

CHAPTER IV: MINISTRY OF MICRO, SMALL & MEDIUM ENTERPRISES

Credit Guarantee Fund Trust for Micro & Small Enterprises

4.1 Functioning of Credit Guarantee Fund Trust for Micro & Small Enterprises

4.1.1 Introduction

4.1.1.1 Definition of Micro, Small & Medium Enterprises

As per the Micro, Small & Medium Enterprises Development (MSMED) Act, 2006 the Micro, Small and Medium Enterprises (MSME) are classified as shown in Table 4.1:

Table 4.1: Definition¹ of Micro, Small and Medium Enterprises

Enterprise Category	Manufacturing Sector (Investment in plant & machinery)	Service Sector (Investment in equipment)
Micro Enterprises	Does not exceed ₹25 lakh	Does not exceed ₹10 lakh
Small Enterprises	More than ₹25 lakh but does not exceed ₹5 crore	More than ₹10 lakh but does not exceed ₹2 crore
Medium Enterprises	More than ₹5 crore but does not exceed ₹10 crore	More than ₹2 crore but does not exceed ₹5 crore

4.1.1.2 Establishment of the Credit Guarantee Fund Trust

Financial inclusion, particularly for the small and medium enterprises is widely recognised as one of the key drivers of economic growth and job creation in all economies. Despite its contribution to the economic development, the small industries sector has been beset with certain handicaps especially of fund availability from formal financial sector. To facilitate fund flow, the Ministry of Small Scale Industries and Agro and Rural Industries (now Ministry of Micro, Small and Medium Enterprises), Government of India (GoI) in consultation with Small Industries Development Bank of India (SIDBI) formulated the Credit Guarantee Fund Scheme for Small Industries (2000).

The Ministry of Micro, Small and Medium Enterprises (MSME), GoI and SIDBI established (27 July 2000) a Trust named 'Credit Guarantee Fund Trust for Micro and Small Enterprises' (hereinafter called as CGTMSE/ Trust) to guarantee the loans and advances (term loan and/ or working capital assistance), sanctioned and disbursed by the lending institutions without any collateral security and/ or third party guarantees to the new or existing Micro and Small Enterprises (manufacturing units including information technology (IT) and software industries or such other industries as may be decided by the

¹ The Ministry of MSME, vide notification dated 1 June 2020, has revised the criteria for classification of micro, small and medium enterprises. However, as the notification will come into effect from 1 July 2020, while the audit period is limited upto March 2019 only, the extant (pre-revised) definition of micro, small and medium enterprises has only been considered in the audit para.

GoI and SIDBI), and to levy guarantee fee/ annual service fee/ other charges on the lending institutions as may be decided from time to time.

The objective of providing guarantee against loans extended by the financial institutions and Non-Banking Financial Companies to the Micro and Small Enterprises (MSEs) was being pursued by implementing (September 2018) following two schemes:

a) Credit Guarantee Fund Scheme for Micro and Small Enterprises (CGS-I, for banks and financial institutions)

Under CGS-I, the Trust covers credit facilities extended by the Member Lending Institutions (MLIs) to a single eligible borrower in Micro and Small Enterprises Sector for credit facility (i) not exceeding ₹50 lakh through Regional Rural Banks/ Financial Institutions/ Small Finance Banks and (ii) not exceeding ₹200 lakh through Scheduled Commercial Banks, select Financial Institutions and Non-Banking Financial Companies by way of term loan and/ or working capital facilities without any collateral security and/ or third party guarantees.

b) Credit Guarantee Fund Scheme for Non-Banking Financial Companies (CGS-II)

CGS-II was launched on 25 January 2017 (modified on 1 April 2018) to cover eligible credit facility sanctioned by the NBFCs to eligible borrowers under MSE sector on portfolio basis.

The important provisions of CGS-I are briefly explained in **Appendix-XV** and the major areas of difference between CGS-I and CGS-II are shown in **Appendix-XVI**.

As of 31 March 2019, the corpus fund of the Trust was ₹6,914.91 crore, of which the GoI had contributed ₹6,414.91 crore (92.77 per cent) while SIDBI had contributed ₹500 crore.

4.1.1.3 Audit objectives

The Audit was conducted to ascertain whether:

- CGTMSE ensured that the provisions of the guarantee schemes were duly complied with and the larger objective of funds flow to MSEs was achieved;
- the corpus fund of CGTMSE was not over-leveraged and the process of claim settlement was simpler to foster confidence among the MLIs in the guarantee instrument; and
- CGTMSE applied adequate checks on guarantee applications of MLIs before approval and issue of guarantees, and internal controls were adequate to ensure compliance of provisions of the schemes by the MLIs to minimise the business risks.

4.1.1.4 Audit criteria

The audit criteria for achieving the audit objectives consisted of:

- The Micro, Small and Medium Enterprises Development Act, 2006
- Credit Guarantee Fund Scheme for Micro and Small Enterprises (CGS-I) and Credit Guarantee Fund Scheme for NBFCs (CGS-II)
- Trust deed and modifications in trust deed made from time to time
- Agenda and Minutes of the meetings of Board of Trustees and other committees
- Circulars/ guidelines/ reports issued by the GoI, SIDBI, RBI and Trust

4.1.1.5 Scope and methodology of audit

The scope of audit included performance of the guarantee schemes (primarily CGS-I) during the period from 1 April 2015 to 30 September 2018. The data relating to previous years was also used at some places for better trend analysis. The report has been updated upto 31 March 2019, wherever data was available.

The audit methodology included Entry Conference (September 2018) with the Management of CGTMSE, review of records, collection and analysis of upfront and back-end data, analysis of data (12,10,061 applications) of live guarantees as on 30 September 2018, issue of audit queries to the Management and obtaining replies thereon, discussion with the Management at different time periods, issue of draft report to the Management (February 2019) and Ministry (May 2019), and Exit Conference (April 2019) with the Management of CGTMSE.

The Management submitted (January 2019 and March 2019) replies to the audit queries and to the draft report. The reply of the Ministry was received in September 2019. The report has been finalised after considering the replies of the Management and Ministry and discussions held with the Management during Exit Conference.

4.1.1.6 Audit limitation

The data on CGTMSE's portal is always in a variable state and does not provide chronological profile of an MSE unit *i.e.* frozen state of events on a particular date and time. As such the data generated by the system at a current date and time for some past date and events, presents the current picture including events occurred after the date for which data has been generated. Absence of frozen data led to non-availability of the correct position of an account as regards chronological details of sanction and disbursement of loans by the MLI, approval of guarantees for the enhanced loan amount, the NPA status of an account on particular date, *etc.* Further, the system counts the term loan and working capital guarantees issued to an MSE unit as two accounts. Ideally the system should count all types of guarantees issued to an MSE unit as one account in order to have complete picture of a particular unit.

4.1.1.7 Acknowledgement

Audit acknowledges the cooperation extended by the Management and the Ministry for timely completion of the audit.

4.1.2 Operational framework of the Trust

4.1.2.1 Business model of CGTMSE

The business model of CGTMSE has the following salient features:

- a) Corpus fund is contributed by GoI and SIDBI, which is also a GoI Undertaking.
- b) CGTMSE is registered as a Trust and its operations are limited to the provisions of the Trust deed executed between GoI and SIDBI. CGTMSE indirectly supports funds flow to the Micro and Small Enterprises (MSEs).
- c) The sanction and disbursement of loans to MSEs is done by the Financial Institutions (FIs). There is no relationship between CGTMSE and borrower MSEs. CGTMSE does not in any way provide supporting facilities to MSEs for availing credit from the FIs.
- d) The eligible FIs known as Member Lending Institutions (MLIs) have to register themselves for availing guarantee from CGTMSE against the credit extended to MSEs. The MLIs have to execute an agreement with CGTMSE for this purpose.
- e) The MLIs can obtain guarantee cover from CGTMSE for credit extended upto ₹2 crore only. The credit facility should be free from any collateral security or third party guarantee for availing guarantee from CGTMSE.
- f) The appraisal of loan applications or appraisal of proposed business is the sole responsibility of the MLIs. Credit rating of loans above ₹50 lakh is mandatory for the MLIs.
- g) CGTMSE approves guarantee once the scheme parameters are fulfilled. CGTMSE issues guarantee on payment of prescribed fees by the MLIs.
- h) The guarantee instrument of CGTMSE covers 50/ 75/ 80/ 85 *per cent* (as per various categories of products/ entrepreneurs/ region) of the loan amount.

4.1.2.2 Comparison of CGTMSE's guarantee instrument with other (Asian) Schemes

CGTMSE has been operating the guarantee instrument for more than 18 years. However, it has not undertaken any study to evaluate its guarantee instrument with other such schemes being operated by other countries across the globe so as to adopt their best practices to make the scheme conducive to the requirement of MSE sector in India. CGTMSE is working in a very limited manner as compared to the major schemes in guarantee segment that are being operated by Japan and South Korea.

A comparison of the guarantee instrument of CGTMSE with other Asian guarantee schemes like Korea Credit Guarantee Fund (KODIT), Japan Finance Corporation (JFC), Japan Federation of Credit Guarantee Corporations (JFG), Credit Guarantee Corporation Malaysia (CGCM) and Perusahaan Umum Jaminan Kredit Indonesia (PUJKI) on certain parameters like contribution to corpus fund, regulatory authority, type of guarantee, credit assessment, types of services provided, type of coverage, percentage of coverage, guarantee fee, fund size, *etc.* is shown in **Appendix-XVII**.

As may be seen from **Appendix-XVII**, there are no exact parallel instruments to enable comparison on best practices. The following points, however, merit attention:

a) **Fund Size:** CGTMSE's corpus fund (US\$ 1.5 billion) is much smaller than the fund size of other countries such as Japan and South Korea.

b) **Operating mechanism:** CGTMSE is indirectly supporting the lending activity of the financial institutions. It does not offer support services to the MSEs like consultancy and management services. There is no direct contact between CGTMSE and the MSE unit requiring funds. The MSEs are directly dependent upon the lenders for financial assistance.

c) **Organisation structure and limitation of Human Resources:** In contrast with the other countries, CGTMSE is operating pan India through only one office with very limited staff. All the higher management personnel (Chief Executive Officer, General Manager and Deputy General Manager) are on deputation from SIDBI while the rest are on contract basis. These factors have made the direct outreach of CGTMSE difficult for MLIs and have posed the risk of inefficient management of the scheme.

The above comparison enables insights into structural dimensions that may need to be addressed to make the credit instrument of CGTMSE effective towards supporting credit flow to MSEs.

The recommendation (June 2019) of U.K. Sinha Committee² is pertinent in the above context. The Committee recommended that CGTMSE is predominantly owned by Government with SIDBI holding a minority share. It is necessary that the top management of CGTMSE are professionalised and sourced from a wider pool. It would also be appropriate that SIDBI disengages itself from day to day management and Board of CGTMSE.

