INDUSTRY CLUSTER

CHAPTER IV: MINISTRY OF FINANCE
(Department of Financial Services)

India Infrastructure Finance Company Limited

4.1 Doubtful recovery of loan and interest

India Infrastrucutre Finance Company Limited, under consortium lending, disbursed a loan of ₹470 crore to Essar Power Gujarat Limited for construction of a thermal power project, without conducting due diligence. Despite commissioning, the project could not be run viably due to non-supply of coal at the rates agreed upon under the Fuel Supply Agreement and the entire loan asset of IIFCL turned (April 2018) non-performing asset, for ₹400.49 crore as on 31 December 2020. This has resulted in doubtful recovery of loan amount of ₹400.49 crore and interest of ₹269.43 crore.

Under a consortium lending, India Infrastrucutre Finance Company Limited (IIFCL) sanctioned (August 2007) a loan of ₹470 crore to Essar Power Gujarat Limited[1] for 1,200 MW imported[2] coal-based power plants at Vadinar, Gujarat. The estimated cost of the project was ₹4,820 crore, which was to be funded in debt-equity ratio of 3:1 with scheduled commissioning in May 2011. Supply of coal as fuel was planned by Essar Power Gujarat Limited through a sister[3] company.

Essar Power Gujarat Limited had signed (February 2007) a Power Purchase Agreement (PPA) with Gujarat Urja Vikas Nigam Limited for sale of 1,000 MW power for 25 years at a firm price and an MoU (June 2007) with a sister company Essar Shipping & Logistics Limited[4] for signing a Fuel Supply Agreement (FSA) for getting supply of imported coal for 25 years. The borrower signed the FSA with the same sister concern, Essar Shipping & Logisitics Limited in May 2008. IIFCL disbursed loan of ₹470 crore to Essar Power Gujarat Limited during October 2009 to May 2012. The plant was commissioned in June 2012.

In September 2010, there was a change in Indonesian regulations, which had implication of increase in coal prices to be imported from Indonesian suppliers. On the plea of hike in prices of imported coal being covered under force majeure clause of the FSA, Essar Shipping & Logistics Limited did not supply the coal and terminated the FSA in December 2013. Since the tariff of power to be supplied under the PPA was insensitive to increase in fuel cost, the additional cost of coal affected the operations and financials of Essar Power Gujarat Limited. The plant was shut down in November 2017 after suffering

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[1] *A subsidiary of Essar Power Limited*
[2] *Indonesian coal*
[3] *Sister Company directly or indirectly belong to the same promoters*
[4] *Another subsidiary of Essar Power Limited*

financial loss of ₹2,514.46 crore during 2012-13 to 2016-17 due to higher cost of generation at ₹3.10 per unit against revenue of ₹2.90 per unit.

On default in repayment of the loan/ interest by Essar Power Gujarat Limited, IIFCL classified the entire loan as Non-Performing Asset (NPA) in April 2018 under RBI guidelines. Government of Gujarat vide its policy direction (3 July 2018) constituted High Power Committee (HPC) to address the stressed assets of three[5] thermal power projects in the State of Gujarat and proposed a rehabilitation package which included, *inter alia*, sacrifice on the part of lenders by 20 paise per unit in capacity charge upto normative availability of 90 *per cent* by reduction in the debt and increase in power tariff. Gujarat Electricity Regulatory Commission approved (April 2020) rehabilitation package. Management informed (February 2021) that sacrifice on the part of lenders by reduction in the debt shall be finalised after formulation of Restructuring/ Resolution plan.

As of 31 December 2020, IIFCL loan recoverable from Essar Power Gujarat Limited stood at ₹400.49 crore excluding interest of ₹269.43 crore. IIFCL created a provision of ₹240.30 crore i.e., 60 *per cent* of outstanding principal against this loan asset.

In this regard, Audit observed that in the PPA, definition of law and change in law/ force majeure covers only laws in India. 'Change in Law' covers 'change in consent/ approvals or licences available or obtained for the project'. Project under the PPA has been defined as design, financing, engineering, procurement, construction of the power station and its operation and maintenance. As such, it did not cover the impact due to change of foreign law for imported coal. Whereas in the FSA, 'Force Majeure'/ 'Change in Law' event covers change, enactment, promulgation, amendment, suspension, or repeal of any applicable laws after the date of agreement which has a material adverse effect on the ability of the party to perform its obligations under this agreement. As such, it did cover any event which had an impact on the price of coal and subsequent refusal of the party to honor its commitment. This fact was neither included in the appraisal note nor any measure was taken to mitigate this risk. This has resulted in the doubtful recovery of dues amounting to ₹669.92 crore (loan of ₹400.49 crore + ₹269.43 crore towards interest) against this loan account.

