced by it in implementation of their directions and to obtain the guidance of the Board on this issue.

[♦] ***Five loans were sanctioned under direct lending scheme without availability of entire land or signing of PPA/FSA in May 2014.***

The Ministry stated (March 2015) that as per Board directives, conditions pertaining to availability of adequate land, FSA and PPA are to be stipulated as pre-disbursement conditions and the Company was following the same.

The reply of the Ministry is not correct because the Board had directed (29 July 2013) the Company to ensure availability of land and critical requirements of FSA and PPA while sanctioning loans i.e. as pre-sanction conditions and not as pre-disbursement conditions. Moreover, no further directive of Board to modify their directive of 29 July 2013 was provided by the Company to Audit.

Conclusion

Inadequacies in assessment of requirement of funds led to the Company facing a situation of progressively increasing surplus liquidity remaining parked in fixed deposits with banks which was not the core business of the Company. The Company was also unable to achieve its lending targets partly due to unattractive lending schemes and partly due to restrictive clauses of its Special Purpose Vehicle. As regards raising of funds, there were instances where the Company did not explore possibilities of cheaper finance available to it. Audit also observed deficiencies in the processing of loan appraisals, sanctions and monitoring.

Recommendations

The Company may:

- ***Assess fund requirements on a realistic basis and maintain detailed workings with documented reasons in support of assessment of requirement of funds.***
- ***Critically review the lending schemes considering the market trends, prevailing rate of interest, publicity requirement and other financial terms to make them attractive to the borrowers and ensure accelerated flow of funds in infrastructure sector.***
- ***Consider inclusion of a 'tag-along' clause for lead lender in the common loan agreements in 'consortium lending' to ensure that the lead lender stays committed to the consortium and the financial interests of the Company are safeguarded.***

MCX Stock Exchange Limited

7.2 Failure of MCX-SX to safeguard its interests

Review of agreements signed by MCX Stock Exchange Limited and Liquidity Enhancement Scheme implemented by the Company.

The MCX Stock Exchange Limited (the Company) was incorporated on 14 August, 2008. Multi Commodity Exchange of India Limited (MCX) and Financial Technologies (India) Limited (FTIL) were its promoters. The Company, upon incorporation in August 2008 had three Directors on the Board. Two Directors were from MCX and one Director was from FTIL who was also Chairman of the Company i.e. MCX-SX (October 2008 to September 2009). Thereafter, representatives from FTIL on the Board increased to two with the induction of Shri Jignesh Shah as Vice Chairman. Shri Joseph Massey, who worked as MD of MCX, joined as Director of the Company in August 2008 and was

appointed as MD & CEO of the Company from June 2009. Shri Jignesh Shah joined the Board of Directors of the Company in October 2008. Both continued until they resigned in October 2013 consequent to the show cause notice issued by Forward Market Commission (FMC) directing them to show cause why they should not be declared not to be 'fit and proper' to be Directors in MCX due to eruption of payment crisis in NSEL.

MCX-SX started its operations from October 2008. In order to operationalise its activities, the Company entered into a series of agreements with FTIL for procurement of software, maintenance services, rendering personnel support services, sharing of services, leasing of accommodation and so on during August 2008 to September 2013. The agreements with FTIL were signed during the tenure of Shri Joseph Massey as Director/MD & CEO. The Company entered into 161 Agreements with different entities, of which audit examined all the 30 Agreements entered into with FTIL, being related party agreements.

Audit scrutiny revealed the following:

7.2.1 Restrictive clauses in agreements in favour of FTIL:

The Company entered into long term agreements with FTIL for its Exchange operations which included purchase and maintenance of DOME and CnS software, ODIN Software licenses, Development and maintenance of Alert Management Software (AMS) and Service Provider Point of Presence (POP) i.e. network infrastructure service. These agreements had restrictive clauses that were against the interests of the Company which made exit from the agreements by way of termination and finding alternate vendor difficult for the Company. MCX-SX made a total payment of ₹ 303.75 crore to FTIL during 2008-09 to 2013-14 which amounted to 52 *per cent* of the total expenditure of the Company.

Some of the major restrictive clauses in the agreements were as under:

- The Company could not use any other software or introduce a new version of any hardware without the consent of FTIL and all hardware was to be of the kind that FTIL agreed to support.

- There was no clause of penalty or compensation in terms of delay in deliverable in any of the agreements entered with FTIL.

