CHAPTER V: MINISTRY OF FINANCE

Cent Bank Home Finance Limited

5.1 Non-adherence to Credit Policy

Non-adherence of Credit Policy and failure of credit appraisal system at the time of sanction and disbursement of loans led to loan accounts becoming NPA and subsequent write off.

The credit policy of Cent Bank Home Finance Limited (CBHFL) stipulates that at the time of sanction of loans, CBHFL obtain and examine, *inter alia*, the following documents:

- Proof of security which includes original registered title deeds in case of purchase of private site/house, original allotment letter, cash paid statements in case of purchase of flat and an undertaking to mortgage the property.
- Installment to Income Ratio, indicating the repaying capacity of the borrower, should be a maximum of 40 *per cent* of gross income for loans sanctioned at branch office level. A relaxation up to 45 *per cent* of gross income can be obtained from the registered office.
- Details of existing loans or CIBIL[1] report.
- Proof of income, address and identity, copy of bank passbook for last six months, agreement for sale of property between the buyer and seller, copy of Income Tax Returns (ITRs) for last three years,

As of 30 June 2016, the non-performing assets (NPA) of CBHFL stood at ₹28.55 crore. Out of this, ₹19.25 crore (67 *per cent*) pertained to 359 NPA accounts from five branches of CBHFL. Audit carried out a test check of 23 loan accounts involving outstanding dues of ₹4.68 crore related to these five branches as under:

Name of branch	NPA loan accounts		Audit coverage	
	No.	Amount (₹crore)	No.	Amount (₹crore)
Agra	8	1.98	7	1.95
Bhopal	39	3.07	4	0.50
Indore	79	5.85	2	0.19
Jabalpur	228	7.76	8	1.70
Nasik	5	0.59	2	0.34
Total	**359**	**19.25**	**23**	**4.68**

The details of the 23 loan accounts is at **Annexure-VII.** Audit examination revealed that the branch offices failed to comply with the credit policy while sanctioning loans as detailed below:

[1] *CIBIL: Credit Information Bureau (India) Limited*

Lack of security: In 8 of the 23 cases studied, the loans were sanctioned and disbursed without adequate security:

- The loans had been extended on the basis of 'Agreement to Sell' in five cases (loan accounts 01702070000006, 01702070000007, 01702070000011, 01702070000012, 01702070000001). In four of these cases, the construction of these properties were 95 *per cent* complete at the time of sanction of loan. However, these properties were not registered even after two to three years of loan sanction and disbursement. In one case, the borrower informed that the construction was sealed by local authorities. It was noticed that for this property, the builder had informed CBHFL at the time of disbursement of the loan that all clearances required for the construction had been obtained, though relevant documents in support of such assertion was not found in the relevant loan file.

- Two loans (loan accounts 01402250000064 and 01402250000065) were sanctioned to two borrowers on the basis of security of the same property. Both the borrowers had the same address, both loans were sanctioned on the same day (25 August 2014) and disbursements against the loans were also made on the same day (31 August 2014). The property was not traceable and hence no security was available with CBHFL.

- Another loan (loan account 00402070001921) was sanctioned based on fraudulent documents. The Legal Scrutiny Report was based on two sale deeds dated 25 August 1980 and 26 September 2013 while the Valuation Report was based on a registered sale deed dated 27 August 2013. Despite the apparent discrepancy, the loan was sanctioned. Subsequently, during legal action for taking over the property, it came to light that the property belonged to a third party.

Repaying capacity of borrowers: In 5 of the 23 loan cases, the 'Instalment to Income Ratio' of 45 *per cent* was breached by the branch sanctioning the loan, even considering the gross income of the borrower as declared in the income tax returns as detailed below:

Loan accounts	Average monthly income (₹ lakh)	Monthly instalment (₹ lakh)	Instalment to Income ratio (%)
01702070000006 01702070000007	1.43	1.10	**76.92**
01702070000011	0.73	0.40	**54.79**
01702070000012	0.61	0.34	**55.74**
01702070000001	0.67	0.73	**108.96**

If the re-payment obligations of the borrower arising out of existing loans were considered, the ratio would be far worse. Thus, while sanctioning these loans, the repayment capacity of the borrowers were not appropriately assessed, assuming higher risks.

CIBIL Reports: As per the credit policy of CBHFL, CIBIL report of the borrower was required to be obtained and examined before sanction of loan. The CIBIL report would enable the branch office to ascertain the indebtedness, creditworthiness and credit exposure of the borrower. Audit noticed the following regarding compliance of this condition:

- In three loan cases (loan accounts 01702070000006, 01702070000007, 01702070000001) the CIBIL reports were not obtained before sanction of the loans. The CIBIL reports obtained subsequently, after sanction and disbursement of the loans indicated that these borrowers had significant outstanding debts at the time of sanction of the loans and hence their credit-worthiness was doubtful.

- In two other loan cases (loan accounts 01702070000012, 01702070000011), CIBIL reports were obtained but the indebtedness of the borrowers reflected in these reports were not duly considered before sanctioning and disbursing these loans.