IIFCL replied (June 2021) that they followed the lead bank for financial appraisal of the project in disbursing the loan as per SIFTI[6] policy and FSA was terminated by Essar Shipping & Logistics Limited due to changes in Indonesian regulations, which led to increase in price of the coal to be imported by Essar Shipping & Logistics Limited. The project was in operation till November 2017.

Reply of IIFCL is to be viewed in light of the following facts:

[5] ***Adani Power Limited: 4,620 MW, Coastal Gujarat Power Limited: 4,150 MW and Essar Power Gujarat Limited: 1,200 MW***

[6] ***Scheme for financing Viable Infrastructure Projects through IIFCL, approved by the Ministry of Finance***

- 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.
- Even though FSA was terminated in December 2013, changes in Indonesian regulations on coal pricing in September 2010 had implication of increase in price of coal and lenders including IIFCL failed to reassess in September 2010 ability of Essar Shipping & Logistics Limited to supply the coal at agreed rate to ensure viability of the project. This change was not covered in the PPA. Even after this event, IIFCL disbursed loan of ₹163.21 crore to Essar Power Gujarat Limited.

Thus, failure of IIFCL in due diligence of the project appraisal led to imprudent disbursement and doubtful recovery of NPA of ₹400.49 crore and ₹269.43 crore towards interest.

The Audit paragraph was issued to the Ministry in May 2021; their response was awaited (July 2021).

IFCI Venture Capital Funds Limited

4.2 Non-recovery of dues from borrowers

IFCI Venture Capital Funds Limited sanctioned two loans to Ashapura Intimates Fashion Limited (₹10 crore) and Arcotech Limited (₹15 crore) in August 2018 and May 2016 respectively. The Company deviated from the terms of its Lending Policy and Loan Agreement while sanctioning/ disbursing the two loans and failed to take timely action in compliance with the Share Pledge Agreements for sale of pledged shares of the borrowers to recover the outstanding dues. This led to non-recovery of outstanding dues of ₹27.34 crore from the two borrowers.

4.2.1 The Executive Committee of Directors of IFCI Venture Capital Funds Limited (Company) sanctioned (8 August 2018) a corporate loan of ₹10 crore to Ashapura Intimates Fashion Limited (AIFL) for general corporate purposes of which ₹9 crore were disbursed on 28 September 2018. The loan was secured by way of pledge of 6,50,000 shares of AIFL, personal guarantee of promoters, post-dated cheques for interest and principal repayment and demand promissory note of ₹10 crore. As per terms of the loan agreement, loan was sanctioned for a period of 33 months, having moratorium of six months and a security cover of 2.5 times of the outstanding loan amount was to be maintained by AIFL at all times.

Lending Policy of the Company stipulated, *inter-alia,* the following:

- The borrower's name should not appear in a latest CIBIL defaulter list, not older than 30 days at the time of sanction. Besides, credit score of borrower/ promoter/ personal guarantors shall not be less than 600 and any deviation shall be approved by the Executive Committee.

- Further, deterioration in any of these conditions has to be referred to the sanctioning authority for taking decision to approve the changes or otherwise, prior to disbursement.
- Updated Net worth certificates of the personal guarantors containing full details of the properties to be obtained before disbursement of loan.
- In case stipulated security cover falls by 10 *per cent* or market value of pledged shares goes down by 25 *per cent* with the security cover being lower than the stipulated security, the borrower shall provide cash margin, failing which the Company may exercise the option to sell the shares.

Further, the Share Pledge agreement stipulated that in case there is a fall in share price of 20 *per cent* or more, as compared to the price at the time of pledging, the borrower shall provide top-up of additional free equity shares or deposit cash margin to provide liquid coverage of at least 2.5 times of the outstanding loan. In case of default in providing top-up or payment of cash margin, the Company shall have right to sell the pledged shares in the open market with one day notice.

The loan agreement stipulated, *inter alia*, the following:

- Prior to disbursement of loan, Credit Information Report would be obtained from existing lenders, which should be satisfactory and the borrower shall submit a letter of No-Set-Off with respect to the account in which disbursement is to be made.
- In case the borrower/ promoters/ guarantors/ pledgers are found to have committed any economic offence or involved in any criminal or unlawful act involving dishonesty, any material breach of trust or violation of statutory laws in force which could have material adverse effect on the business, the Company reserves the right to recall the loan after giving two week's notice.