- The Company could not obtain similar services from any other service provider during the term of these agreements unless mutually agreed.

- The initial tenure of the purchase of DOME & CnS agreement was 33 years effective from August 2008 which would automatically stand renewed for further block of 33 years. With an addendum (November 2012), the tenure was changed to the effect that the agreement would be automatically renewed for a further block of 33 years and the total duration of agreement became 99 years which is beyond normal comprehension of standard agreements.

- Under the agreement for ODIN software license, FTIL would charge the Company for trading members' licenses for a minimum period of three months being the lock in period. Even if a member disassociated himself from the exchange during lock-in-period, MCX-SX was not entitled to reduce the number of software licenses.

- The agreement for ODIN software license provided for minimum monthly commitment, of ₹ 35 lakhs for first year, ₹ 50 lakhs and ₹ 60 lakhs per segment respectively for second and third year. The basis of the minimum monthly commitment or the extent of actual for providing ODIN licences was not on record.

- In case of premature rescission of the agreement for DOME and CnS, Alert Management Software (AMS) license, Service provider Point of Presence etc. MCX-SX had to make payments to FTIL for the remaining term of the agreement. The AMS agreement further contained a clause for payment of penalty @ 50 *per cent* of the AMC charges payable in the event of premature rescission.

The charges payable to FTIL in case of termination were as under:

Name of agreement	**Total amount payable (₹ in crore)**
DOME and CnS	324
AMS	90
Service Provider Point of Presence and co-location	16.58

From the above, it is clear that the agreements with FTIL were not on 'arm length' basis but on 'arm child' basis as the influence of the elder party was significant. The conditions in the agreements made the Company dependent on FTIL with no reasonable route of exit from the agreement.

The Company stated (December 2014) that the new management had initiated a review to establish the reasonableness of charges for similar line of business. Renegotiation of the commercial terms of the agreements with FTIL was in progress. Some agreements were suspended partially.

Reply establishes the fact that the terms of agreement with FTIL unduly favored FTIL and did not safeguard the interests of MCX-SX.

7.2.2 Defective assessment of requirements:

The Company entered into two agreements for Co-Location services (January 2013) to avail the space at FTIL's data center for hosting and offer co-location services to its trading members and service agreements for Web Services and Cost sharing arrangements for utilizing the services of personnel from FTIL for various activities and also for sharing the cost of infrastructure, computer peripheral, hardware, software etc. (effective from August 2008 / February 2009). Fees was payable in advance on yearly basis. The Company paid ₹ 6.40 crore for hiring 32 full racks for Co-location services for 2013. The requirement was reduced to 16 full racks in December 2013 and the Company

paid ₹3.20 crore for 2014. The Company paid FTIL a total of ₹ 6.42 crore towards web services and cost sharing.

Audit observed that the Company projected its requirement at higher level without flexibility for downward reduction and could not fully utilize the capacity available in respect of Co-location services. The Company did not conduct an independent review of the terms and conditions of the agreements in terms of the requirement of facilities, deployment of manpower, the rates and the tenure of the agreement etc. Also, FTIL was not responsible for any delay in the delivery of the deliverables, under the agreement. Thus the terms of agreement were loaded in FTIL's favour. Further, audit could not satisfy itself of the details of actual availment of services by the Company from FTIL, in the absence of records.

The Company stated (January 2015) that the agreement for service provider POP & Co-location services were made by erstwhile management and the new management has suspended the Co-location services agreement from 1 July 2014. The activity has been shifted to the Data Centre in the new premises and is being managed by the Company and services are being availed on actual basis.

The suspension of agreement is in line with the audit contention and is only an interim measure which does not relieve the Company from its liabilities.

7.2.3 Non-review of Liquidity Enhancement Scheme despite fall in business volume and the accumulated losses

SEBI introduced 'Liquidity Enhancement Scheme (LES)' from 2 June 2011 to enhance liquidity of illiquid securities in equity derivative segment (EDS) and extended it to Equity Capital Market (ECM) in February 2013. MCX-SX having commenced trade in ECM and EDS in the same month, without waiting for the performance of the members enrolled, introduced the scheme immediately. The Company additionally introduced an 'Additional Incentive scheme' for a period from March 2013 to June 2013 with specific cash rewards in each category.