Disbursement in violation of sanction: In two cases (loan accounts 00202070004589 and 00202070004590), disbursements were made in violation of the terms of disbursement specified in the loan sanction letters. As per the terms of sanction, the loans were to be disbursed based on the progress of construction. However, loans were disbursed though no construction was done on the plot.

Deficient documents: In 8 of the 23 cases, the documents based on which loans were sanctioned were deficient. However, credit appraisal by CBHFL did not flag these obvious discrepancies:

- The documents submitted in three loan accounts were incomplete. For loan account 00402070001917, no income tax return was submitted while for loan account 01302090000019, the borrower submitted income tax returns for two instead of the stipulated three years. For another loan account 00402080000135, bank statement of borrowers was not available on record.

- The documents based on which loans were sanctioned had obvious discrepancies in six instances.
  - In case of loan account 00402070001917, different residential addresses in application form, bank pass book, agreement to sell, sale deed and loan sanction letter were indicated.
  - Two loans (00202070004618 and 00202280000001) were sanctioned for purchase and furnishing of a house. The valuation report of the property (22 March 2014) stated that it was under construction while the credit appraisal (20 October 2014) stated that the property had been constructed in 2013. The builder handed over actual possession of the property in 2016 to the seller who agreed to sell the property to borrower and for which loan was availed. Loan for furnishing this property was sanctioned in October 2014, though it was not under the possession of either the seller or the borrower.
  - In case of loan account 01302080000065, the borrower submitted unsigned documents in support of income.
  - In case of two loan cases (01702080000006 and 01702080000009), the Residence Verification Report and Business Verification Report dated 26 November 2013 did not recommend sanction of the loans as the addresses of the borrowers were not found and the business unit was closed

at the time of the inspection. The loan was, however, sanctioned and disbursed.

The Management stated (October 2017) that loans had been written off where the possibility of recovery was minimum and that steps were taken to strengthen collection and recovery in delinquent cases which were monitored closely. The Management also stated that five loan cases have been reported (May 2017) as fraud to National Housing Bank (NHB). FIR in respect of two loans had been lodged in April 2017 whereas FIR in respect of another case was lodged in February 2016. Physical possession of the properties had been taken in five cases and auction of the properties would be held soon. In the remaining cases, steps for physical possession of the property had been initiated.

The reporting of the five fraud cases to NHB, filing of FIR in April 2017 and legal action for possession of properties in five cases was initiated by the Management after being pointed out by Audit in February 2017. In eight cases, it was seen that though legal action was initiated, possession of the property was yet (October 2017) to take place. Out of ₹4.68 crore covered in audit, CBHFL has written off ₹2.05 crore (related to five cases of Agra Branch, two cases of Nasik Branch and one case of Jabalpur Branch) during 2016-17.

Non-adherence of Credit Policy and failure of credit appraisal system at the time of sanction and disbursement of loans led to loan accounts becoming NPA and subsequently written-off.

As Audit has test checked a small sample, there is a need for the Management to carry out a detailed analysis of all NPA accounts and take appropriate action. The Management should take appropriate action to fix responsibility of the officials who failed to apply mandatory checks before sanctioning bad loans.

The matter was referred to the Ministry in November 2017; their reply was awaited (February 2018).

IFCI Infrastructure Development Limited

5.2 Injudicious decision to continue with a residential project with Floor Area Ratio in excess of allowable limits making the project unviable

IFCI Infrastructure Development Limited proceeded with the construction of the Housing Project '21st Milestone Residency' at Ghaziabad with Floor Area Ratio (FAR) of 2.5 without analysing the profitability of the project, against FAR of 1.5 permitted by Ghaziabad Development Authority. Further, delay in initiating action for obtaining additional FAR through compounding procedure led to loss of ₹11.36 crore.

IFCI Infrastructure Development Limited (the Company) decided to develop (February 2009) residential project viz '21st Milestone Residency' at Ghaziabad, Uttar Pradesh on the land received from IFCI Limited (its holding company) against equity contribution of ₹23.38 crore.

The Company appointed (February 2009) M/s Holistic Urban Innovations Private Limited (consultant) as Architect and Project Management Consultant for the said project on nomination basis at a consolidated fee of 4.5 *per cent* (subsequently enhanced to 9.5 *per cent* in December 2011) of the actual project cost.

The consultant developed the concept plan based on a Floor Area Ratio (FAR)[2] of 2.5 (four towers with 14 floors each) at an estimated cost of ₹118.53 crore excluding cost of land. The plan was apprised (27 February 2009) to the Board of the Company. Subsequently, the Board was also informed (June 2010) that the estimated profit from this project would be ₹34 crore. On submission (November 2009) of drawings to Ghaziabad Development Authority (GDA), it was intimated by GDA that the said land was earmarked as a residential zone with low density and the FAR applicable was 1.5 (equivalent to 22921.54 square metre) only. Accordingly, the consultant submitted a revised plan with a FAR of 1.5 and the same was approved (March 2010) by GDA with maximum permissible 10 floors in each of the four towers subject to the condition that necessary No Objection Certificates (NOC) and statutory approvals would be submitted in due course.