4.1.2.3 Absence of regulatory framework

CGTMSE is an important component of the country's financial architecture. It is guided by the provisions of the declaration of Trust executed (27 July 2000) between the Settlers and its subsequent amendments. The operations are based on CGS-I and CGS-II, which have been approved by the Board of Trustees and Settlers.

However, the Trust has no regulatory authority like Reserve Bank of India in case of banking sector and Securities and Exchange Board of India in case of financial and stock markets. The GoI/ Trust has not fixed any norms/ benchmarks with regard to minimum liquidity requirement for the Trust vis-a-vis guarantees approved/ issued, capital adequacy, solvency requirements, exposure cap for various types of MLIs, disclosure norms and accounting standards to be followed, etc.

² *Shri U.K. Sinha had submitted a Report of the Expert Committee on Micro, Small and Medium Enterprises to the RBI Governor in June 2019. The Committee was constituted by RBI under the chairmanship of Shri U.K. Sinha to undertake a comprehensive review of the MSME sector and to identify causes and propose long-term solutions, for their economic and financial sustainability.*

Further, there is no involvement of the Trust in facilitating credit to the unfunded MSEs as appraisal, sanction, disbursement and recovery proceedings are entirely the responsibilities of the MLIs as per the approved schemes. There are no laws to regulate many aspects of the Trust like scope of operations, governance, capital and operating requirements, as well as their access to the state-owned funds. Furthermore, the Trust has not established/ framed Audit Committee, Risk Management Committee, Human Resource Policy, *etc.* Also, there is no Chief Risk Officer for ensuring that risks relating to credit, market, operations and liquidity of the corpus fund are identified, assessed, managed, monitored and reported to the senior management and the Board.

The Board of Trustees (BoT) in its fifty second meeting (November 2015) approved a proposal for formulation of regulatory guidelines for the Trust by a consultant firm. The consultant firm in its report (May 2017) included suggestions on accounting framework for CGTMSE, fixing minimum parameters like solvency and capital adequacy, exposure norms, leverage ratio and establishment of regulatory authority for the Trust. However, the report of the consultant was not placed before the BoT.

Audit observed that regulators can improve the environment for issuing guarantees in particular by establishing minimum capital requirements, appropriate solvency ratio and transparency criteria. Such controls help improve banking sector confidence in the guarantee schemes and can help prevent any major crisis stemming from poorly issued guarantees. Further, external supervision would provide a positive effect on the guarantee system, since it will reduce the risk of fund mismanagement. Regulation contributes to the credibility of the schemes, and in case the scheme is supported by public resources, regulators can ensure the protection of those resources.

The U.K. Sinha Committee recommended recently (June 2019) that “All Credit Guarantee Schemes should be subject to the regulation and supervision of RBI. These guidelines could draw upon the well acknowledged principle for design, implementation and evaluation of Public Credit Guarantee Schemes for SMEs which has been evolved by the World Bank Group”.

The Management (March 2019) and Ministry (September 2019) stated that CGTMSE is monitored by its Board and the Settlers as regards its operations, financial position, etc. It further stated that CGTMSE had hired a consultant for carrying out the Business Process Reengineering (BPR) and Enterprise Risk Management (ERM) Framework, which was underway. The Audit suggestions had been discussed with the consultant for their consideration during BPR and ERM exercise and upon completion of the exercise, the recommendations would be put up to Board/ Settlers for their consideration.

4.1.2.4 Overlapping roles of CGTMSE and National Credit Guarantee Trustee Company Limited

National Credit Guarantee Trustee Company Limited (NCGTC) was incorporated (28 March 2014) to manage and operate various credit guarantee trust funds. As of

30 September 2018, NCGTC was managing five³ funds. Out of these five funds, Credit Guarantee Fund for Micro Units (CGFMU) provides guarantees for loans up to the specified limit (currently ₹10 lakh) sanctioned by Banks/ NBFCs/ MFIs/ other financial intermediaries engaged in providing credit facilities to eligible micro units. Overdraft loan amount of ₹5,000 sanctioned under Pradhan Mantri Jan Dhan Yojana (PMJDY) accounts are also eligible to be covered under CGFMU. The Department of Financial Services, Ministry of Finance (GoI) notified (18 April 2016) CGFMU for providing guarantees to loans extended under Pradhan Mantri Mudra Yojana (PMMY). CGFMU covered micro loans sanctioned since 8 April 2015.

The Board in its fifty first meeting (5 August 2015) resolved that no fresh guarantees would be approved by the Trust to its MLIs for loans upto ₹10 lakh once the guarantee scheme under Pradhan Mantri Mudra Yojana (PMMY/ MUDRA) was made operational by NCGTC. The decision was taken to avoid overlapping of guarantees on loans upto ₹10 lakh to enable CGTMSE to focus on higher ticket size transactions of more than ₹10 lakh and less than ₹100 lakh, and to deleverage the corpus of CGTMSE over a period by limiting its scheme to loans above ₹10 lakh.

The Trust conveyed the decision of the Board to the Settlers (31 August 2015) and the Ministry of MSME intimated (16 November 2015) that the stoppage of guarantee covers for the loans upto ₹10 lakh may be put on hold by CGTMSE till the guarantee scheme under PMMY was notified by the Ministry of Finance.

While the decision of Government was pending, the Trust decided (August 2016) that option of choosing the guarantee scheme operated by CGTMSE and NCGTC may be left to the MLIs while applying for guarantee cover for eligible loans upto ₹10 lakh till a final call is taken on the proposal. Accordingly, the Trust introduced (October 2016) an additional field in the application form i.e. “whether the credit facility is covered under PMMY/ MUDRA: Yes/ No”. The MLIs, therefore, had choice to obtain guarantee cover from either CGTMSE or NCGTC for loans upto ₹10 lakh.

The Ministry sent (6 January 2017) the minutes of the meeting⁴ held on 5 January 2017 wherein it was mentioned that loans upto ₹10 lakh should not be covered under CGTMSE and should be covered under MUDRA. Further, loans eligible under other target specific schemes like Credit Guarantee Fund for Stand-up India (CGFSI), Credit Enhancement Guarantee Scheme for Scheduled Castes (CEGSS) should also not be covered under CGTMSE. However, loans not eligible under CGFSI and CEGSS should be covered under Credit Guarantee scheme.

³ (i) Credit Guarantee Fund for Skill Development, (ii) Credit Guarantee Fund for Education Loans, (iii) Credit Guarantee Fund for Factoring, (iv) Credit Guarantee Fund for Micro Units (CGFMU) and (v) Credit Guarantee Fund for Stand up India

⁴ The meeting was held on 5 January 2017 at New Delhi with the officials of banks, SIDBI and CGTMSE under the chairmanship of Secretary (MSME) to discuss the package for supporting Micro and Small Enterprises- Augmentation of corpus of CGTMSE, as also to get the feedback on the concerns of MSMEs being addressed through the said package.

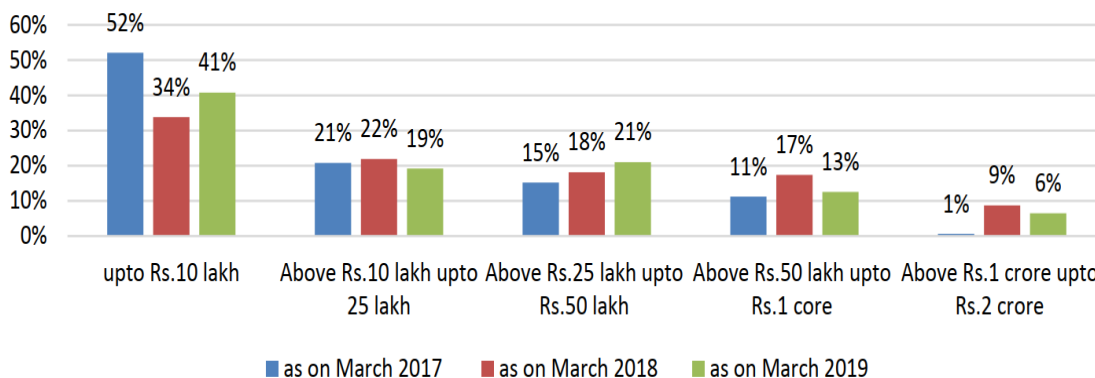
Audit noticed that the Trust did not implement the directions of the Ministry and continued to provide guarantees against loans, which were eligible for guarantee cover under the CGFMU of NCGTC. Thus, both NCGTC and CGTMSE were issuing guarantees against loans upto ₹10 lakh for same type of projects/ business.

Audit observed that facility of guarantees for same type of projects from two different Government backed institutions not only results in overlapping of functions of the institutions but also hampers the growth of both the institutions as time, manpower and other resources are invested in promoting the same product. Besides, CGTMSE also runs the risk of over-leveraging since a particular loan may be covered by the guarantee covers of both CGTMSE as well as NCGTC. Further, there was no synergy, control and co-ordination between the systems of NCGTC and CGTMSE and among different MLIs to identify and prevent cases where borrowers had obtained loans from different MLIs and the MLIs had obtained guarantee cover from both CGTMSE and NCGTC. The MLIs did not take responsibility of mutual exclusion. Thus, the loan funds could get concentrated on some of the aware entrepreneurs/ MLIs and spread of credit funds would not happen horizontally.

In this regard, the U.K. Sinha Committee observed that while both CGTMSE and NCGTC offered the credit guarantee product, the guarantee structure and features were different. Structurally, the primary difference was that the CGTMSE is an individual loan level guarantee scheme while CGFMU for MUDRA loans, run by NCGTC, is a portfolio level guarantee scheme. This means that pay-outs happen under CGTMSE when individual loans, covered under the scheme, begin to default. In contrast, pay-outs happen in CGFMU only when the threshold NPA level of the portfolio is breached.

Chart 4.1 shows the distribution of CGTMSE guarantees across various slabs of loan values. It may be noted that the largest proportion of guarantees goes to loans upto ₹10 lakh, which are mandated to be unsecured. This creates an overlap between CGTMSE and MUDRA.

Chart 4.1: Slab (year) wise guarantee outstanding - Percentage share



Source: U.K. Sinha Committee report

The Trust by not implementing the directions of the Ministry had issued 3,70,391 number of guarantees amounting to ₹10,743.65 crore against loans upto ₹10 lakh during the period from 6 January 2017 to 30 September 2018, which would otherwise have had to be issued by NCGTC.

The Management (March 2019) and the Ministry (September 2019) stated that the minutes of the Ministry were deliberated (March 2017) by the Board and it was felt that since stoppage of guarantee cover upto ₹10 lakh by CGTMSE may affect a large number of micro enterprises, the consultation with all the stakeholders was desirable before taking any decision. A number of MLIs gave feedback that they favoured guarantee cover of CGTMSE over CGFMU and wanted the CGTMSE Scheme to continue till such time the shortcomings of CGFMU scheme were addressed. During Exit Conference, the Management stated that extending of credit guarantee under both CGTMSE and NGCTC encourages competition.