During the period of operation of the scheme only 51 new members were admitted to the exchange. Also the volume of trade in the exchange in ECM increased from ₹ 27.18 crore (March 2013) to ₹ 2972 crore (June 2013) and then declined continuously upto ₹ 416 crore (March 2014). The volume of trade in EDS increased from ₹ 7707.22 crore (March 2013) to ₹ 32685.58 crore (July 2013) and then declined continuously upto ₹ 1280.19 crore (March 2014). The scheme envisaged incentive payment for any performance of trade on the exchange, without incentivizing volume of trade above a certain level or any focus on illiquid stocks.

Audit observed that as the Company was faced with difficulty in volume growth coupled with heavy operating expenditure, it should have reviewed the performance of its members before introduction of such scheme as the scheme envisaged payment of incentive even for normal performance. The Company discontinued the scheme on 10 April 2014 during which period, it had already paid a total incentive of ₹ 43.30 crore.

The Company replied (August/December 2014) that the scheme was introduced with the approval of its Board of Directors and the operation of the scheme was reported to the Board periodically. Further, in view of reducing the operating costs and to initiate steps for revival of the exchange, LES was discontinued in April 2014.

The reply supports the audit observation that the introduction of the scheme entailed high operating cost and was not beneficial to the Company and had to be ultimately discontinued.

7.2.4 Infrastructure and Personnel issues:

(a) Imprudent decision to acquire office accommodation on lease at Bandra Kurla Complex (BKC) Mumbai resulting in avoidable expenditure of ₹ 13.79 crore

The Company entered into an agreement (May 2013) with M/s. BKC Properties Private Limited for taking the premises (15000 sq. ft) at Vibgyor Tower, BKC, Bandra (East), Mumbai on lease for a period of five years (60 months) effective from 15 March 2013. The Company paid (May 2013) a refundable interest free security deposit of ₹ 4 crore. The rent payable for the accommodation was ₹ 44.48 lakh per month in addition to maintenance charges. The property was on lease to FTIL before being taken up by MCX-SX and the assets left over by FTIL were purchased by the Company for ₹ 2.63 crore. Thus, the Company paid ₹ 13.796 crore (August 2014) towards Deposit (₹ 4 crore), license fee, maintenance charges and car parking charges (₹ 7.16 crore) and towards used assets from FTIL without assessing the necessity for additional space.

In this regard, audit observed the following:

- The Company committed itself for occupation for 5 years in March 2013 itself by signing the term sheet even before the Management Committee of the Board of Directors approved the proposal in May 2013.
- The space at BKC was not fully occupied till August 2014 and therefore was only partially utilized during March 2013 to July 2014.
- There was no valuation report/justification available on record for the leftover assets purchased from FTIL. The assets are being depreciated at the book rate obtained from FTIL.
- The agreement contained a lock-in period of 36 months. Therefore, license fee had to be paid for a minimum period of 36 months irrespective of actual utilization of the premises. Thus, the Company committed itself to payment of license fee alone, to the extent of ₹16.01 crore (₹ 44.48 lakh x 36 months).

The Company stated (December 2014) that the new premise was fully occupied from August 2014.

(b) Outsourcing the functions of Personnel, Administration and Procurement

The Company entered (26 December 2008) into Memorandum of Understanding with FTIL for availing Management and other support services effective from October 2008 at

monthly service charges of ₹ 35 lakh. The scope of agreement was later revised to ₹ 15 lakh per month (effective April 2011).

Audit observed the following:

- The initial MoU gave FTIL the right to take decisions in respect of critical areas like business strategy, strategic recommendations to the business team, review of product performance, review of requirements for expansion and enhancement of capacity etc. This made the Company vulnerable and dependent on FTIL and compromised the confidentiality of its operations.
- The Company did not recruit its own personnel or attempt to outsource through tender mechanism.
- Additionally, Exchange specific services viz. Auditor, Business Analyst etc. were availed through exchange of correspondence with the approval of MD & CEO and were not backed by any formal agreement or approval of the Board. An amount of ₹ 14.36 crore on this account was paid during the three years period ending 31 March 2014.
- The reasonability of the rate of payments, confirmation of deliveries and requirement for continuation of these resources was not on record and could not be verified.

The Company stated (December 2014) that the services as per the MoU have been discontinued by the new management and all these functions are now been carried out by the Company itself.