Regulations of GDA permitted purchase of 10 *per cent* of sanctioned FAR through compounding and 33 *per cent* on payment of additional fee. Accordingly, the maximum admissible FAR including additional FAR that could be purchased for this project was 2.15[3] only. The Company entered (July 2010) into an agreement with M/s Solutrean Building Technologies Limited (SBTL) for construction work on a turnkey basis at ₹59.79 crore with scheduled completion in July 2012 and started construction of the building (August 2010) on an FAR of 2.5 based on the recommendation of the consultant to maximise the gains in the project. When the construction crossed 11th floor in three towers and 10th floor in one tower, against the maximum permissible limit of 10 floors in each tower as per approved plan, GDA issued (July 2011) notice to stop the construction work. However, the internal finishing work was continued and that was also stopped by GDA in December 2012.

The consultant applied for revised NOC for height clearance from the Airports Authority of India in December 2012. On receipt (April 2013) of the NOCs, revised plan was submitted (18 December 2013) for purchase of additional FAR and the same was approved (February 2014), subject to payment of compounding fee and penalty of ₹6.94 crore. Further, GDA directed (May 2014) to submit a Gift deed for land admeasuring 1362.97 square meters for road widening. On making the requisite payment[4] (March to June 2014) the construction work was resumed in December 2014. Considering the cost escalation due to stoppage of work for 2 years, a supplementary agreement was entered into (September 2015) with SBTL. GDA released (7 September 2016) the final compounding drawings allowing a net permissible FAR of 33459.27 square metre

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[2] ***Floor Area Ratio (FAR) is the ratio of total area on all the floors of a building on a certain plot divided by the total area of the plot***

[3] ***Sanctioned FAR of 1.5+10 per cent of 1.5 i.e. 0.15 + 33 per cent of 1.5 i.e. 0.5 =2.15.***

[4] ***A payment of ₹7.45 crore was made including penal interest of ₹0.51 crore towards delay in payment of compounding fees***

(which worked out to FAR of 2.19[5]) consisting of 258 units which were already constructed by July 2011. Out of these 258 units, the company sold (till October 2017) 213 units and 45 units remained unsold.

The project has been completed in all respects and the completion certificate has been received from GDA in December 2017.

Audit observed that –

- The Company unauthorisedly started construction of 11/12th floor against the permissible limit of 10 floors without initiating any action for purchase of additional FAR.

- The Company without analysing the admissibility of maximum purchasable FAR and profitability of the project proceeded with construction based on FAR of 2.5 without the approval of the Board. This was brought (March 2014) to the notice of the Board only while seeking approval for payment of compounding fee. The Board was left with no alternative but to approve the payment of compounding fee to GDA.

- The consultant failed to initiate action for purchase of additional FAR[6] immediately on award of contract to SBTL in July 2010. Action was initiated only in July 2012 i.e. after a lapse of 2 years which led to cost overrun of ₹6.28 crore in construction of flats. Audit analysis of actual expenditure (₹141.88 crore[7]) incurred on the project vis-a-vis the revenue earned (₹84 crore) and likely to be earned (₹46.52 crore) for the unsold units as estimated by the Company, revealed that the project would result in a loss of ₹11.36 crore despite the fact that a rate of ₹6400 per sq. ft. was assumed by the Company while estimating revenue against a rate of ₹3500 per sq. ft. obtained for Sales in November 2012. Further, the loss was likely to increase as the Company would be liable to pay penalty under Real Estate (Regulation and Development) Act 2016 for delay in handing over of possession to flat owners.

The Company stated (October 2017) that construction of project with FAR of 1.5 would have resulted in losses. Hence, to ensure that the project was profitable and to maximise the revenue, the Company decided to go for construction in excess of 1.5 FAR on the advice of the consultant. The calculation of loss in the project was incorrect because no money was borrowed by the company for the project. Further, the project was not at loss even at present despite considering cost escalation and may earn a profit of ₹2.77 crore.

The reply is not tenable because-

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[5] ***33459.27 sq. mtrs divided by Net plot area i.e. 15281.03 sq. mtrs= 2.19. Permissible FAR of 33459.27 sq. mtrs included FAR of 681.48 sq. mtrs towards 50 per cent compensatory FAR allowed in lieu of gift deed of land of 1362.97 sq. mtrs made by the Company***

[6] ***Required for construction above 10th floor***

[7] ***Land cost (₹28.32 crore), construction cost including compounding fees, penalty and taxes (₹102.16 crore) and borrowing cost (₹11.40 crore)***

- While deciding to proceed with construction with FAR of 2.5, no cost analysis was done. A cost analysis adopting three different FARs of 1.5, 1.89 and 2.2 was carried out only in March 2014 and the analysis revealed that under all the three options, project would incur losses. Therefore, the contention of the Company to adopt FAR of 2.5 on the ground of profitability of the project was injudicious.

