Chapter 4: Compliance with Guidelines issued by Reserve Bank of India

Reserve Bank of India (RBI) issued directions to NBFCs-ND-SI which are known as Prudential Norms of RBI. As per these directions, every NBFC should, after taking into account the degree of well defined credit weaknesses and the extent of dependence on collateral security for realization, classify its loans and advances and any other forms of credit into Standard, Sub-standard, Doubtful and Loss assets. Provisioning norms have also been specified for each category of these assets. RBI also issued guidelines regarding conversion of debt into equity, restructuring and security valuation. Review of compliance with these guidelines by IFCI revealed the following:

4.1 Norms of RBI for asset classification and provisioning.

RBI stipulates that the assets in respect of which the interest or principal remains due for more than five months are classified as NPAs. Further, NPAs have to be classified into Sub-standard, Doubtful and Loss assets and provision is required to be made there against after taking into account the time lag between an account becoming non-performing, its recognition as such, the realization of the security and the erosion over time in the value of security charged as per the norms prescribed below:

Table-4: Classification and provisioning norms of RBI

Nature of assets	Classification norms	Provisioning norms
1.Loss Assets	a) An asset which has been identified as such by NBFC / internal / external auditor / RBI to the extent it is not written-off. b) An asset which is adversely affected by a potential threat of non-recoverability due to erosion / non-availability of security or due to fraud by the borrower.	The entire asset shall be written off. If the assets were permitted to remain in the books for any reason, 100 *per cent* of the outstanding should be provided for.
2.Doubtful Assets	An asset which remains a sub-standard asset for a period exceeding 16[21] months.	(a) 100 *per cent* provision to the extent to which the advance was not covered by the realizable value of the security. (b) In addition to item (a) above, depending upon the period for which the asset has remained doubtful, provision to the extent of 20% to 50% of the secured portion (i.e. estimated realizable

[21] Revised to 16 months w.e.f. 2015-16 from earlier norm of 18 months.

		value of the outstanding) should be made on the following basis:
Period for which the asset had been considered as doubtful:		*Provision (as per cent)*
Up to one year		*20*
One to three year		*30*
More than three year		*50*
3.Sub-standard assets	An asset which has been classified as NPA for a period not exceeding 16[22] months.	A general provision of 10 *per cent* of total outstanding shall be made.

Compliance with the above provisioning norms was reviewed in Audit and the following deficiencies were observed:

- Loans given to Lavasa Corporation Limited was incorrectly shown as Sub-Standard instead of loss assets in terms of above RBI guidelines in view of inadequate security available and filing of a winding up petition by the Company which led to over statement of profit by ₹ 54.18 crore in 2015-16.

  Management replied (November 2016) that the outstanding loan was additionally secured to the extent of 40 *per cent* by way of tangible security and 10 *per cent* provision was made on 31 March 2016 based on the period of default. The replies are not tenable in view of available security being inadequate.
- Credit facility extended to Pipavav Marine and Offshore Limited (PMOL) for the years 2013-14 and 2014-15 was shown as standard asset despite inadequate security cover, poor past track record of the group, instead of being treated as doubtful asset as per RBI guidelines. This led to over statement of profit by ₹ 79.36 crore and ₹ 151.96 crore respectively.

  Management replied (November 2016) that adequate security cover was available.

  The reply is not tenable as the security cover of 1.22 is still below the GLP stipulated cover of minimum 2 times.
- The security provided against outstanding loan of ₹ 38.02 crore given to Wisdom Global Enterprises Limited (WGEL) was under dispute and accordingly 100 *per cent* provision was required against which the Company had made partial provision. This resulted in over statement of profit by ₹ 12.10 crore in 2015-16.

  Management accepted (November 2016) the fact that agricultural land which was security for this loan was under the possession of a third party, besides the fact that there was a dispute on the title of the land.

4.2 Prudential norms for conversion of outstanding principal into Debt or Equity

1. As per RBI Guidelines (March / July 2015) if debt or equity investment was created by conversion of outstanding principal it would be classified in the same asset classification

[22] Revised to 16 months w.e.f. 2015-16 from earlier norm of 18 months.

category as the restructured advance. Further, such converted instruments were to be treated as 'Current Investment' and valued as under:

(i) Equity classified as standard asset will be valued either at market value if quoted or break-up value if not quoted

(ii) Equity investments classified as NPA should be valued at market value if quoted and at ₹ 1 if equity is not quoted.

2. Further, as per RBI Guidelines, any conversion of debt into equity should be done only in case of listed companies.

However, a review of compliance with the above guidelines revealed that:

- Unquoted equity shares of Essar Steel Limited, Neelachal Ispat Nigam Limited and Polygenta Technologies Limited acquired by conversion of debt into equity as part of restructuring, were treated as fresh investments under non-current investment instead of current investment as stipulated vide RBI Guidelines (March / July 2015). This resulted in overstatement of profit by ₹ 2.96 crore in 2014-15 and ₹ 2.05 crore in 2015-16.

  Management replied (November 2016) that since the investments in these companies were not intended to be held for less than one year, these were categorized as Long Term investments as per RBI guidelines.

  Replies are not tenable as these investments were converted securities for which the stated RBI guidelines were violated.

4.3 Accounting for long-term non-current investment

RBI Guidelines (March / July 2015) stipulate that long-term investment are to be valued in accordance with Accounting Standards issued by the Institute of Chartered Accountants of India i.e. Accounting Standard-13 which required that a decline, other than temporary, had to be charged to profit and loss account.

However, during 2014-15 the Company adopted a policy for provision against diminution in value of equity shares as per which no diminution was required to be provided till there was default in buyback arrangement and the decline in book value of unquoted equity was more than 75 *per cent*. This was in violation of the above RBI Guidelines.