(c) Payment of gratuity to MD &CEO on resignation

Shri Joseph Massey joined the Company as MD & CEO from 1st June 2009 and through agreements (June 2010 and March 2013) his tenure was extended for a further period of three years each. He resigned on 9 October 2013 as a fallout of the show cause notice issued by FMC declaring him as not 'fit and proper' person to hold any post in any Exchange.

Audit observed that the Company paid gratuity of ₹ 53.31 lakh to Sh. Massey for rendering total service of 11 years which included his earlier service in MCX. As Sh Massey was not transferred from MCX to MCX-SX and rather joined the Company upon resignation from the former, as per the Group Gratuity Policy, his service in MCX-SX alone was to be counted for payment of gratuity. Further, as he rendered less than 5 years of service in MCX-SX, he was not entitled to payment of gratuity at all. Thus, the payment of gratuity amount of ₹ 53.31 lakh was not in order.

The Company stated (August 2014) that it has sought legal opinion on the issue which is still awaited.

Conclusion

MCX-SX had entered into long term agreements with its related party FTIL that entailed various restrictive clauses as well as high costs. Further, the PSU Banks had 67 *per cent* shareholding as on 31 March 2010 and had their nominees on the Board of the Company during 30 April 2010 to 20 September 2012. These nominees of PSU banks on the Board of MCX-SX did not review these unfavourable agreements and failed to protect the interests of the banks they represented. Despite present action by new management, by way of suspension of various agreements with FTIL, the liability due to restrictive clauses in these agreements would continue as only interim action to suspend only a few agreements has been taken (January 2015).

The matter was reported (September 2014) to the Ministry; their reply was awaited (March 2015).

Security Printing and Minting Corporation of India Limited

7.3 Infructuous expenditure due to printing of fresh bank notes bearing the signature of former Governor of RBI

Security Printing and Minting Corporation Limited continued printing bank notes with the signature of former Governor of RBI even in 2014 though the then Governor had completed his tenure in September 2013 and thereby incurred an infructuous expenditure of ₹ 36.69 crore.

Bharatiya Reserve Bank Note Mudran Private Limited (BRBNMPL) is the nominated agency of Reserve Bank of India (RBI) for issuing the designs/printing plates with the approved signature of Governor of RBI to Security Printing and Minting Corporation of India Limited (the Company). Dr. D. Subbarao was the Governor of Reserve Bank of India (RBI) from 5 September 2008 to 4 September 2013 and Dr. Raghuram G. Rajan assumed office from 4 September 2013. BRBNMPL intimated Bank Note Press (BNP), Dewas (Madhya Pradesh), a unit of the Company, vide letter dated 14 September 2013 that approval of RBI to specimen note of ₹ 10 denomination with signature of new Governor was received and requested BNP to collect security material to start regular bank note printing. BRBNMPL also intimated (17 October 2013) BNP the approval of machine proof of ₹ 50, ₹ 100 and ₹ 500 denomination bank notes incorporating the signature of new Governor and asked BNP to furnish details for preparation of Nickel Altos.

Audit examination revealed that RBI had advised (September 2008) (at the time of change of charge of the then RBI Governor in that year) that all the bank note printing presses may start printing bank notes bearing the signature of new Governor in all denominations w.e.f. 1 January of 2009. Accordingly, at the time of change-over of RBI Governor in 2013, BNP, Dewas should have followed the same instruction and started printing bank notes with the signature of new Governor of RBI w.e.f. 1 January 2014. While Currency Note Press, Nashik, another unit of the Company, followed this procedure, BNP did not incorporate the signature of new RBI Governor w.e.f. 1 January 2014 but continued printing bank notes with the signature of former RBI Governor till 25 February 2014. BNP printed 372 million pieces (mpcs) bank notes during January to

February 2014 and remitted 146 mpcs to various regional offices of RBI which intimated (25 February 2014) that printing of notes with the signature of former Governor of RBI was not in order and directed the Company not to remit such notes forthwith. Audit examination revealed that 226.48♥ mpcs of bank notes of ₹ 20, ₹ 100 and ₹ 500 denomination costing ₹ 36.69 crore were still lying at BNP store (March 2015) and the chances of lifting of these notes by RBI were very remote as these notes were printed in 2014 carrying the signature of former Governor, who had completed his tenure in September 2013.