- The Company borrowed a term loan of ₹60 crore and issued bonds valuing ₹75 crores for the ongoing projects and the interest cost was apportioned. Interest apportioned to this project was ₹11.40 crore. The projected profit of ₹2.77 crore given in the reply was calculated without considering this borrowing cost. Further, a component included in revenue was compensatory FAR in view of Gift deed of land for road widening amounting to ₹2.73 crore. This was not correct as the revenue was calculated based on the FAR of 2.19 which already included compensatory FAR permitted in lieu of gift deed. Therefore, consideration of monetised value of ₹2.73 crore towards compensatory FAR as additional revenue was not correct.

Thus, injudicious decision to execute the project with FAR of 2.5 without initiating timely action for obtaining statutory clearances is likely to lead to a loss of ₹11.36 crore.

The matter was referred to the Ministry in November 2017; their reply was awaited (February 2018).

India Infrastructure Finance Company Limited

5.3 Doubtful recovery of dues

IIFCL failed to realistically assess the expected revenue from real estate development of 2500 hectares of land along the 165 km expressway between Noida and Agra even though the real estate component in the project was critical for its viability. IIFCL sanctioned and disbursed the loan at a time when the real estate industry was in strain and real estate development of the project was stalled due to restrictions imposed by the National Green Tribunal on construction activities around 10 km radius of Okhla Bird Sanctuary. IIFCL also unduly relaxed pre-commitment condition of obtaining second credit rating of the project and disbursed the loan amount despite the project company facing severe financial crunch. These led to doubtful recovery of dues of ₹1089.89 crore.

India Infrastructure Finance Company Limited (IIFCL) sanctioned (30 July 2014) a loan of ₹900 crore to M/s Jaypee Infratech Limited (borrower) under Takeout Finance Scheme[8] for refinancing the Yamuna Expressway Project. The loan proposal was vetted by an Independent Evaluation Committee (14 March 2015) constituted as per Reserve Bank of India directives. Post vetting, IIFCL revalidated (24 March 2015) the sanction and disbursed the loan amount of ₹900 crore (01 June 2015). The loan account of IIFCL

[8] *Approved by an Empowered Committee comprising Secretary (Economic Affairs), Secretary, Planning Commission, Secretary (Expenditure) and Secretary (Financial Sector) as convener and in his absence Special Secretary/Additional Secretary (Financial Sector) and Secretary of the line Ministry dealing with the subject*

remained un-serviced and turned NPA[9] in December 2016. The outstanding dues stood at ₹1089.89 crore (including an interest component of ₹189.89 crore) in December 2017.

Audit observed that:

- The project included construction and operation of an expressway of 165 km between Noida and Agra and real estate development of 2500 hectares of land along the expressway. The project was critically dependent on income from real estate development. In fact, the debt service coverage ratio (DSCR) of the project was found to be acceptable assuming 42 *per cent* aggregate revenue from real estate. The criticality of the real estate component in the project viability was recognised by IIFCL as early as November 2013, when its Management and Investment Committee (MIC) advised that it would be essential to consider how the company would service its loan obligations when cash flows proposed through real estate development decline. It was, therefore, known that any delay in completion of the real estate component and/or reduction in expected revenue from real estate would significantly impact the project viability and debt serviceability.

- Restrictions on real estate development along the expressway had been imposed (October 2013) by the National Green Tribunal (NGT) due to raising of objections by environmental activists on the construction activities around Okhla Bird Sanctuary (within 10 km radius).The restrictions continued at the time of sanction of the loan by IIFCL (July 2014/March 2015) and disbursement (June 2015). Considering that implementation of the real estate component was critical for ensuring debt serviceability, it would have been prudent to assess the effect of the NGT restrictions on the real estate development component before sanction/ disbursement of the loan. At the time of sanction of the loan, it was not known to IIFCL whether or when NGT would lift the restriction. NGT lifted the restrictions only in August 2015 but by then, the real estate projects had suffered setbacks, the promoters faced severe financial crunch and the real estate project could not be completed as envisaged.

- The real estate sector was under strain during this period. It was noticed that borrower earned a declining margin from its real estate business; reducing from 67 *per cent* in 2010-11 to 43 *per cent* in 2013-14. The revenue earned in 2013-14 was ₹1258 crore as against an estimated revenue of ₹3184 crore. Despite this downward trend, IIFCL considered the estimated revenues of ₹2203 crore, ₹3312 crore, ₹4954 crore, ₹5279 crore from real estate for the years 2014-15, 2015-16, 2016-17, 2017-18 respectively proposed in the Information Memoranda of the lead lender while sanctioning the loan. The assessment of real estate revenue from the project by IIFCL while sanctioning the loan was thus un-realistic. As per information furnished by the borrower (January 2017), the actual revenue from real estate during 2014-15 and 2015-16 was ₹553 crore and ₹147 crore respectively. As debt serviceability depended upon real estate revenues, adoption of un-realistically high real estate revenue led to poor pre-loan assessment.