The reply is not acceptable as the action taken by CGTMSE was in violation of its own resolution and the decision of Ministry of MSME. CGTMSE's view that it would affect large number of micro enterprises was not based on facts as the guarantee facility for loans upto ₹10 lakh was to be provided by NGCTC. On the other hand, if sectoral fund requirements were being met adequately with CGTMSE and expansion in the MSME segment was visible, need for NGCTC itself with overlapping role becomes questionable. As such, no approval was obtained from GoI for continuing the guarantee for loans upto ₹10 lakh. The Management did not support their reply with details on the shortcomings of CGFMU or problems faced by the MLIs in obtaining guarantee cover from NCGTC. Further, the Management's claim that MLIs favour CGTMSE's cover was not correct as the guarantees issued by NCGTC under CGFMU had increased (by 1,082.54 *per cent*) from ₹3,156.66 crore in 2016-17 to ₹37,328.66 crore in 2018-19.

4.1.2.5 Impact of CGTMSE guarantee instrument

The Trust measured the impact of CGTMSE guarantee instrument as shown in Table 4.2:

Table 4.2: Impact of CGTMSE guarantee instrument

Particulars	As on 31 March 2018	As on 31 March 2017
Cumulative Guarantees approved (in Numbers)	30,29,948	27,72,744
Cumulative Loan Amount (extended by MLIs) (₹crore)	1,46,829	1,28,787
Estimated turnover of guaranteed units (₹crore)	12,15,212	10,18,285
Estimated exports by guaranteed units (₹crore)	8,593	7,762
Estimated employment generation (Nos. lakh)	100	90.61
Schedule caste/ Schedule Tribe (<i>per cent</i> to total guarantee amount)	3.81	3.86
Women beneficiary (<i>per cent</i> to total guarantee amount)	15.92	15.66
Minority (<i>per cent</i> to total guarantee amount)	4.14	4.30
North Eastern region (<i>per cent</i>)	3.77	3.75

Audit noticed that the turnover, exports and employment figures were all estimated based on the information furnished by MLIs at the time of lodging application with the Trust for seeking guarantee cover and the data were not realistic or actual. The Trust also did not call for the details or get the details uploaded from the MLIs in its portal after commencement of business by the MSEs or close of a MSE unit after making default.

During Exit Conference, the Management accepted the fact and stated that efforts would be made to measure the realistic impact of the guarantees on a sample basis. This should be done with verifiable data and not just projected estimations.

The Ministry stated (September 2019) that data in respect of turnover, exports, employment generation, etc. are fed by MLIs after due diligence, appraisal and sanction of credit facility while applying for guarantee cover. It was also stated that CGTMSE has initiated process for pan India impact assessment study by a professional agency.

The reply is not acceptable in view of the deficiencies noticed in the quality of data fed by the MLIs, as mentioned in para 4.1.6.1 wherein the Management and Ministry have stated that CGTMSE had hired an external consultant and would endeavour to address the data gaps.

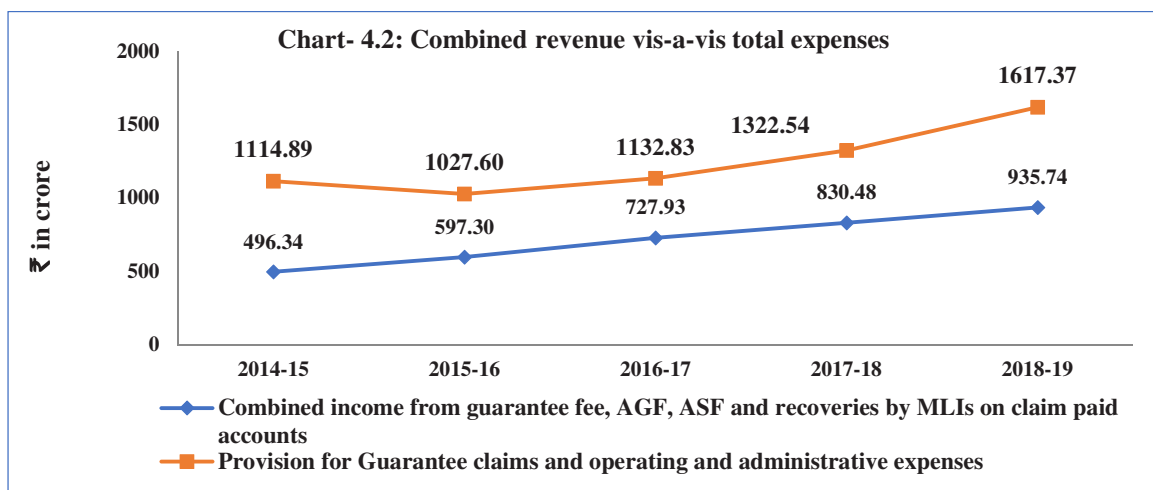
4.1.3 Performance of the Trust

4.1.3.1 Financial performance

The financial performance of the Trust during the period from 2014-15 to 2018-19 is given in **Appendix-XVIII**. The Trust has reported excess of income over expenditure as (-) ₹179.08 crore, ₹7.85 crore, ₹26.28 crore, ₹45.20 crore and ₹83.36 crore for the years ending March 2015 to March 2019 respectively. The increase in excess of income over expenditure during 2018-19 was mainly due to interest on refund of income tax of ₹62.47 crore.

However, it was seen that income from core⁵ activities during the years 2014-15 to 2018-19 was only 45 per cent, 58 per cent, 64 per cent, 63 per cent and 58 per cent of the requirement against provision for claims and operating and administrative expenses, as indicated in the chart 4.2 alongside.

⁵ *Guarantee fee, annual guarantee fee, annual service fee and recoveries by MLIs on claim paid accounts.*



The shortfall, however, did not result in default on claims as their procedure allowed spacing out disbursements against claims. Further, income from non-core activities (viz. interest earned from investments, income from mutual funds and interest on refund of income tax) supplemented the solvency of the Trust in payment of claims.

(a) Corpus fund of the Trust

The GoI (M/o MSME) and SIDBI established (27 July 2000) the Trust with an initial corpus fund of ₹1 lakh. The GoI and SIDBI contributed in the ratio of 80:20 and as per the Trust deed, further contributions to the corpus were to be made in the same proportion. The Trust deed was modified (28 June 2007 and 3 January 2017) and the corpus fund was decided to be ₹7,500 crore. The share of GoI and SIDBI was decided to be ₹7,000 crore and ₹500 crore respectively. It was also decided that SIDBI would not make any contributions to the corpus fund beyond ₹500 crore and any further contributions would have to be made by the GoI only.

As of 31 March 2019, the corpus fund of the Trust was ₹6,914.91 crore, of which the GoI had contributed ₹6,414.91 crore (92.77 per cent) while SIDBI had contributed its entire share of ₹500 crore. Of its share of ₹6,414.91 crore, the GoI had made major contribution of ₹3,699.90 crore (57.68 per cent) and ₹715 crore (11.15 per cent) to the corpus fund during the years 2017-18 and 2018-19 respectively.

(b) Leverage on corpus fund

The Board in its sixth meeting (9 July 2001) decided that CGTMSE would have a leverage of guaranteeing collateral-free credit nearly five times of its corpus fund. The leverage was temporarily increased (Thirty sixth meeting dated 24 December 2010) to 10 times. The position of corpus fund, outstanding guarantees, liability assessed against outstanding guarantees and leverage on corpus based upon liability against outstanding guarantees at the end of the year during the period from 2015-16 to 2018-19 was as shown in the Table 4.3:

Table 4.3: Leverage on Corpus Fund of CGTMSE(**₹ in crore**)

Year	Corpus fund	Outstanding guarantees as on 31 March	Liability against outstanding guarantees	Corpus leverage based on Liability against outstanding guarantees (times)
(1)	(2)	(3)	(4)	(5) = (4)/(2)
2015-16	2,431.54	62,318	45,271	18.62
2016-17	2,500.01	67,762	49,567	19.83
2017-18	6,199.91	70,310	50,660	8.17
2018-19	6,914.91	74,330	55,526	8.03

The leverage benchmark on the basis of guarantee approvals does not exhibit the correct picture as the Trust is liable to pay only the guaranteed portion (excluding proportion of risk shared by the MLIs) in the worst-case scenario. Thus, liability against outstanding guarantees is an indicative benchmark to assess the leverage on corpus fund. The reduction in leverage during 2017-18 and 2018-19 was attributed to infusion of funds by the Settlers during 2017-18 (₹3,699.90 crore) and 2018-19 (₹715 crore). The leverage of 8.03 times would, however, continue to increase with the continuous process of issue of guarantees.

Analysis, however, revealed that the Trust had not estimated outgo towards first claims rejected on technical grounds (deficient documents and others) and the second claims expected to be lodged by the MLIs. As such leveraging should not only account for the accepted claims but total commitment (including deferred cases). Further, instead of rejection, there has to be IEC⁶ to ensure correct submission by making the process simpler. That would generate more confidence in MLIs on the efficacy of guarantee instrument and provide assurance to motivate them for larger front end support to MSE sector.

The Management (March 2019) and Ministry (September 2019) stated that fixing the benchmark for leverage on a realistic basis to exhibit the correct position was noted. The reply, however, did not address the issue of adequacy of corpus, the liability against which keeps on increasing due to ongoing process of issue of guarantees and non-estimated claims (first and second claims rejected on technical grounds). However, it is also important to increase the coverage along with better recovery from MLIs on defaults to support Government fund infusion.

(c) **Participation of CGTMSE in total outstanding credit to MSEs**

The Department of Financial Services, Ministry of Finance (GoI) had set up (September 2014) the K.V Kamath Committee to examine the financial architecture of the MSME sector. In its report submitted in February 2015, the Committee recommended that the outstanding credit guaranteed under CGTMSE (for MSEs) needs to be enhanced to an acceptable level of guarantees (around 15 *per cent* of total MSME banking credit compared to around 25 *per cent* as per global experience).

⁶ *Information Education Campaign*

Table 4.4 shows the participation of CGTMSE in total outstanding credit to MSEs at the end of financial years 2016-19.

Table 4.4: Credit flows to MSE sector vis-à-vis outstanding guarantees issued by CGTMSE

Year	Amount outstanding (in ₹100 crore)	MSE credit as percentage of adjusted net bank credit	Outstanding guarantees of CGTMSE (in ₹100 crore)	Percentage of CGTMSE's outstanding guarantee to total amount outstanding to MSEs
2015-16	9,964.30	14.60	623.18	6.25
2016-17	10,701.30	14.30	677.62	6.33
2017-18	11,493.50	14.60	703.10	6.11
2018-19	13,132.30	15.05	743.30	5.66

It would be seen that CGTMSE's participation in total outstanding credit to MSE sector as at 31 March 2019 was only 5.66 *per cent* which was much below than that recommended (around 15 *per cent*) by the K.V. Kamath Committee.