The Company stated (February 2015) that:

(i) Bank notes, which were printed between 1 January and 25 February 2014 were not rejected by RBI;

(ii) BNP, Dewas had supplied 146 mpcs bank notes to RBI valued at ₹ 38 crore in 2013-14 and the payment for the same had already been released by RBI; and

(iii) According to press release issued by RBI on 4 March 2014, these bank notes were legal tender. Part of these bank notes had already been issued by RBI to the Public being valid legal tender. Further, the bank notes in stock would be despatched as soon as instruction was received from RBI.

The reply is to be viewed in the light of fact that RBI had categorically asked the Company in February 2014 itself to stop sending such bank notes which were not in order. Further, RBI did not issue any delivery schedule for lifting of these bank notes even after lapse of more than one year. Moreover, RBI did not respond to request of the Company made in June/December 2014 so far (February 2015). Accordingly, the chances of lifting of these notes by RBI were bleak.

Thus, the expenditure of ₹ 36.69 crore, being cost of production of 226.48 mpcs bank notes bearing the signature of former RBI Governor with 2014 as the year of printing had become infructuous.

The matter was reported to the Ministry in December 2014; their reply was awaited (March 2015).

The New India Assurance Company Limited

7.4 Co-insurance business with private general insurance companies

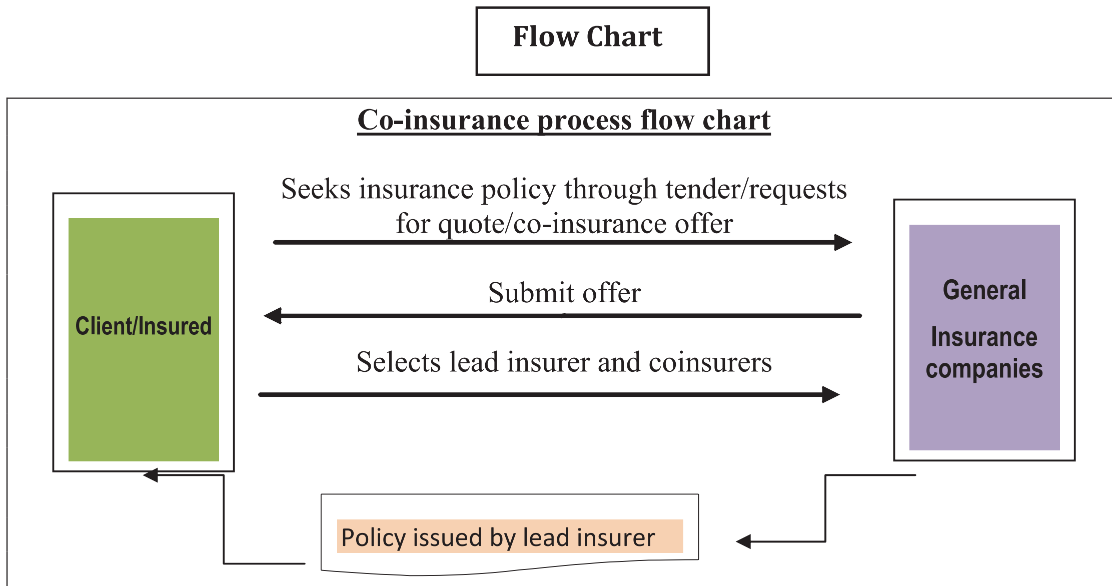
7.4.1 Introduction

The insurance market was opened by the IRDA (Insurance Regulatory and Development Authority) in August 2000 to private insurance companies, thus ending the monopoly of PSU general insurance companies. There are co-insurance arrangements between the PSU insurance companies and the private insurance companies. Under co-insurance, one

♥ ***60.82 Mpcs intaglio printed, 21.17 Mpcs numbered printed, 41.49 Mpcs bundled and 103.00 Mpcs Packed.***

company (known as the "lead insurer") underwrites the insurance business and shares a part of that business with other public/private insurance business. The premium is shared by these companies and the claims, if any, are also made good by them. The following flow chart explains the co-insurance process. As can be seen, the insured plays a prominent role in selecting the lead insurer and the co-insurance share of each co-insurer as well. The insurance companies resort to co-insurance arrangements in order to spread risk emanating from underwriting mega risk/high risk policies.