Further, a test check revealed that as a result of this policy, the Company has made no / inadequate provision against long-term investment of ₹ 734.31 crore in respect of six equity investments[23] in 2014-15 despite erosion of net-worth, continuous cash losses, negative earnings per share, accumulated losses and having no / defaulted buyback commitment by investee companies.

Adoption of the same practice in 2015-16 also resulted in inadequate provision against long-term investment of ₹ 706.17 crore in respect of five of the above six companies during the previous year.

[23] ABG Cement Limited, Gayatri Hi-Tech Hotels Limited, HPCL Mittal Energy, Gujarat State Energy Generation Limited, MCX Stock Exchange and Chennai Network Infrastructure Limited.

Valuation of unquoted equity on the basis of book value alone did not reflect a true value of the investment. The diminution in the value of such unquoted shares needed to be appropriately provided for in order to reflect the true value of the investments. Valuations of investments also gain importance from the fact that assistance under financing is usually in the form of unquoted equity and buyback defaults do not get reflected in the NPA position of the Company, though these are basically bad investments.

Management replied (November 2016) that there was no short provision. However, these investments would be re-assessed by undertaking fresh valuation in 2016-17.

Replies have to be viewed against the fact that the companies in which these investments were made, were financially stressed besides having no buyback commitments/defaults in buyback.

4.4 Restructuring norms of RBI

RBI's Prudential Norms (March / July 2015) on restructuring of the advances by NBFCs stipulate that no account shall be taken up for restructuring unless financial viability and a reasonable certainty of repayment from the borrower are established. The deviations from the above norms were observed in the following cases:

- The Company sanctioned a rescheduling package (June 2015) to Gayatri Energy Ventures Private Limited (GEVPL) by excluding there from the buyback liability of ₹150 crore from the viability projection on the ground that the same was to be borne by GPL (the parent company) and not GEVPL (the borrower) whose account was being restructured. Further, restructuring was approved without analyzing the viability of repayments to be done by GPL and without taking into cognizance the deterioration in its financial health and the fact that GPL was facing liquidity crunch and all its debts were restructured under the Joint Lenders Forum (JLF[24]) in January 2015. This action of the Company was an attempt to evergreen a weak credit facility of GEVPL.

  Management's reply (November 2016) that projections of both GEVPL and GPL have been considered, is not tenable as financial viability could not have been established especially since GPL's debt was restructured under JLF in January 2015 while restructuring of GEVPL took place in June 2015.

- In respect of Ind Swift Laboratories Limited (ISLL) and Ind Swift Limited (ISL), restructuring was done (June 2013) despite losses incurred by the borrowers in 2012-13 (₹120.94crore and ₹ 119.91 crore in ISL and ISLL respectively), huge finance cost and negative cash earning per shares and the fact that the borrowers had defaulted in honouring the Corporate Debt Restructuring package of July 2012. Thus, financial viability remained to be established.

  Management stated (November 2016) that the debt in respect of both the companies were assigned in March 2016. The reply has not addressed the issue of restructuring of debts without establishing financial viability as pointed out by Audit.

[24] A committee of lenders to formulate a joint Corrective Action Plan for early resolution of stressed account under RBI's JLF Guidelines.

- In respect of IVRCL Indore Gujarat Toll Limited (IIGTL) Indore and IVRCL Chengapalli Toll Limited (ICTL), Audit observed that the Company's assessment of the financial viability in both the cases presumed the availability of outside funds, which were to come from divestment[25] of the borrowers' investments in several other projects including the present one itself (ICTL) and not from internal accruals i.e. from cash flows of the projects themselves for which the facility was sanctioned. As the deeds of sale for investment were not yet concluded, the reasonability of their accruals in the projected future three years could not be assumed. Hence, financial viability remained to be established as per RBI's norms. The impact on profitability due to restructuring (due to interest reversal and additional provisioning) amounted to ₹ 13.91 crore and ₹ 13.26 crore in respect of IIGTL and ICTL respectively.

  Management replied (November 2016) that the Company is in the process of selling stake in three SPVs and has also obtained consent from all the lenders for the sale process.
  The replies are not tenable due to the fact that the financial viability for restructuring remained to be established as the sale of SPVs was not completed.

4.5 Norms for retrospective restructuring issued by RBI

As per RBI norms (March /July 2015), NBFCs cannot reschedule /restructure/renegotiate borrowers' accounts with retrospective effect. Audit, however, observed violations of these norms in the following cases:

- As against the borrower's requests for restructuring in respect of IVRCL Gujarat and IVRCL Chengapalli, it was observed that IFCI granted restructuring for both w.e.f. 30 June 2014 i.e. prior to receipt of application for restructuring (October 2014 and November 2014 with respect to IVRCL, Gujarat and IVRCL, Chengapalli respectively)**.** The reason for doing the same was to avoid the loan from turning into a NPA which would have resulted in higher NPA provisioning at 10 *per cent* instead of the present five *per cent* provided.
  Management stated (November 2016) that in their understanding the interest prior to date of receipt of application can also be funded.
  The replies are not tenable as restructuring of the loans with retrospective effect is not allowed as per RBI's guidelines.
- In respect of Binani Cement Limited (BCL) the restructuring proposal was approved (9 December 2014) by restructuring debts with effect from 15 February 2014 i.e. from a date prior to receipt of BCL's restructuring request (2 August 2014) which was in violation of the above stated RBI Guidelines as the account was restructured with retrospective effect.

Management stated (November 2016) that the restructuring proposal was approved by the Board on 12 August 2014 and the Master Restructuring Agreement was signed on 13 December 2014.The reply has, however, not addressed the issue of retrospective restructuring of debts as pointed out by Audit.

[25] It is the process of selling assets of the company for generating cash flows to pay back its debts.