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[9] ***NPA: Non-Performing Asset***

- The guidelines governing Takeout Finance Scheme for IIFCL specifies that IIFCL should not lend to any project which has a credit rating, equal to or lower than BB[10]. The loan terms in the instant project, *inter alia*, provided that the sanction would be effective only after obtaining credit rating for the project from two reputed agencies. The promoters furnished one credit rating obtained from Credit Analysis and Research Limited (CARE) in March 2015 which had awarded 'BBB-'rating to the project. The promoters sought relaxation of 90 days for furnishing the second rating and requested IIFCL to disburse the loan. IIFCL relaxed this condition and disbursed ₹900 crore. However, the borrower did not obtain rating from second agency even within the extended time and this condition had not been complied with even after a year (June 2016). Audit noticed that subsequent ratings by CARE downgraded the rating of the project to 'BB' in June 2015 and to 'D' in September 2015. The decline in credit rating was on account of slowdown in real estate sales and high debt levels resulting in weak liquidity position and delays in debt servicing. Relaxation of pre-commitment condition regarding second credit rating was not in the financial interest of IIFCL. Besides, the downgrade in credit rating was on account of strain in real estate business which was evident at the time IIFCL sanctioned the loan.

- It was also noticed that the power of relaxing pre-commitment conditions rests with the MIC of the Board. In this case, the relaxation was approved by CMD, IIFCL but the proposal for ratification of this relaxation was not placed before MIC.

The project is presently under resolution as per Insolvency and Bankruptcy Code 2016. As such, the recovery of dues against this loan account is doubtful.

The Management stated (July/September 2017) that:

(i) DSCR was assessed as a benchmark for viability purpose. The DSCR of the project was impacted on account of non-completion of the land development segment of the project. However, road segment of the project was generating revenues more than projected.

(ii) The relaxation for obtaining second credit rating had been provided for 90 days as an interim arrangement to facilitate timely disbursement. The entire status of compliances in relation to the relaxations allowed was placed before the MIC and the same was ratified.

(iii) Though NGT curtailed the area of construction around Okhla Bird Sanctuary, all restrictions were cleared in August 2015, which ratified the decision of IIFCL to sanction the loan in March 2015.

The reply is not acceptable in view of the following:

- DSCR of the project was critically dependent upon revenues from real estate development. At the time of sanction (July 2014/March 2015) of the loan by IIFCL, NGT had imposed restrictions on real estate development along the

[10] ***Instruments with this rating are considered to have moderate risk of default regarding timely servicing of financial obligations***

expressway and it was not known when or whether these restrictions would be lifted. By the time NGT cleared the restrictions (August 2015), the real estate projects in the vicinity of the project area had been adversely affected and this in turn had caused paucity of funds due to non-realisation of construction-linked payments, further affecting the projected revenue streams and repayment of debt liabilities.

- Reasons that led to lower grading of the project in the subsequent credit ratings was evident at the time of sanction of loan. Allowing more time for obtaining the second rating and disbursement of loan was, therefore, detrimental to the interests of IIFCL.

- Placing information regarding compliances against relaxations allowed for the project to MIC (June 2016), a year after disbursement of the loan (June 2015), cannot be construed as obtaining ratification for the relaxation from MIC.

Thus, IIFCL failed to realistically assess the expected revenue from real estate development of 2500 hectares of land along the 165 km expressway between Noida and Agra even though the real estate component in the project was critical for its viability. IIFCL sanctioned and disbursed the loan at a time when the real estate industry was in strain and real estate development of the project was stalled due to restrictions imposed by the NGT on construction activities around 10 km radius of Okhla Bird Sanctuary. IIFCL also unduly relaxed pre-commitment condition of obtaining second credit rating of the project and disbursed the loan amount despite the fact that the project company faced severe financial crunch. These led to doubtful recovery of dues of ₹1089.89 crore.

The matter was referred to the Ministry in October 2017; their reply was awaited (February 2018).

5.4 Inconsistency in credit appraisal and non-compliance with RBI guidelines

The internal credit appraisal assigned different risk scores against the financial and execution capabilities of the core promoter for the four projects though it was based on same set of information. This led to sanction of loan to technically and financially weak promoter. Disbursement of loan without adhering to RBI guidelines led to release of funds disproportionate to the actual progress of the projects. Eventually, the projects were terminated and loan disbursals of ₹76.46 crore had to be written off.