Flow Chart



During the period April 2012 to March 2013, New India Assurance Company Ltd (the company) assumed 968 co-insurance incoming businesses, where private general insurers were the leaders, for a total premium income of ₹ 135.94 crore. Audit reviewed 38 cases pertaining to the Mumbai Regional offices of the company out of 968 cases for the year 2012-13. These 38 cases registered a premium income of ₹ 69.80 crore (51.35 *per cent* of the total premium) and incurred a claim of ₹ 23.46 crore (33 *per cent* on the premium of ₹ 69.80 crore). Of the 38 test checked cases, 20 cases belonged to Fire class of business, 5 cases pertained to Engineering, 8 cases to Marine, 4 cases to Health and 1 to Miscellaneous (Public liability) class of business.

Audit scrutiny focused on whether the company had underwriting norms for co-insurance in place and whether these norms were followed consistently. Audit also looked into the safeguarding of financial interests by the company while entering into the co-insurance arrangements with the private insurance companies. The audit findings are stated below:

7.4.2 Underwriting Policy/Guidelines

The company put in place the revised underwriting policy (November 2007) which prescribed the general underwriting principles (self-sustainability), underwriting limits of officials, the authorities to decide the limits etc. This did not cover co-insurance arrangements. The Company has not yet framed specific guidelines for its co-insurance business.

Ministry has stated in its reply (March 2015) that, the underwriting guidelines adopted by the company are applicable to the incoming coinsurance. However, in view of the nature of co-insurance business wherein role of the lead insurance Company and that of the client in determining the terms and conditions of the insurance contract, is significant, specific guidelines for this area of business are essential.

7.4.3 Inadequate Risk and Client Profile

Prudent and sound underwriting warranted that an underwriter maintained a risk profile and client profile which influenced the underwriter in deciding whether to accept or reject the risk. A prudent judgment was made by the underwriter by analyzing the existing loss record and future risk exposure. Hence in order to assess the prudency of underwriting co-insurance business, the Audit test checked whether the Company recorded the most vital information such as Incurred Claims Ratio of the risk in the previous three years, Average Combined Ratio on the risk in previous three years and details of risk such as the location of the risk, total exposure, break up of Sum Insured, the project report, annual reports, risk inspection reports, mode of conveyance in the case of marine cargo business etc., as relevant to the case before acceptance of the risk. It was observed that in only 3 out of the 38 cases basic details in respect of risk and client profile were maintained by the Company.

The Underwriting guidelines (Brokers policy-HO:FTD:9-12, dated 30th July 2012) directed that for proper evaluation of risks/proposals, finalizing prudent terms and rates and mitigating the probability of any bad underwriting, the mandatory submission of minimum 3 years premium and claims experience by the brokers was to be ensured. Audit noticed that in 19 out of 38 cases the Incurred Claims Ratio which is the most vital information in decision making was not available. In 7 out of these 19 cases, claims for an amount of ₹ 3.03 crore were settled. Thus the company assumed risk without assessing the gravity of risk.

Ministry stated in its reply (March 2015), that Company has instructed (August 2014) the operating offices to file all such details while accepting incoming co-insurance business.

The company issued a circular based on the audit observation. However, the company needs to make a policy, on the issue of Co-insurance.

7.4.4 Inadequacies in Risk Assessment and Approval

The company vide its Board note dated December 2007, laid down a broad framework for classification of risks, rating of risks, rating pattern of risk, merit rating or scoring of risks and acceptance limits of risks for the operating offices.

Risk Inspection is one of the tools of risk assessment followed in Insurance Industry. Further, the IRDA instructions (December 2007) also stated that individual rated risks, i.e., risks above a certain limit of Sum Insured (as per the product classification of the underwriting policy) were to be rated based on the Inspection report.

Audit observed that in none of the 25 fire and Engineering cases, risk inspection was carried out by the company itself or the Inspection report of the lead insurer obtained

before acceptance of the risk. It was seen that of these 25 cases the Company settled 6 claims for an amount of ₹ 21.78 crore.

Audit observed that none of the 38 cases had justification notes for acceptance, duly approved by the Competent Authority. It was observed that though 12 out 38 risks were of Sum Insured (SI) exceeding ₹ 500 crore, the laid down procedure in respect of risk inspection was not followed.

Ministry stated in its reply (March 2015), that the Company has instructed the operating offices to adhere to the procedure for acceptance of incoming co-insurance specially with reference to collection of data along with incurred claims ratio for the last three years and fire fighting and inbuilt safety measures.