Considering (i) the outstanding amount of credit flows to MSEs as per RBI's Annual Reports, (ii) Kamath Committee's recommendation of CGTMSE's participation to the extent of 15 *per cent* and (iii) CGTMSE's recommended leverage of 10 times, CGTMSE would have a corpus deficit of ₹12,514 crore, ₹13,551 crore, ₹11,040 crore and ₹12,783 crore at the end of financial years 2015-16, 2016-17, 2017-18 and 2018-19 respectively. With the available corpus fund, CGTMSE would have been leveraged to the extent of 61.46 times, 64.20 times, 27.81 times and 28.49 times at the end of each of the four financial years.

4.1.3.2 Operational performance

(a) Achievement of targets

The Trust set an internal target for issue of guarantees amounting to ₹40,387 crore (₹23,487 crore under CGS-I and ₹16,900 crore under CGS-II) for the year 2018-19. The Trust approved guarantees amounting to ₹24,204.13 crore and ₹5,964.44 crore under CGS-I and CGS-II respectively. The fund size was not a factor in fixation of targets. The actual achievement in issue of guarantees during the year 2018-19 was only ₹15,241.57 crore (1.79 lakh number of guarantees) under CGS-I and ₹5,964.44 crore (0.64 lakh number of guarantees) under CGS-II. The overall achievement⁷ of CGTMSE against the targets during 2018-19 was only 53 *per cent*.

Audit observed that CGTMSE's business model is entirely dependent upon the MLIs, which may or may not seek guarantee covers against collateral free loans issued to the MSEs. The MLIs have their own priority sector lending targets based upon the guidelines/ regulations issued by the RBI. As such the internal targets fixed by CGTMSE have no rational basis unless the same are duly linked with the targets of the registered MLIs.

⁷ The achievement against targets under CGS-I and CGS-II was 65 *per cent* and 35 *per cent* respectively.

The flow of credit depends upon market dynamics and sectoral requirement of funds, which may vary from State to State due to diversified regional availability of resources and culture in the country. CGTMSE, therefore, needs to fix realistic targets based upon its the fund size, sectoral/ industry specific requirement of funds which can be determined from industry associations, independent studies by CGTMSE or other institutions, economic census/ MSME census, other data available with various Ministries and Departments of the State and Central Governments and consultations with the State Governments. As such, CGTMSE needs to revamp its business model and to take into confidence the MLIs to achieve the targets and larger objective of flow of funds for balanced regional development of MSEs and regional generation of employment.

The Management stated (March 2019) that MLIs have their own targets for MSEs including priority sector lending and the CGS facilitates them in extending credit to MSEs. It thus helps the MLIs in meeting their targets and in turn the GoI's objectives of balanced regional and social development.

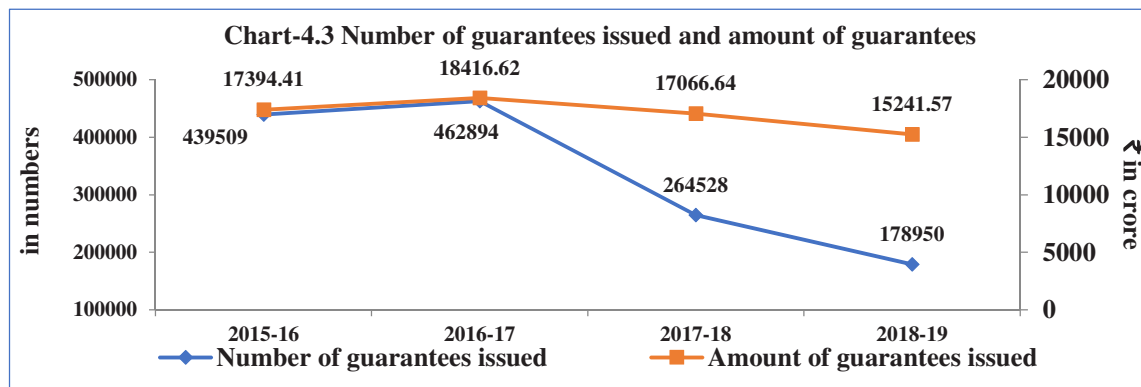
The Ministry added (September 2019) that CGTMSE is dependent on MLIs for business and it may not be in a position to execute a targeted approach of its own.

As such, the Ministry's reply supports Audit observation but a growing organisation like CGTMSE may consider fixing the targets based on rational analysis of information for sectoral performance/ expansion and proactive flow of credit to contribute to the GoI's objectives of economic growth and development.

Audit observed that as a purely Government sponsored guarantee instrument, the Trust has remained reactive to the role of MLIs. As such, MLIs assurance in the Trust can give impetus to the financial support to MSEs. Hence, the Trust may contribute to MLIs' plan for giving due impetus to fund the unfunded MSEs of the States which would also help it in expanding its own coverage.

(b) Decline in guarantee cover and money guaranteed

The Trust had approved 33.96 lakh cumulative guarantee proposals amounting to ₹1,69,948.37 crore since inception (July 2000) to 31 March 2019. Out of 33.96 lakh proposals, the Trust had issued 29.79 lakh guarantee covers amounting to ₹1,51,483.96 crore upto 31 March 2019. The trend in number and amount of guarantees issued during 2015-19 is shown in the chart 4.3:



It would be seen that the business of the Trust was on declining trend as the number of guarantee covers issued to the MLIs for collateral free credit allowed to MSE sector drastically declined (61 *per cent*) from 4.63 lakh to 1.79 lakh during 2016-19. The corresponding amount of guarantees issued declined (17 *per cent*) from ₹18,416.62 crore to ₹15,241.57 crore during this period.

The Trust did not analyse the reasons for decline in guarantee cover obtained by the MLIs. Audit observed that incorporation of NCGTC which provides guarantees for loans upto ₹10 lakh under CGFMU had led to decline in the business of the Trust as the slab-wise coverage of loans upto ₹10 lakh reduced from 4.77 lakh (₹9,994.11 crore) in 2015-16 to 2.25 lakh (₹6,450.28 crore) in 2017-18 as shown in Table 4.5:

Table 4.5: Slab-wise coverage of loan upto ₹10 lakh

Range	2015-16		2016-17		2017-18	
	No. of proposals	Amount approved (₹ in crore)	No. of proposals	Amount approved (₹ in crore)	No. of proposals	Amount approved (₹ in crore)
Upto ₹1 lakh	2,44,943	1,155.62	1,75,554	952.59	74,283	447.43
₹1 to ₹2 lakh	90,867	1,503.97	97,181	1,615.62	54,204	908.35
₹2 to ₹5 lakh	87,557	3,254.71	86,484	3,288.85	57,884	2,166.72
₹5 to ₹10 lakh	53,712	4,079.81	58,105	4,529.72	38,451	2,927.78
Total	4,77,079	9,994.11	4,17,324	10,386.78	2,24,822	6,450.28

The effect of NCGTC on the business of CGTMSE could be measured from the fact that more than 90 *per cent* of the business of CGTMSE comprises of guarantees upto ₹10 lakh. NCGTC had issued guarantees amounting to ₹3,156.66 crore (3,25,322 number) in 2016-17, ₹36,725.10 crore (26,12,777 number) in 2017-18, and ₹37,328.66 crore (17,74,036 number) in 2018-19 under CGFMU.

The Ministry and Management did not provide any reply to the Audit observation.

4.1.4 Appraisal, credit rating and issue of guarantees

The credit guarantee schemes framed by the Trust do not provide for any mechanism for appraisal of loan applications/ projects of the borrowers. The responsibility of appraisal lies with the MLIs. The lending institutions are required to evaluate credit applications by using prudent banking judgement and use their business discretion/ due diligence in selecting commercially viable proposals and handle the account(s) of the borrowers with normal banking prudence.

4.1.4.1 Inadequate system for approval of guarantees

The CGS-I requires the MLIs to upload the borrower's information in the prescribed format for obtaining guarantee cover from the Trust. Audit noticed that the Trust approves/ issues guarantees on the basis of mandatory details filled by the MLIs like type of activity, industry nature, interest rate charged by the bank and the amount of loan, type of loan, details of borrowers/ MSE unit, *etc.* The MLIs are not required to upload the

financial details of the primary security created by the borrowers after disbursement of loan. These details are uploaded at the time of marking NPA and lodgement of the first claim.

Audit observed that the present system merely verifies that the MLIs had filled the mandatory details of the borrowers. Approval/ issue of guarantees on this basis did not take into consideration the management of the borrower unit, technical feasibility of the project and financial capacity of the borrower/ promoters. Even the system/ portal is not adequate enough to verify the accuracy of the details filled by the MLIs as pointed out in para 4.1.6.1. The reasons for accounts becoming NPA as mentioned by the MLIs included low generation of income due to downtrend and mismanagement, business failure/ closure, diversion of funds, business not able to compete in market, incompetent management, etc. The reasons indicate inadequate appraisal of projects by the MLIs as well as failure of the Trust in ensuring proper assessment of applications before approving/ issuing guarantees.

The inspection reports of the MLIs disclosed major discrepancies like non-verification of Credit Information Bureau (India) Limited (CIBIL) report of the borrower, CIBIL report showing overdue but not taken into account by the MLIs, appraisal note not signed by the officials, non-availability of pre-sanction reports with the MLIs, pre-sanction due diligence not carried out properly, non-availability of credit information report of the borrowers, *etc.* Besides, the Trust had detected fraudulent loans (12 cases) during inspections of MLIs (2016-18).

The above shortcomings indicate lack of responsibility and accountability of the MLIs in appraisal of loan applications prior to sanction and disbursement of loans. As such, the Trust needs to put in place an adequate control system consisting of quantitative and qualitative criterion prior to issue of guarantees to minimise moral hazard and NPAs on account of above reasons.

Inadequate system of approval of guarantees had jeopardised the financial interests and business viability of the Trust as can be seen from the fact that income from core business activities was not adequate to meet the claims which resulted in deferment of the claims (para 4.1.3.1) and high level of NPAs. It may be seen that the Trust guarantees major portion of the amount in default (50 *per cent* to 85 *per cent* of the loan amount guaranteed) which further underlines the requirement of an adequate system to minimise NPAs and claims on account of above reasons.

The Management stated (March 2019) that CGTMSE has implemented system of basic scrutiny of guarantee applications above ₹1 crore on certain key parameters at the time of approval of guarantee. Further, the Trust has recently formulated guidelines for online capturing of financial data such as operating income, Profit After Tax (PAT), debt-equity ratio, net-worth, current ratio, CIBIL score of the chief promoters, total assets, *etc.* in guarantee application form based on the ticket size of the guarantee amount. In case of any deviations in the appraisal process before sanctioning of the loan on account of

delinquencies in the due diligence on the part of the MLI, the Trust is not liable to pay the defaulted amount in respect of such accounts.

The Ministry added (September 2019) that CGTMSE has proved its viability by successful operation over 18 years.

The guidelines as mentioned by the Management were introduced (13 November 2018) and made applicable from 1 December 2018 after being pointing out by audit. The details as mentioned by the Management were not applicable for loan size upto ₹10 lakh despite the Trust having business of around 90 *per cent* in this ticket size. Further, there were no guidelines for decision-making based upon the information collected. Also, the online module did not provide any platform for decision-making based on these details. As regards rejection of claims on account of delinquencies in appraisal by MLIs, the inspections carried out by the Trust were meagre to find out the delinquencies on the part of MLIs.