The market price of shares of AIFL declined to ₹341.50, i.e., by 22.20 *per cent*, on the date of disbursement of the loan (28 September 2018), as against the pledged price of ₹439, and therefore, the Company demanded a top up of 83,138 shares to maintain security cover of 2.5 times on the same day. AIFL pledged 2,55,000 additional shares on 01 October 2018. On 03 October 2018, the share price of AIFL further declined to ₹246 (i.e., by 44 *per cent* from the pledge price) leading to a shortfall in available security cover by ₹2.47 crore[7] against the required security cover of ₹22.50 crore. The Company, therefore, raised a demand (03 October 2018) for cash margin of ₹2.50 crore from AIFL, which was not deposited by AIFL. The Company directed (08 October 2018) AIFL to submit bank account statement in which the loan was disbursed, which disclosed that the amount disbursed by the Company had been transferred to the personal account of the promoter. Further, the

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[7] ***No. of shares pledged as on 3 October 2018 = 6,50,000+2,55,000= 9,05,000***
Share price as on 3 October 2018 was ₹246 and the Company takes 90 per cent of the closing market price for evaluating the security cover. Hence, the available security cover was ₹20.03 crore (i.e., 246 * 90% * 9,05,000). Minimum security cover required was 2.5 times of loan amount i.e., ₹22.50 crore. Therefore, shortfall in security was ₹2.47 crore (₹22.50 crore - ₹20.03 crore).

main promoter of AIFL was missing since 02 October 2018. CARE ratings of AIFL also got downgraded to CARE C in December 2018.

AIFL defaulted in payment since 31 December 2018 i.e., within a short period from the date of disbursement of loan. The Company deposited the post-dated cheques in December 2018, January 2019 and February 2019 but the same were returned by the drawee banks due to insufficient funds. The outstanding loan stood at ₹9.31 crore[8] as on 28 February 2019. After several follow-ups for cash margin and top-up of security, the Company issued a recall notice on 18 February 2019. As there was no response from AIFL, the Company sold (19 February 2019) 41,369 shares of AIFL and recovered an amount of ₹4.36 lakh. Further sale of shares was put on hold to avoid further erosion in the security cover. Guarantee invocation notice was issued on 26 February 2019. Loan account of AIFL was declared as NPA on 31 March 2019. The Company declared AIFL as fraud case and reported (May 2019) the same to Reserve Bank of India and also filed (January 2020) a complaint with the Central Bureau of Investigation. The Company also filed (March 2019 and May 2019) criminal complaints u/s 138 of Negotiable Instruments Act and application before Debt Recovery Tribunal, Delhi in July 2019. The National Company Law Tribunal passed order (05 October 2020) for liquidation of AIFL based on a Corporate Insolvency application filed by IDFC Bank. Accordingly, the Company filed claim with the liquidator on 14 October 2020.

In this regard, Audit observed that the Company deviated from its own lending policy, share pledge agreement and loan agreement as detailed below:

- At the time of sanctioning of loan, CIBIL defaulters' list considered was more than 30 days old.

- At the time of sanctioning of loan, the credit score of one of the promoters was 662, which decreased to 543 (26 September 2018) before disbursement. This deviation was, therefore, required to be approved by the Executive Committee, being the sanctioning authority. However, it was not submitted to Executive Committee but disclosed in the disbursement note only, which was submitted to the Managing Director.

- The Company accepted Net worth certificates of personal guarantors as on 31 March 2017 instead of 31 March 2018. Moreover, net worth of personal guarantors majorly included investment in shares of AIFL itself.

- Credit Information Report from the largest lender to AIFL i.e., State Bank of India (SBI) and letter of No-Set-Off from SBI were not obtained by the Company before disbursing the loan amount.

- Despite being aware (10 October 2018) of the fact that missing promoter of AIFL had siphoned off the loan amount, the Company did not recall the loan immediately in accordance with the loan agreement and recalled the loan only on 18 February 2019.

[8] ***₹9.31 crore = Principal ₹9 crore and Interest ₹31 lakh***

- Between the date of failure (03 October 2018) to deposit cash margin by AIFL and the date (19 February 2019), on which the Company sold 41,360 shares of AIFL, approximately 2.83 crore shares of AIFL had been traded in NSE/ BSE at a price ranging from ₹221 to ₹11 per share. However, the Company did not initiate timely action for sale of pledged shares after the failure to deposit cash margin by AIFL and waited till 19 February 2019 when it sold only 41,369 shares out of 9,05,000 pledged shares for ₹4.36 lakh. The share price had declined by 95 *per cent* during the intervening period.