7.4.5 Acceptance of Risk at Lesser Rate under Co-insurance

Audit observed in 9 out of 38 cases coinsurance shares was accepted at a rate lower than that quoted by the Company at the time of participation in the tender for 100 *per cent* share in these nine cases. The lower premium amounted to ₹ 2.02 crore in these nine cases. Of these 9 cases Company settled 3 claims of ₹ 2.27 crore. The percentage of under quote exceeded 15 *per cent* in 5 cases resulting in total under quote of premium by ₹ 1.48 crore.

Ministry has stated in its reply (March 2015) that the co-insurance share is accepted only after proper assessment and evaluation of the risk. Due diligence is also observed while accepting coinsurance share. Further, the premium rates are based on certain assumptions as perceived by the underwriter.

However, as the Company did not provide any justification for accepting the same risk subsequently at a lesser rate and in the absence of guidelines, the acceptable range of variance could not be verified.

7.4.6 Inconsistencies in the policies of the company and the lender

The Public sector general insurance companies and private sector general insurance companies entered into Coinsurance agreement on 20 February 2009 which provided that as soon as the policy was issued by the leader a certified true policy copy was to be made available to the co-insurers.

Audit observed that in all the 38 cases, the company did not collect a copy of the original policy issued by the Lead insurers. At the instance of Audit, the company obtained the copy from the lead insurers and inconsistencies were noticed in 6 out of the 38 cases. A comparison of the significant inconsistencies is cited below:

Sl. No	Insured / Leader	Particulars
1	Deepak Fertilizers (12140144125100000003) (Leader Bajaj Allianz General)	The company policy copy showed sum insured (SI) at ₹ 3000 crore whereas leaders policy showed SI at ₹ 300 crore.

2	Deepak Fertilizers (12140144125100000002) (Leader Bajaj Allianz General Insurance)	The company policy copy showed SI at ₹ 5.72 crore whereas leaders policy showed SI at ₹ 10.35 crore.
3	Tinplate (12140244125800000001) (Leader: TATA AIG General Insurance)	SI in the leader's policy copy was ₹ 2,62,45,738 whereas it was ₹ 2,64,81,358 in the company's copy, i.e., it was higher by ₹ 2.36 lakh. The company policy copy showed 100 *per cent* premium at ₹ 37,735 whereas the leader's policy copy showed it at ₹ 37,400.
4	Gallant Metals Ltd (11280011120600000001) (Leader: ICICI Lombard)	Leader's policy showed SI of ₹ 396.75 crore whereas company policy showed SI of ₹ 356.75 crore. The company policy showed premium of ₹ 40,02,145 whereas Leader's policy showed a premium of ₹ 40,04,984.
5	AES Solar Ltd (12050011120600000004) (Leader: TATA AIG General)	Sum insured for MLOP and FLOP under Business Interruption insurance section was Nil in the company's policy copy whereas it was ₹ 31 crore in leader's policy copy.
6	Deepak Fertilizers (121401441111201000000025) (Leader: Bajaj Allianz)	The company's policy copy showed premium at ₹ 2.154 crore and SI at ₹ 2705.90 crore whereas the leader's policy showed premium at ₹ 2.146 crore and SI at ₹ 2410.32 crore.

Ministry has stated in its reply (March 2015) that, though the lead insurers are required to share policy copies, sometime the Company do not get the same. To book the premium the underwriting office indexes the coinsurance share by inputting the available information.

7.4.7 Inadequacies in the Underwriting Software (CWISS)

The company has developed a software called CWISS (Centralised Web based Insurance System Solution) to facilitate its insurance activities. Current year's policy issued by the company carries the previous year's policy number if the company has 100 *per cent* share in the policy (non co-insurance policy). However, if a policy under co-insurance is renewed, the previous year's policy number is not indicated. As this facility would enable the company in obtaining the previous history of the risk, CWISS needs to have this functionality.

Ministry has stated in its reply (March 2015) that the service provider is in the process of devising a workflow whereby this can be put to production.

Conclusion

The Company needs to address the issues of obtaining risk profile and client profile before acceptance of co-insurance contracts. Detailed justification for accepting co-insurance at lesser rate than higher rate quoted for 100 *per cent* share should be recorded. Copies of co-insurance contracts should necessarily be obtained from the lead insurer to rule out possible inconsistencies.

Audit holds the view that the system and procedures adopted by the company in accepting the co-insurance business need review and improvement.

Ministry replied that the Company had noted the discrepancies pointed out by audit and assured remedial measures to streamline the procedures.