The reply of the Ministry does not hold good in the light of the deficiencies pointed out by the Trust itself during inspections of MLIs.

4.1.4.2 Gaps in process of credit rating of borrowers

Clause 9 of CGS-I provides that all proposals for sanction of guarantee approvals for credit facilities above ₹50 lakh and upto ₹200 lakh will have to be rated internally by the MLI and should be of investment grade. Further, the format prescribed by the Trust for guarantee initialisation stated that the MLIs may indicate 'NA' for loan facility upto ₹50 lakh, if rating is not available.

The Trust/ Scheme had, however, not defined the term 'Investment Grade' and therefore, allowed the MLIs to consider a proposal to be of investment grade as per their considerations.

Analysis of the live applications (as on 30 September 2018) disclosed that the column indicating internal rating was either left blank by the MLIs or the column indicated NA and characters like nil, ~, *etc.* in 10.92 lakh cases (90 *per cent*) out of total 12.10 lakh applications. This includes 4,495 cases where the guarantee amount was more than ₹50 lakh. In remaining 1.18 lakh cases, the MLIs indicated symbols like A, B, B+, B++, BB+, BBB, numerals, percentages, *etc.* In only 567 cases, the ratings were having symbols like MSME-1, MSME-II, SME-1, SME-2, indicating ratings prescribed under the Performance & Credit Rating Scheme for Micro & Small Enterprises.

Audit observed that the Scheme did not encourage ratings of the proposals, as ratings were not required for credit proposals upto ₹50 lakh. Further, no rating structure had been prescribed like that of various rating agencies. The system, therefore, allowed the MLIs to put any character/ numeral/ symbol in the internal rating column. The application was processed by the Trust without giving cognizance to the fact that the project was really rated or not by the MLI before sanction and disbursement. This is proved from the fact

that the system accepted characters like NA, *NA,, -----, etc. even in cases where the sanctioned credit facility was more than ₹50 lakh.

Audit further observed that despite the Scheme was silent on a uniform rating structure, the Trust did not put in place a mechanism to evaluate or assess the adequacy of the ratings done by the MLIs as the physical document was not required to be uploaded in the system. The inspection teams of the Trust did not comment on the accuracy and adequacy of ratings done by the MLIs in the absence of any prescribed uniform rating structure. The inspection teams only considered whether the MLI has done internal rating or not.

Audit also noticed that the MLIs were required to indicate the rating of the proposals in the online system upto 25 May 2016. The Trust weakened the existing system by allowing the MLIs to indicate only 'Yes' or 'No' in the column of internal rating and investment grade. This may allow the MLIs an opportunity to create rating report at a later stage or at the time of lodgement of claims instead of due diligence prior to sanctioning of loan as also pointed by the inspection teams of the Trust.

The Management (March 2019) and the Ministry (September 2019) stated that all MLIs were regulated by RBI and they were required to comply with the risk management guidelines stipulated by RBI. Accordingly, MLIs were having their internal credit rating tools for rating the borrower units at the time of sanction (above a certain level of exposure, as per their internal policies). Further, investment grades are defined by MLIs as per their Board approved policies. Scrutinising the rating report alone at CGTMSE would not add value. It was also stated that instead of assuming the responsibility of appraisal, due diligence, rating, verification of security creation, etc. of over one lakh borrowers during a year, it is more practical to extend guarantee to such MLIs with superior credit portfolio and track record.

The reply is not convincing as the Trust failed to obtain any assurance from the MLIs that credit rating/ appraisal of the projects/ units was done as per the RBI guidelines. Further, the Trust was required to issue guarantees only for those proposals, which were properly rated by the MLIs to avoid problems of moral hazard. The Audit observation should be seen in the context of RBI's observation in its Report⁸ (2015) which stated "on account of substantial moral hazard inherent in such schemes and in absence of a robust oversight mechanism from the CGTMSE, the present scheme has got reduced to one that incentivises lax credit processing by the banks and reduced credit discipline on the part of the borrowers. This problem has the potential to play havoc with our financial system and must be addressed by the CGTMSE on priority basis".

Hence, instead of passing on the responsibility of assurance to MLIs totally, CGTMSE should strengthen its own process to ensure reliability of end use of funds through better MLI-CGTMSE interface.

⁸ *Report on the functioning of CGTMSE and the credit guarantee system in India, submitted by a three member team formed (2015-16) by the GoI (MSME division) and RBI.*

4.1.4.3 Issue of guarantees on the basis of personal guarantees of the borrowers without creation of primary security

The Trust requires that the lender should give importance to project viability and secure the credit facility purely on the primary security of the assets financed. Clause 7(iii) of the Scheme requires the lending institution to safeguard the primary securities taken from the borrower in respect of a credit facility in good and enforceable condition. Further, the guarantee initialisation form mentions that the Scheme envisages creation of primary security out of the loan/ credit provided to the borrower.

The Board in its forty third meeting (September 2013) decided that creation of primary security for providing guarantee cover was envisaged in the scheme and hence credit facilities which do not envisage creation of assets would not be eligible under the scheme.

Audit noticed that the Trust did not implement checks in the online system to ensure that the credit facility extended by the MLIs created primary security out of the credit facility extended to a borrower. The relevant column in the online system viz. 'APP_IS_PRIMARY SECURITY' was left blank in 100 *per cent* cases by the MLIs.

Audit scrutiny disclosed that the Trust received a letter dated 8 March 2017 from Deutsche Bank AG (DBAG) regarding acceptance of personal guarantees as primary securities, based on discussion and confirmation by the Trust on acceptance of personal guarantees as primary security vide email dated 28 January 2009. The DBAG also stated that it accepted personal guarantees of promoters as primary security wherein (i) the MSE have already hypothecated all stock and book debts to their main banker and (ii) no primary security was created by the MSEs especially in the service sector and funds were needed for opening a new office wherein the main expenses like salary, rent, *etc.* were required to be paid off.

The Trust informed (12 April 2017) the DBAG that the Trust would honour the claims, if any, emanating against the guarantees to avoid inconvenience to the clients whom guarantee cover has already been committed in respect of credit facilities sanctioned based on email confirmation in January 2009. The Trust, however, clarified that, henceforth, no guarantee cover would be extended where the primary security was not available and credit facilities were extended purely based on personal guarantee of the promoter. The Trust suggested the DBAG to carry out changes in its business module to enable CGTMSE to continue to support.

The Board deliberated (19 July 2017) on the significance of unsecured loans/ subordinated debts/ risk capital extended especially by private and foreign banks which

were vital for MSEs and approved that guarantee covers for loans extended on the basis of personal guarantees may be provided subject to certain conditions⁹.

Audit observed that the Trust issued guarantees to the DBAG upto April 2017 in violation of the scheme and without any approval of the BoT, as creation of primary security was a precondition for availing guarantee cover under the scheme. Further, the decision of the Board to allow personal guarantees was also not as per the terms and conditions of the scheme approved by the Settlers.

It is pertinent to mention that the entire guarantee covers obtained by the DBAG were based on personal guarantees of the promoters which indicates that it was extending credit facilities at the terms beneficial to it. As of 31 March 2019, the Trust has issued 7,217 guarantee covers¹⁰ of ₹2,203.62 crore to DBAG based upon the personal guarantees of the promoters out of which 908 cases (₹265.10 crore) were marked as NPA. The Trust has settled 451 claims (₹47.22 crore) out of the marked NPAs.

Another foreign MLI (Standard Chartered Bank) also started (January 2018) issuing credit facilities based on the personal guarantees of the promoters after decision of the Trust to allow guarantee covers in certain cases. This MLI obtained 102 guarantee covers amounting to ₹72.13 crore from the Trust during the period from 23 January 2018 to 30 September 2018. All the guarantee covers were obtained on the personal guarantees of the promoters, which indicate that it had stopped extending credit facilities which envisaged creation of primary assets.

The Ministry did not reply to Audit observation. The Management, however, stated (March 2019) that in view of lack of clarity in the scheme, some of the MLIs covered a few cases with only personal guarantees of the borrower. The same was reported and ratified by the Board in view of satisfactory performance of the portfolio covered, NPA percentage and payouts recorded for such coverage. The Management also stated that these credit facilities complement the existing credit facilities from the regular bankers of MSEs and are significant for MSEs, such as liquidity, fund support for fulfilling orders, faster credit delivery, *etc.* Depriving MSEs of the guarantee cover due to non-availability of primary security would affect the viability of the unit and slowdown the flow of credit to MSEs.

The reply was not acceptable as clause 7 of the scheme clearly stipulated creation of primary security. The decision of the Board to extend guarantee covers on the basis of personal guarantees was not as per the scheme approved by the Settlers. The extension of guarantee by the Trust to the foreign banks in respect of credit facilities sanctioned against personal guarantees of the borrowers, in violation of the scheme guidelines, may be got investigated and responsibility thereof may be fixed.

⁹ (i) *business loans only upto ₹50 lakh (overall exposure per borrower), (ii) fixing of exposure cap per MLI on cumulative guarantees to be approved and (iii) restriction on claim payout upto maximum of three per cent of the cumulative guarantees.*

¹⁰ *The Trust has received guarantee fee of ₹2.80 crore against the issued guarantees.*

4.1.4.4 Lack of mechanism to ensure non-acceptance of collateral and third party guarantees by the member lending institutions

The primary objective of establishing the Trust by the Settlers was to provide guarantee against loans not secured by collateral or third party guarantees. Clause 4 of the Scheme also stipulates that the Trust would cover credit facilities extended by MLIs to a single eligible borrower in MSE sector for credit facilities (term loan and/ or working capital) without any collateral security and/ or third party guarantees.

The MLIs while applying for guarantee cover had to mark 'Yes' or 'No' options in the columns indicating 'Collateral Security Taken' and 'Third Party Guarantee'. The column indicating 'Collateral Security Taken' was a mandatory field while column indicating 'Third Party Guarantee Taken' was not marked as mandatory even though the Scheme did not allow acceptance of third party guarantees.

The Trust introduced (28 February 2018) a 'Hybrid Security' product wherein the MLIs were allowed to obtain collateral security for a part of the credit facility whereas the remaining part of the credit facility upto a maximum of ₹200 lakh could be covered under Scheme. Accordingly, a new field was inserted in the online portal with the name 'Application Under Hybrid Security Model'. The MLIs obtaining guarantee cover under hybrid security model have to click 'Yes' or 'No' in this column.

Review of the data of live guarantees (guarantee started prior to 28 February 2018) disclosed that the MLIs took collateral security from the borrowers in 314 cases (₹42.50 crore), third party guarantees in 391 cases (₹45.59 crore) and both collateral and third party guarantee in 28 cases (₹3.68 crore). The Trust provided three¹¹ sanction letters of HDFC Bank out of the above mentioned cases. The sanction letters mentioned 'Nil' collateral security but there was no mention of third party guarantees.