India Infrastructure Finance Company Limited (IIFCL) sanctioned (June 2012 to July 2013) loans aggregating ₹104.98 crore to four Special Purpose Vehicle (SPVs) companies[11] incorporated by Concast Infratech Limited (CIL) as core promoter[12] for

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[11] *(i) Concast Dhaneta Road Projects Private Limited (ii) Concast Jawasa Road Projects Private Limited, (iii) Concast Ambha Road Projects Private Limited and (iv) Concast Morena Road Projects Private Limited*

[12] *Held 74 per cent equity in the SPVs and remaining 24 per cent was held by Roman Tarmat Limited in first three SPVs and Prakash Asphaltings and Toll Highways (India) Limited in fourth SPV*

executing four road projects[13]. The road projects had been awarded to these SPVs by Madhya Pradesh Road Development Corporation Limited (MPRDC) on design, build, finance, operate and transfer (DBFOT) basis and concession agreements signed between 22 December 2011 and 15 October 2012. IIFCL disbursed ₹76.46 crore to these projects between September 2012 and December 2014 and the entire amount was written off in March 2016 as indicated in the table below:

Sl. No.	Name of project	Date of proposal	New business committee clearance	Credit appraisal grid clearance	Date of sanction	Amount of loan (₹ crore)	Amount disbursed and written off (₹ crore)
1	Dhaneta	23.05.2012	23.05.2012	23.05.2012	05.06.2012	26.00	21.74
2	Jawasa	09.07.2012	09.07.2012	19.07.2012	03.08.2012	14.08	11.97
3	Ambha	11.07.2012	20.07.2012	23.07.2012	03.09.2012	31.75	28.00
4	Morena	21.05.2013	14.06.2013	19.06.2013	19.07.2013	33.15	14.75
Total						**104.98**	**76.46**

Review of records pertaining to the above loans indicated shortcomings in credit appraisal and disbursement of loans as discussed below:

(i) Shortcomings in credit appraisal:

IIFCL carried out internal credit appraisal prior to sanctioning loans. The following table indicates internal credit rating score of the four projects, based on which these loans were sanctioned:

Particulars	**Internal credit rating score[14] based on financial year 2011-12**			
	Dhaneta	**Jawasa**	**Ambha**	**Morena**
Environment Risk	4.00	4.00	4.00	4.00
Business Risk	5.00	5.00	5.00	5.17
Critical Risk – Build Phase	5.33	5.33	5.33	5.33
Financial Risk – Build Phase	5.80	4.80	7.80	7.40
Execution Risk – Build Phase	4.00	3.67	4.34	5.00
Completion Risk – Build Phase	5.50	5.25	4.75	4.00
Overall Rating	4.75	4.46	4.54	4.50
Date of Assessment	24.05.2012	16.07.2012	20.07.2012	18.06.2013

As can be seen from the above table, risk scores for the four projects were not consistent though the core promoter was the same for all the four projects and the assessments were carried out based on the same information:

- There were significant variations in assessment of financial risk of the sponsor during the 'build phase' across projects. The memorandum to the Board in respect of Dhaneta project expressed (May 2012) an apprehension regarding the financial capability of the core promoter to bring in equity. For the other three projects, however, the memoranda to the Board (July/August 2012 and June 2013), indicated that the financial health of the core promoter was sound. Audit noticed

[13] Four stretches of Dhaneta Road Projects of 92.83 KM, two stretches of Jawasa Road Projects of 44.97 KM, four stretches of Ambha Road Projects of 91.34 KM and one stretch of Morena Road Project of 71.86 KM

[14] The score on each parameter is assessed on a scale of 0 to 10; higher score indicating lower risk

that all four memoranda were based on the same set of financial statements of the core promoter. It was seen that the core promoter had taken up nine road projects (including the above four projects) and the equity contribution for simultaneously implementing them was significant at ₹351.85 crore. However, the financial capability of the core promoter to undertake all these projects was not examined in the course of credit appraisal carried out by IIFCL. Subsequently, the project activities were stopped since September 2014 in case of Jawasa project and since December 2014 in case of Dhaneta, Ambha and Morena projects due to financial crunch of the core promoter.

- The experience of the core promoter was also assessed differently across the four projects. The memorandum to the Board in case of Dhaneta project stated (May 2012) that the core promoter did not have experience of road projects and parent company of the core promoter was engaged in manufacture of TMT bars and other metal products. However, subsequent memoranda in respect of the other three projects stated (July/August 2012 and June 2013) that the core promoter had requisite experience and good track record in development, construction and operation of infrastructure projects. Audit noticed that the core promoter had been incorporated in September 2010 and till sanction of the last loan in July 2013, had not completed any project or generated any operational revenue. It was also noticed that the Engineering, Procurement and Construction (EPC) contracts for execution of all four projects were entrusted to the core promoter (CIL).

(ii) Shortcomings in disbursement of loans:

IIFCL had voluntarily adopted the Prudential Norms of Reserve Bank of India (RBI) applicable to Non-Banking Financial Companies from 2011-12 onwards and formally came under RBI supervision from 09 September 2013. RBI issued guidelines in July 2013 urging the financial institutions to minimize reliance on external agencies and to strengthen internal mechanism to ensure end-use of loan funds.