Thus, the Trust did not implement adequate checks in the system to prima facie reject those applications where the MLIs had indicated acceptance of collateral and third party guarantees from the borrowers. Further, the approver of the guarantee applications had also ignored these vital facts. This indicates that the MLIs had double secured themselves by accepting collateral or third party guarantees as CGTMSE was not required to issue guarantee cover to these MLIs where they had accepted collateral and third party guarantees from the MSEs.

The Ministry did not reply to Audit observation. The Management, however, stated (March 2019) that filling the status of 'collateral security' and 'third party guarantee' was mandatory for the MLI with 'yes' or 'no' option. The system rejects the application if the MLI clicks 'yes' for collateral security or third party guarantee taken. The fields were made optional after introduction of 'hybrid security' product.

¹¹ (i) Date of sanction 19 July 2007 for working capital facility, (ii) Date of sanction 11 May 2015 for renewal of combined credit facilities and (iii) Date of sanction 19 June 2017 for renewal and enhancement of combined credit facilities.

The reply is not correct in view of the cases highlighted above. All the cases mentioned above pertain to the period prior to introduction of 'hybrid security' product.

4.1.4.5 Issue of guarantees despite inordinate delay in submission of application by the MLIs

Clause 4 of the CGS-I required the MLIs to obtain guarantee cover in respect of credit proposals sanctioned in the quarter April-June, July-September, October-December and January-March prior to expiry of the following quarter *i.e.* July-September, October-December, January-March and April-June respectively.

The Trust issued 9.56 lakh guarantee covers against term credit facilities to various MLIs during the period from 1 April 2015 to 30 September 2018. Audit noticed that the MLIs in 39,456 cases applied for guarantee covers even after the expiry of the quarter following the quarter in which the loan was sanctioned. The delay in submitting application for guarantee covers ranged upto 3,809 days in 39,456 cases (guarantees amounting to ₹1,260.92 crore). Audit excluded the period of 180 days (which is the maximum time available to a MLI for obtaining guarantee cover) from the period between the date of sanction and date of application for guarantee cover. As such the number of cases and the period of delay would be more when calculated on case to case basis. The range of delay in 39,456 cases beyond the expiry of following quarter was as shown in Table 4.6:

Table 4.6: Range of delay in applying for guarantee cover by MLIs

Range of delay (in days)	Number of cases	Guarantee amount (₹ in crore)	Range of delay (in days)	Number of cases	Guarantee amount (₹ in crore)
181 to 270	38,164	1,230.46	601 to 700	127	1.75
271 to 300	262	9.71	701 to 1000	196	3.54
301 to 330	255	3.92	1001 to 2000	64	2.81
331 to 450	191	5.27	2001 to 3809	5	0.34
451 to 600	192	3.12			
Total				39,456	1,260.92

On the other hand, in 17 cases (guarantees amounting to ₹1.31 crore), the date of sanction was after the date of submission of application by the MLI for obtaining guarantee cover (**Appendix-XIX**). The difference between the date of sanction and date of submission of application ranged between 1 day and 3,573 days. This indicated that the MLIs provided incorrect date in the online system but the system did not validate the same due to inadequate checks and therefore a future date of sanction was allowed. Further, the approver of the application did not take into consideration the date of sanction while issuing guarantees. The system should not have allowed the MLIs to submit applications in such cases.

Out of 39,456 cases, the Trust had settled claims amounting to ₹11.93 crore towards first claim (*i.e.* 75 per cent of the total claim amount) in 703 cases. The Trust received guarantee fee of ₹0.27 crore in these 703 cases.

Audit noticed that the Delegation of Powers allowed the approving authority and the Deputy General Manager (to be reported to General Manager/ CEO) to condone delay in lodgement of application for guarantee cover upto one and three months respectively. However, the Trust provided (July 2018) a further time period of three months on the request of MLIs, provided the account was standard (not being a Special Mention Account) as on the date of application. Thus, all the MLIs were allowed an additional time period of three months for submission of applications for guarantee covers. The decision of the Management to allow a further time period of three months was in violation of the Scheme provisions and was also not approved by the Board.

The Ministry did not reply to Audit observation. The Management, however, stated (March 2019) that most of the MLIs represented to CGTMSE that applications could not be lodged due to some unavoidable circumstances viz. natural calamities, amalgamation of MLIs, technical errors *etc.* CGTMSE regularised the delay on the requests of MLIs.

The fact, however, remains that inordinate delay in submission of applications by the MLIs and subsequent approval of guarantees by the Trust was in violation of the scheme approved by the Settlers.

4.1.4.6 Issue of guarantees to units not falling under Micro/ Small category

The Micro, Small and Medium Enterprises Development (MSMED) Act, 2006 classifies the Micro and Small Enterprises (MSEs) as manufacturing and service enterprises based upon the investment in plant and machinery and investment in equipment as stated in Table 4.7:

Table 4.7: Classification of Micro and Small Enterprises

Sector	Micro Enterprises	Small Enterprises
Manufacturing	Investment in plant & machinery does not exceed ₹25 lakh	Investment in plant and machinery more than ₹25 lakh but does not exceed ₹5 crore
Service	Investment in equipment does not exceed ₹10 lakh	Investment in equipment more than ₹10 lakh but does not exceed ₹2 crore

While calculating the investment in plant and machinery, the cost of pollution control, research and development, industrial safety devices and such other items as may be specified, by notification, shall be excluded.

Review of the data of live guarantees as on 30 September 2018 disclosed that in 3,055 term credit cases (guarantees amounting to ₹1,467.88 crore), the enterprise was marked as a micro unit but the term credit extended by the MLI and guarantees issued by the Trust was more than ₹25 lakh and upto ₹2 crore. As per definition of the Act, these units could not be considered as micro enterprises as the investment in plant and machinery/ equipment has exceeded the limit of ₹25 lakh.

Further, after adding promoters contribution to the term credit sanctioned/ guarantee issued, the investment in equipment in 15 cases under service sector worked out to more than ₹2 crore (guarantees amounting to ₹25.10 crore). As the Act had fixed the limit of

investment in equipment in service sector upto ₹10 lakh (micro) and ₹2 crore (small), these 15 cases cannot be considered under MSE as the investment in equipment had exceeded the limit of ₹2 crore. The Trust was, therefore, not required to issue guarantees in these 15 cases.

Also, the Trust calculated the guaranteed fee based upon the 'flag' that unit was micro enterprise or not and hence, it short recovered guarantee fee to the extent of 0.15 per cent to 0.25 per cent¹² of the standard rate and Risk premium in 3,055 cases.

The Ministry did not reply to the Audit observation. The Management, however, stated (March 2019) that categorisation of borrowers under micro and small enterprises falls under the purview of MLIs. The Trust accepts data furnished by the MLIs and issue guarantees as per the undertaking executed with the MLIs. MLIs were regulated by RBI and periodical data was being furnished by them to Government departments.

The reply needs to be reviewed in the context that the guarantee fee recovered by the Trust was based upon categorisation (micro or small industry) and, therefore, the same should have been verified by the Trust for correct recovery of fee and related issue of guarantee cover as it may directly impact their revenue receipts.

4.1.5 Non-performing assets, claims, inspection and recoveries from MLIs

The RBI's Master Circular on Prudential norms on Income Recognition, Asset Classification and Provisioning pertaining to Advances (1 July 2015) defines an asset as non-performing when it ceases to generate income for the bank. A non-performing asset (NPA) is a loan or an advance where (i) interest and/ or instalment of principal remain overdue for a period of more than 90 days in respect of a term loan, (ii) the account remains 'out of order' in respect of an Overdraft/ Cash Credit, (iii) the bill remains overdue for a period of more than 90 days in the case of bills purchased and discounted, etc.

4.1.5.1 Classification of NPAs

The RBI's Master Circular provided that the banks should establish appropriate internal systems for proper and timely identification of NPAs, and the system should ensure that doubts in asset classification due to any reason are settled through specified internal channels within one month from the date on which the account would have been classified as NPA as per extant guidelines. Accordingly, the MLIs should mark the account as NPA in CGTMSE's portal within one month once classified as NPA in their own system. This would enable CGTMSE to assess the correct position of NPAs in its system and likely claims on this account. Audit, however, noticed that the Trust had allowed (November 2009) the MLIs to mark NPAs in a particular calendar quarter, by end of subsequent quarter, which is not as per RBI directions. Further, the MLIs did not mark NPAs even as per scheme and the delay was condoned by the Trust.

¹² As per the fee structure applicable for guarantees sanctioned on or after 1 January 2013.

The Management (March 2019) and the Ministry (September 2019) stated that MLIs were given time to mark NPA in CGTMSE portal till the end of the subsequent quarter from the NPA date as it was a subsequent activity after the account turned NPA. Many accounts remain NPA for a short period and become standard after overdue are settled. It further stated that delay in marking NPAs was condoned when huge numbers of requests were received from the MLIs. Also during the demonetisation phase, the MLIs could not mark NPA due to post-demonetisation work-load and stress.

Audit analysis of the cases which were marked as NPAs by MLIs during the period from 1 April 2015 to 30 September 2018 is shown in Table 4.8:

Table 4.8: Time taken in marking NPAs by MLIs

No. days	0-10	11-20	21 -30	31-60	61-90	91-180	181-365	Total
No. of cases becoming NPA from the date of start of guarantee	567	494	592	2,113	3,210	13,756	43,018	63,750
Amount of guarantee cover (₹ in crore)	19.29	15.17	13.91	62.50	89.33	441.8	1,718.36	2,360.36
Number of cases where first claim was paid	7	9	7	42	87	3,820	13,815	17,787
Amount of claim (₹ in crore)	0.34	0.28	0.09	0.29	1.01	72.33	317.46	391.80
Time taken in marking NPA from the actual NPA date	1 to 2,408	2 to 1,858	1 to 1,766	0 to 2,201	1 to 2,519	0 to 3,185	0 to 3,352	

It would be seen that:

- MLIs marked 1,653 cases (guarantee amounting to ₹48.37 crore) as NPA within 30 days from the guarantee start date and the Trust made payment of first claim in 23 cases amounting to ₹71 lakh. The MLIs have taken a time period of 1 day to 2,408 days in marking these cases as NPA in the CGTMSE portal.
- The MLIs marked 5,323 cases (guarantee amounting to ₹151.83 crore) as NPA within 31 days to 90 days from the guarantee start date wherein first claim was settled in 129 cases amounting to ₹1.30 crore. The MLIs took a time period of upto 2,519 days in marking these cases as NPA.

Audit also noticed that in 348 cases (guarantee amounting to ₹19.23 crore), the actual NPA date was either the date of commencement of guarantee or prior to the date of commencement of guarantee. The Trust paid claim in four such cases amounting to ₹75.36 lakh. Further, in 71 cases (guarantees amounting to ₹6.42 crore), the date of marking NPA was prior to the date of actual NPA. The trust settled first claim of ₹1.59 crore in 32 such cases.