Audit noticed that disbursements were made to the projects without any independent assessment carried out by IIFCL regarding the end use of funds. In fact, out of ₹76.46 crore disbursed against these loans, ₹48.23 crore was disbursed after September 2013 when the RBI guidelines became applicable to IIFCL. Disbursements were made from time to time, based on the reports of Lenders' Independent Engineer (LIE)[15] and certificates of Chartered Accountants (CAs)[16]. An assessment of the Independent Engineer (IE) appointed by MPRDC (March 2015), indicated that the actual progress of projects was not commensurate with the payments made to the EPC contractor and were considerably at variance with the physical progress reported by LIE as indicated in the following table:

[15] ***Lenders' Independent Engineer was appointed by the borrower in consultation with the lead lender and the cost of engaging would be borne by the borrower***

[16] ***Chartered Accountants are appointed by the borrower as the Company's (SPV's) auditor***

Sl. No.	Name of project	EPC contract value	Amount paid to EPC contractor	Payment made up to	Physical progress (in *per cent*)		Expenditure incurred based on progress assessed by IE
		(₹crore)			As per LIE	As per IE	
1	Dhaneta	112.68	112.25	31.08.2014	70.00	56.00	63.10
2	Jawasa	64.45	55.14	31.05.2014	55.00	38.00	24.49
3	Ambha	136.22	129.96	09.12.2014	50.00	30.00	40.87
4	Morena	137.30	55.74	31.07.2014	21.00	<20.00	27.44
Total		**450.65**	**353.09**				**155.90**

Against payment of ₹353.09 crore (representing 78 *per cent* of total EPC contract value) actual progress as assessed by the IE of MPRDC was only ₹155.90 crore (*i.e.,* 35 *per cent* of the EPC contract value). Considering the significant difference and keeping in view the fact that the core promoter was also the EPC contractor, diversion of loan funds cannot be ruled out.

(iii) Lack of security and write off of dues:

MPRDC terminated (April 2015) the concession agreements due to slow progress of work, non-achievement of project milestones and default in payment of dues as per concession agreement [17] . Though MPRDC endorsed (February/March 2015) the termination notices to the Lead Lenders of the projects informing of the intention to substitute the concession agreements, they did not respond within the prescribed time of 15 days from the date of issue of such notices. As a result, the lenders lost their chance to secure their financial interest in these projects. MPRDC awarded the contracts subsequently to a different contractor. The disbursed amount (₹76.46 crore) of these loans was finally written off in March 2016.

The Management replied (September 2017) that:

- It relied on the due-diligence of lead lenders and on the turnover, net-worth and experience of the parent company of the core promoter. At the time of termination of the concession agreements, more than 50 *per cent* had been completed in three out of the four projects had been completed. The promoters had infused required contribution in all projects and the contribution in Morena project was commensurate to its actual progress. The projects did not achieve milestones on account of various reasons related to obligations of concession agreements.

- The lead bank carried out regular monitoring and disbursements were made on the basis of the reports of Lenders' Independent Engineer (LIE) and certificates of Chartered Accountants. The LIE considered physical progress including works in progress and soft costs whereas the IE considered only completed works in their assessment.

- IIFCL came under the supervision of RBI only on 9 September 2013, while these loans were sanctioned much before that.

[17] ***Payment of penalty for delayed achievement of financial closure, fees of Independent Engineer engaged by MPRDC, penalty towards delay in submitting performance guarantee, and penalty towards delay in achieving project milestones***

The reply is not acceptable in view of the following:

- The primary responsibility of any financial institution is to satisfy itself about the credentials of projects under consideration for sanction of loan, irrespective of its appraisal by other financial institutions. The slow progress of project execution and consequent termination of concession agreements, substantiated weak financial and technical capabilities of the core promoter. MPRDC also noted that the stoppage of project execution was due to fund constraints of the core promoter. At the time of termination of concession agreements, the actual progress was more than 50 *per cent* in Dhaneta project alone.

- The argument that the IE did not consider soft costs while assessing physical progress of projects is not tenable. Audit has highlighted release of funds without ensuring end-use of funds available with the EPC contractor. In fact, IIFCL itself has requested (November 2015) forensic audit of accounts of Dhaneta and Ambha projects in view of significant variation in the reports of LIE and IE.

- The Management contention that IIFCL came under RBI supervision from September 2013 onwards is not justified as it had adopted RBI Prudential Norms voluntarily from 2011-12. Besides, majority of the disbursements were made after formal adoption of RBI norms (September 2013).

The internal credit appraisal assigned different risk scores against the financial and execution capabilities of the core promoter for the four projects though it was based on same set of information. This led to sanction of loan to technically and financially weak promoter. Disbursement of loan without adhering to RBI guidelines led to release of funds disproportionate to the actual progress of the projects. Eventually, the projects were terminated and loan disbursals of ₹76.46 crore had to be written off.

The matter was referred to the Ministry in October 2017; their reply was awaited (February 2018).