The accounts becoming NPAs within a very short period indicates lack of appraisal by the MLIs and also lack of adequate internal control and checks within the Trust to ensure that only good and eligible cases are lodged by the MLIs for obtaining guarantee covers.

The Management (March 2019) and the Ministry (September 2019) stated that it would arrange for study of cases where accounts became NPA within 90 days of issue of guarantee and first claim was released. Necessary improvements in the system would be considered. As regards date of marking NPA prior to the date of actual NPA, it was stated that some MLIs entered wrong date of NPA erroneously.

4.1.5.2 Inspection of and recoveries from MLIs

Clauses 7(i), (ii), (vii) and 13 of the CGS-I put responsibility and accountability of the MLIs as regards sanction, monitoring and remittance of recoveries to the Trust. The clauses provided that the lending institution should evaluate credit applications by using prudent banking judgement and shall use their business discretion/ due diligence in selecting commercially viable proposals and conduct the account(s) of the borrowers with normal banking prudence.

Clause 15 (ii) of the Scheme provides that the Trust has the right to inspect or call for copies of the books of account and other records (including any book of instructions or manual or circulars covering general instructions regarding conduct of advances) of the lending institution and of any borrower from the lending institution. Every officer or other employee of the lending institution or the borrower who is in a position to do so shall make available to the officers of the Trust or SIDBI or the person appointed for the inspection as the case may be, the books of account and other records and information which are in his possession.

The Trust carried out inspections in respect of 1,749 number of accounts during 2015-16 to 2017-18, as given in Table 4.9:

Table 4.9: Inspections of MLIs carried out by CGTMSE

Year	No. of MLIs covered	No. of zones of MLIs/ areas covered	No. of accounts covered
2015-16	15	26	237
2016-17	13	44	829
2017-18	12	20	683
Total			1,749

Audit observed that the Trust did not plan the inspections as no criterion was fixed for selection of MLI, targets and achievements in respect of MLIs and accounts to be covered and regions to be focused upon. During 2016-17 and 2017-18, the Trust carried out inspections where claim settled was more than ₹10 lakh on sample basis. Further, inspections were carried out to ensure that the amount recovered by the MLIs post claim settlement is apportioned as per the guidelines of the scheme and the balance is remitted to CGTMSE. Thus, no inspection was carried out in respect of accounts where claim has not been lodged by the MLI.

Scrutiny of Inspection Reports disclosed serious shortcomings viz. i) stock statements not submitted by the borrowers timely to the MLI, ii) internal reports of the MLIs indicating the borrower as wilful defaulter but not reported to the RBI, iii) non-availability of staff accountability reports, iv) one-time settlements done by the MLIs but recoveries not remitted to the Trust, v) non-availability of end use reports of the funds, vi) legal action taken by the MLIs after lodgement of the claims, vii) recoveries post-NPA date not mentioned by the MLIs in claim form, viii) recoveries not remitted to the Trust after payment of claim by the Trust, ix) inspections not carried out by the MLIs as per norms, x) mismatch of NPA date recorded in the CGTMSE's portal with actual record, xi) serious lapses on the part of MLI staff as per staff accountability report, xii) end use of funds not found satisfactory, xiii) pre-sanction due diligence not observed by the MLIs, xiv) project financials and estimates and sales tax return not obtained from the borrowers, xv) KYC documents not signed by the borrowers at the time of sanction, xvi) sanction of loans before receipt of pre-sanction reports, xvii) forged balance sheet and profit and loss statement submitted by the borrower, etc.

Clause 10 (v) of the scheme provided that the lending institution would be liable to refund the claim released by the Trust together with penal interest at the rate of four *per cent* per annum above the prevailing bank rate, if a recall is made by the Trust in the event of serious deficiencies having existed in the matter of appraisal/ renewal/ follow-up/ conduct of the credit facility or where there existed suppression of any material information on part of the lending institutions for the settlement of claims.

Audit noticed that the inspection reports pointed out recoveries of ₹71.41 crore in 507 (29 *per cent*) out of 1,749 accounts. The MLIs deposited ₹23.76 crore in 203 cases after delays ranging between 4 days and 722 days. The Trust, however, did not charge interest on delay in remittance of the amount. As of March 2018, ₹48.96 crore was pending for recovery in 368 cases (in some cases the amount remitted was more than pointed out during inspection due to further recovery by the MLI and in some cases partial remittance was made).

It could be concluded that inspections being carried out by the Trust were not commensurate with the guarantees issued, NPAs reported, claims lodged by the MLIs and shortcomings noticed in the inspection reports. The shortcomings pointed out in the Inspection Reports clearly indicate that the MLIs were not adhering to the terms and conditions of the scheme. Non-adherence of the terms and conditions adversely impacts the financial interests of the Trust. Further, lack of due diligence in sanctioning of the credit and non-deposit of recoveries indicate sanction of fraudulent loans and retention of exchequer's money with malaise intentions. It is clear that the MLIs would not have remitted the moneys to the Trust had they been not pointed out by the Inspection teams of the Trust. Audit further observed that the Trust had not exercised the penal provision as mentioned in clause 10 (v) of the Scheme on any of the MLIs to minimise the fraudulent loans and non-remittance of Government money.

The RBI made (2015) several suggestions in this regard which inter alia included (i) to put in place suitable incentives and penalties framework to enable the MLIs to undertake the same rigorous credit discipline and post disbursement follow up in collateral free loans as in the case of collateral backed loans, (ii) mandatory internal rating of all the collateral free loans irrespective of the loan amount, (iii) to put in place a strong data analytics team and a robust oversight mechanism over the MLIs, (iv) to revamp the IT infrastructure, etc.

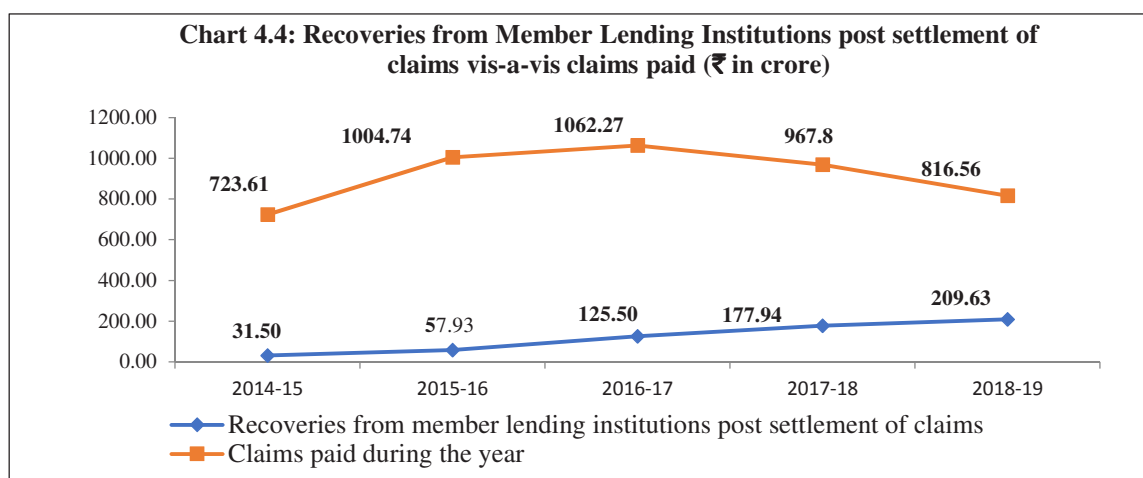
The Trust, however, had not implemented the suggestions and recommendations made by the RBI.

The Management (March 2019) and Ministry (September 2019) accepted the facts and stated that the Trust as a part of policy would put in place a systematic approach to improve the effectiveness of inspection.

4.1.5.3 Recoveries from MLIs post-settlement of claims

Clause 7(v) of the Scheme provides that the payment of guarantee claim by the Trust to the lending institution does not in any way take away the responsibility of the lending institution to recover the entire outstanding amount of the credit from the borrower. Further, Clause 13 of the Scheme requires the lending institutions to deposit the money recovered post-settlement of claims with the Trust after adjusting the legal cost of recovery incurred by the MLIs. The Trust is required to appropriate the recoveries first towards the pending annual service fee/ annual guarantee fee, penal interest, and other charge to the Trust, if any, in respect of the credit facility towards which the amount has been recovered by the lending institution and the balance, if any, shall be appropriated in such a manner so that losses on account of deficit in recovery of the credit facility between the Trust and the lending institution are in the proportion of risk shared.

The recoveries from MLIs post-settlement of claims vis-a-vis claims paid during the period from 2014-15 to 2018-19 is depicted in the chart 4.4 below:



It would be seen that the recoveries from MLIs post-settlement of claims was on increasing trend since the year 2014-15. However, there always remained a wide gap between recovery and claims paid during the year.

The Trust observed from the inspection reports that the MLIs were not remitting the recoveries made by them post-settlement of claims. As such, the Trust directed (March 2014) the MLIs to submit a certificate from the Statutory Auditors stating that recoveries made by the MLI post-settlement of claims by the CGTMSE in respect of guarantee covered under the CGS have been duly passed on to the CGTMSE as per the provisions of the CGS. The said certificate was to be submitted once in a year by the 30 September of the next financial year.

However, only few MLIs (around 10) submitted certificates of the Statutory Auditors. Further, the certificates provided by the MLIs contain ambiguous language. The Trust did not give stress on submission of certificate of the Statutory Auditors and started taking online declaration and undertaking from the MLIs before lodging of the claims.

Audit observed that certificates of the Statutory Auditors provided an adequate mechanism to safeguard the financial interests of the Trust and to ensure that all the money recovered by the MLIs post-settlement of claims have been remitted to the Trust after deduction of legal expenses. However, the Trust by allowing online declaration and undertaking again provided an opportunity to the MLIs to retain the exchequer's money as the certificates created a legal binding of fulfilment of duties on the Statutory Auditors while the MLIs even after submitting undertakings could shed their responsibility by saying that remittance was left inadvertently or the staff was not aware about it which is evident from the inspection reports. It is pertinent to mention here that the RBI in its report (2015) has mentioned in detail about the moral hazards inherent in the scheme.

The Ministry did not reply to Audit observation. The Management, however, accepted (March 2019) the facts and stated that most of the MLIs were finding it very difficult to get the Statutory Auditors certificate since it was not possible for the auditors to verify the transactions at branch level. The CGTMSE, therefore, started accepting online declaration and undertaking from the MLIs.

The reply is not acceptable as the Trust should have implemented a better control/monitoring mechanism whereby the financial interests of the Trust could be safeguarded.

4.1.6 Internal control

4.1.6.1 Quality of data fed by the MLIs

The MLIs are required to fill the data of applications for seeking guarantee cover in the prescribed format on the portal of the CGTMSE. Audit noticed that the MLIs did not fill the non-mandatory data and further the quality of data fed was very poor. Many fields (examples given in the table below) were left blank by the MLIs or incorrect data was

fed. Review of some of the important fields of the data of live applications (12.10 lakh cases) disclosed certain discrepancies as shown in Table 4.10:

Table 4.10: Discrepancies in the data fed by MLIs on CGTMSE portal

Field	Audit observation
PMR_CHIEF_LEGAL_ID and PMR_CHIEF_LEGAL_TYPE	The information about legal ID and type of the chief promoter of the MSE unit was not mentioned in 99.84 <i>per cent</i> cases.
PMR_CHIEF_DOB	The date of birth of the chief promoter was left blank in 36.13 <i>per cent</i> cases. Further, the data shows the year of birth as earlier as 1794, 1657, 1690, 1653, 1904, <i>etc.</i> in many cases.
PMR_CHIEF_SOCIAL_CATEGORY	The social category was blank in 46.81 <i>per cent</i> cases.
APP_IS_PRIMARY_SECURITY	100 <i>per cent</i> blank
TRM_AMOUNT_SANCTIONED_DT	The year of sanction of the term credit mentioned 2020, 2021, 2022, 2097, 2098, which were factually incorrect.
SSI_CITY	The city in which MSE unit was established was left blank in three cases. Further, there were numerous cases where some number was mentioned instead of the name of city.
SSI_PINCODE	The pin code of the location of MSE unit was mentioned as '000000' in 871 cases. There were cases where the pin code started with digit 9 but the same was not correct because all the pin codes starting from 90 to 99 have been earmarked for army postal service.
SSI_IT_PAN	The booklet of instructions issued by the CGTMSE provided that a borrower is required to obtain IT PAN number prior to availing of credit facility from eligible MLI. IT PAN number is to be indicated in respect of credit facility above ₹10/ ₹5 lakh as per Income Tax Act 1961. Further, CGTMSE was not insisting for IT PAN in respect of loans upto ₹10 lakh (upto 2015-16) and ₹5 lakh (2017 onwards) at the time of availing guarantee cover. The directions as regards mentioning of IT PAN number in cases of guarantees more than ₹10/ ₹5 lakh was not adhered to. The data did not contain IT PAN number of MSE unit in 10.43 lakh (86.22 <i>per cent</i>) cases. In these cases, the field was either blank or contained either '0' or some name, character, numbers, or a number which did not conform to the format of IT PAN number.
SSI_NO_OF_EMPLOYEES	The number of employees mentioned in 1,852 cases was either zero or the column was left blank.
SSI_PROJECTED_SALES_TURNOVER	The projected sales turnover in 6,007 cases was either 0 or was blank or the turnover indicated was upto ₹1000 only.
TRM_INTEREST_RATE	The rate of interest of term credit was 0, 1, 2, 3 and 4 <i>per cent</i> in 4,324 cases indicating requirement of checking of credit facility extended by the MLIs as the interest rates were much lower as compared to the prevailing rates.
WCP_INTEREST	The rate of working capital interest (fund based and non-fund based) was indicated as 0, 1, 2, 3 and 4 <i>per cent</i> in 929 cases.

Field	Audit observation
	Also, there were cases where the rate of interest was 70 and 95 <i>per cent</i> .
CHIEF_PROMOTER_MOBILE	The Chief Promoter's mobile number was either not mentioned or was incorrect in more than 94 <i>per cent</i> cases.
SSI_DISTRICT_NAME	The name of the District of the MSE unit was left blank in two cases.

The above mentioned instances are illustrative and not exhaustive indicating poor system and internal controls prevailing in the CGTMSE. The online system should not accept incorrect data or if redundant/ incorrect data was accepted by the system it should attract the attention of approver of guarantees.

The Management (March 2019) and Ministry (September 2019) accepted the facts and stated that the Trust was carrying out BPR exercise by engaging an external consultant and it would be endeavoured to address data gaps. The reply did not address concerns emanating from the quality of data fed by the MLIs, which shows poor appraisal by the MLIs. These concerns need to be addressed by the Trust prior to issue of guarantees.

4.1.6.2 Issue of guarantee cover more than once on same application

As per process in vogue, the MLIs make online application on the CGTMSE portal in the prescribed format for obtaining guarantee cover against the eligible credit facilities rendered by them to the MSEs. Online approval of guarantee applications fulfilling the eligibility criteria of the scheme is done and CGPAN¹³ is generated which is unique to the credit facility (Term Loan/ Working capital). The demand advice (CGDAN¹⁴) is generated and demanded by end of the day as per rate applicable which is visible to MLIs online for facilitating payments. The annual guarantee fee (AGF) is to be paid within 30 days of generation of demand or first disbursement of loan by the MLI whichever is later.

Audit noticed that the MLIs applied for guarantee covers more than once for the same application/ credit facility and the Trust also provided guarantee cover to the MLIs as per their application. In this process, the system generated a new CGPAN for the already covered facility. The online system was, therefore, not capable of generating alert when the same application was submitted by the MLI for guarantee cover. Further, the approver of the guarantee applications also did not verify the duplicate record and give cognizance to the alert even if some alert was generated by the system for duplicate record.

The information provided by the Trust disclosed 122 cases where the MLIs submitted the same application for guarantee cover more than once. The Trust issued guarantees amounting to ₹17.15 crore in these cases. These numbers are only indicative and do not represent the entire cases where duplicate CGPAN was generated by the system. The issue of duplicate guarantees on the same applications comes to the notice of Trust only

¹³ CGPAN represents the application identification number in respect of a guarantee application.

¹⁴ CGDAN represents the demand advice reference generated for claiming guarantee fee.

when the MLI requests for refund of fee deposited by it on the ground that the application was inadvertently lodged twice. The Trust cancelled the duplicate guarantee after verification and refunded the fee in all cases where the MLI had made such requests.

Issue of duplicate guarantee for already covered cases raises questions on the capability of the online system and indicates lack of adequate internal controls in issue of guarantees. The Trust by issuing duplicate guarantees had not only compromised with its financial interests but also showed lack of business prudence and provided an opportunity to the MLIs to lodge dummy applications. This could be highly detrimental to the interests of the Trust as all the activities including approval of claims are being done online without transfer of a single paper record.

The Management (March 2019) and Ministry (September 2019) while accepting the facts stated that the duplicate guarantees in almost all the cases were issued only due to inadvertent errors made by the MLIs. The duplicate guarantees were cancelled upon the requests of the MLIs.

The Management did not give any action plan or proposal to ensure non-recurrence of such events in the future.

4.1.7 Conclusion

- (i) The Trust continued to extend credit guarantee for the loans upto ₹10 lakh though the Ministry had directed to discontinue them, as these guarantees were covered by NCGTC.
- (ii) The Trust did not have any regulatory authority and there were no laws to regulate many aspects of the Trust like scope of its operations, governance, capital and operating requirements, as well as access to the state owned funds.
- (iii) The impact of CGTMSE in terms of turnover, exports and employment figures of MSEs were all estimated based on the information furnished by MLIs at the time of lodging application for seeking guarantee cover.
- (iv) The Trust has not fixed benchmark leverage on corpus fund on appropriate basis to generate more confidence in MLIs on the efficacy of the guarantee instrument and assurance to motivate them for larger front end support to MSE sector.
- (v) The present system of approval of guarantees merely provided an assurance that the MLIs had filled only the mandatory details of the borrowers. Even the system/ portal was not adequate enough to verify the accuracy of the details filled by the MLIs. Further, the Scheme did not encourage ratings of the proposals as ratings were not required for credit proposals upto ₹50 lakh.

- (vi) The Trust issued guarantees on the basis of personal guarantees of the borrowers without creation of primary security which was against the approved scheme guidelines.
- (vii) The MLIs applied for guarantee covers even after the expiry of the quarter following the quarter in which the loan was sanctioned.
- (viii) The enterprise was marked as a micro unit but the term credit extended by the MLI and guarantees issued by the Trust was more than ₹25 lakh and upto ₹2 crore. As per definition of the Act, these units could not be considered as micro enterprises as the investment in plant and machinery/ equipment has exceeded the limit of ₹25 lakh.
- (ix) The policy of the Trust to allow a time period upto the end of next quarter for marking NPA was not in consonance with RBI's directions to the banks.
- (x) The Trust did not plan the inspections of MLIs as no criterion was fixed for selection of MLIs, targets and achievements in respect of MLIs and accounts to be covered and regions to be focused upon. During 2016-17 and 2017-18, the Trust carried out inspections on sample basis where claim settled was more than ₹10 lakh. The inspections were not commensurate with the guarantees issued, NPAs reported, claims lodged by the MLIs and shortcomings noticed in the inspection reports.
- (xi) The MLIs were not remitting all the recoveries made by them post-settlement of claims.
- (xii) The MLIs did not fill the non-mandatory data and further the quality of data fed was very poor. Many fields were left blank by the MLIs or incorrect data was fed.
- (xiii) The MLIs applied for guarantee covers more than once for the same application/ credit facility and the Trust also issued guarantee cover to the MLIs as per their application which was against the financial interests, business prudence and indicates poor internal control.

4.1.8 Recommendations

- (i) The Government may decide the role to be played both by CGTMSE and NCGTC with regard to guaranteeing the loans upto ₹10 lakh.
- (ii) The Government may bring the functions of the Trust under an appropriate regulatory authority to enable balancing the objective of easy fund availability with financial discipline and ensuring wider coverage of low end entrepreneurial activities.
- (iii) The Trust may consider measuring the impact of CGTMSE on economic growth, based on realistic data interface with the MLIs.

- (iv) The Trust needs to adopt a suitable benchmark to reflect the correct position of leverage on the corpus fund of the Trust considering outstanding guarantees, claims rejected on technical grounds and likely to be re-lodged and estimated second claims.
- (v) The Trust needs to implement a robust appraisal model for the guarantee applications submitted by the MLIs. Further, the Trust should ensure credit rating of all the credit proposals to streamline the flow of funds to MSEs.
- (vi) The Trust needs to ensure that the approved scheme guidelines are adhered to in extending the guarantees only against primary security. The extension of guarantee by the Trust to the foreign banks in respect of credit facilities sanctioned against personal guarantees of the borrowers, in violation of the scheme guidelines, may be got investigated and responsibility thereof may be fixed.
- (vii) The Trust needs to ensure that the MLIs lodge the applications in time after sanction or disbursement of the loans.
- (viii) The Trust should ensure that guarantees are issued only to those enterprises/ units which fall under the definition of MSE prescribed in the Act.
- (ix) The Trust should ensure that the MLIs mark NPAs in CGTMSE's portal as and when the account is classified as NPA in their system.
- (x) The Trust needs to plan the inspections of MLIs based on key parameters like guarantees issued, level of NPAs, claims, etc.
- (xi) The Trust needs to put in place an appropriate system to ensure that recoveries made by the MLIs are timely remitted to the Trust.
- (xii) The Trust needs to ensure that the MLIs correctly fill-in all the required data on CGTMSE's portal.
- (xiii) The Trust needs to put in place adequate internal and validation checks in the system so that duplicate guarantees are not issued.