The Oriental Insurance Company Limited

5.5 Violation of specific directions of the Ministry leading to loss of premium

The Oriental Insurance Company Limited did not adhere to the guidelines issued by the Ministry of Finance in respect of appropriate pricing while underwriting the group health insurance policies. Consequently, the Company under charged the premium by ₹145.26 crore during 2014-15 to 2016-17.

In view of continued losses suffered by public Sector General Insurance Companies (PSGICs) in the group health insurance portfolio, Department of Financial Services, Ministry of Finance (MoF), issued guidelines (May/July 2012) for pricing of health insurance policies. As per the guidelines, the group health insurance policies (GHIPs) should be appropriately priced, duly considering the burning cost [18], Management

[18] *Estimated cost of claims in the forthcoming insurance period calculated from previous years' experience adjusted for changes in the numbers insured, the nature of cover and medical inflation*

Expenses (ME), Medical Inflation (MI) etc. to ensure that the Combined Ratio (CR)[19] should be less than 95 *per cent* of the premium charged. Policies not conforming to this ratio were not to be renewed. It was also laid down in the aforesaid guidelines, that no discount would be given in the standalone GHIPs where the CR was more than 100 *per cent*. In July 2012, it was reiterated that these guidelines were mandatory and no discretion in this regard was available to PSU Companies.

Audit reviewed 63 standalone GHIPs (having premium of ₹1 crore or more) underwritten/renewed by Mumbai Regional Office (MRO)-I, MRO-II, MRO-III, RO-Bengaluru and RO-Chennai of the Oriental Insurance Company Limited (OICL) during 2014-15 to 2016-17 and observed that the incurred claim ratio (ICR)[20] in respect of 40 GHIPs[21] exceeded 100 *per cent* and ranged from 101 *per cent* to 157 *per cent* **(Annexure-VIII)**.

Audit observed that OICL renewed 40 of these GHIPs in violation of the above guidelines by fixing the premium for these policies without ensuring that the CR was within 95 *per cent*. OICL worked out the premium, taking into consideration the previous year's annualised claim outgo adjusted with the lives proposed to be covered under policies being renewed, TPA charges and Brokerage but did not include medical inflation and management expenses. Further, the premium finally charged was even less than the premium worked out by OICL. This was in clear deviation from the guidelines of MoF.

The minimum premium to be charged as per the aforesaid guidelines worked out to ₹786.19 crore **(Annexure-IX)** taking into consideration the estimated annualised claim outgo adjusted with the lives, TPA charges, brokerage/commission and MI[22] only. ME could not be included in the above calculation due to absence of any benchmark. Against this, OICL charged the premium of ₹640.93 crore only on renewal thereby violating the specific guidelines of the Ministry of Finance, which led to a loss of ₹145.26 crore.

The Management replied (December 2017) that:

- Audit has considered burning cost after adding TPA Charges and brokerage and commission to annualised claim outgo. In fact, burning cost is always a pure claim cost and is not inclusive of TPA Charges and Brokerage or commission to it.

- High ICR of certain number of policies was not due to non-adherence to the guidelines. As a matter of fact, the pricing of these tailor made group health insurance policies was market driven and depending on competition. The price of the policies could not be factored and determined with set of limited parameters as severe price competition was witnessed in group health insurance pricing and the final price for such policies was determined by the market i.e. what client and his broker were able to negotiate amongst 30 General Insurers & Standalone Health Insurers who aggressively

[19] ***Ratio of Incurred claim plus Management Expenses, Agent's/Broker's Commission, Third Party Administrator (TPA) Commission and any other Expenses to the premium charged***

[20] ***It represents the ratio of net incurred claim to net earned premium***

[21] ***Underwritten/renewed by MRO-II, RO-Bengaluru and RO-Chennai***

[22] ***As per the consumer price indices report of the Ministry of Statistics and Programme Implementation (MOSPI), Government of India***

target such high volume business. Further, the price arrived at by audit was not always the price on which the business was available in the competitive market.

Reply of the Management is not tenable in view of the following:

- Audit has worked out premium to be charged based on Combined Ratio which includes incurred claims, management expenses, Agents'/Brokers' commission, TPA commission, medical inflation and any other expense as per guidelines of the Ministry. As already stated, component of management expenses could not be considered by Audit in above working in the absence of any benchmark for the same. Had management expenses also been included, amount of loss would have been higher.

- As per Ministry of Finance's guidelines, Policies not conforming to combined ratio exceeding 95 *per cent* were not to be renewed. The reply is silent as to why these Standalone GHIPs were renewed.

- Non-charging of premium adequate to cover higher CR exceeding 95 *per cent* at the time of renewal of policies is likely to impact long run sustainability of the Company and harm its competitiveness. This was emphasised by the Ministry of Finance also vide their letter (June 2017) addressed to CMDs of all the Public Sector General Insurance Companies (PSGICs) wherein it was clearly stated that PSGICs were violating government advisories leading to huge underwriting losses as a result of which these companies were solely dependent upon the investment income which was not a sustainable arrangement in the long run.

The matter was referred to the Ministry in October 2017; their reply was awaited (February 2018).