Thus, the Company did not comply with the provisions of lending policy while sanctioning and disbursing the loan to AIFL and also failed to take timely action as per the provisions of loan agreement and share pledge agreement for recalling the loan or for selling the pledged shares to recover the outstanding loan of ₹12.55 crore from AIFL.

The Management accepted (February 2021) the facts that (i) Net worth certificate of personal guarantors was one year old instead of updated net worth certificate, and (ii) the deviation from lending policy regarding requirement of CIBIL credit score was submitted in disbursement note only instead of submitting to the Executive Committee. The Management further stated that:

- As per the directions of the Executive Committee, an affidavit/ undertaking/ other supporting documents from the borrower regarding the regular conduct of AIFL with SBI, supported with copy of request letter submitted to SBI for said NOC to verify the conduct of the loan account, was obtained from the borrower.

- The Company was unable to sell any share due to continuous downward freeze and low liquidity in the market, and to safeguard further erosion in security cover, the sale was put on hold.

- The Company did regular follow-ups to pressurise the borrower for top-up of additional shares/ alternate security/ for providing cash margins and clear the overdues to regularise the loan account.

The reply is not tenable in view of the following:

- Submission of deviation regarding credit score in the disbursement note was not justified as any deviation after the sanction of loan should have been submitted to sanctioning authority (i.e., Executive Committee).

- Affidavit obtained from the borrower regarding regular conduct with SBI cannot serve the purpose of obtaining Credit Information Report from SBI.

- The share price of AIFL was depicting a persistently declining trend right after the disbursement of loan. The Company should, therefore, have taken prompt action for sale of pledged shares right after the failure of AIFL to provide cash margin i.e., after 03 October 2018. There was adequate trading volume at NSE/ BSE between the period 03 October 2018 and 19 February 2019 (date of sale of shares) to dispose off the pledged shares.

Thus, non-compliance with the terms of the lending policy, loan agreement and share pledge agreement and failure to take timely action to sell the pledged shares led to non-recovery of outstanding dues of ₹12.55 crore[9] from AIFL (as on 31 January 2021).

4.2.2 The Executive Committee of Directors of IFCI Venture Capital Funds Ltd. (Company) approved (May 2016) a corporate loan of ₹15 crore at an interest rate of 14.50 *per cent* per annum payable on monthly basis to Arcotech Limited (Borrower). As per lending policy of the Company, if external credit rating of the borrower is more than six months old, internal rating was required to be got done. However, the Company relaxed the required condition of obtaining a credit rating certificate, not more than six months old, at the time of sanctioning the facility to the Borrower. The approved loan was to be utilised for long-term augmentation of working capital requirements of the Borrower. The tenure of the loan was 48 months (including moratorium of 12 months) from the date of first disbursement, and it was to be repaid in equal quarterly instalments payable on the last day of each quarter after moratorium period. Corporate Loan Agreement and Share Pledge Agreement were entered into with the Borrower on 09 June 2016 and the loan amount was disbursed on 09/10 June 2016.

As per the Loan Agreement, the loan was secured with a total security cover of 2.5 times by way of pledge of listed 13,00,000 equity shares of ₹370 each. In addition, post-dated cheques for interest and principal repayment were also obtained. Borrower split (June 2017) its share in the ratio of 1:5. Accordingly, the number of shares pledged with the Company increased from 13 lakh to 65 lakh. Due to split of share, the market price of the same was also adjusted accordingly i.e., ₹74 per share (₹370/5).

The loan agreement further stipulated that in case of fall in share price, between 10 *per cent* to 20 *per cent*, as compared to the price at the time of pledge, the Borrower would top-up pledge of free equity shares within three working days and in case there is 20 *per cent* or more fall in share price, the Borrower shall deposit cash margin to maintain the security coverage of at least 2.5 times of the outstanding debt at all times during the currency of the loan.

The Borrower was irregular in payment of interest on due dates from May 2017 and in repayment of principal due from August 2017 (being the due month for first instalment of principal repayment). Requisite security cover was maintained by the Borrower till September 2017. Meanwhile, the share price of the Borrower declined, from pledged price of ₹74 (derived pledged price after split of share) to ₹65.10 (more than 10 *per cent* decline) on 16 October 2017 and to ₹58.95 (more than 20 *per cent* decline) on 25 October 2017. The Company asked the Borrower (October 2017) to replenish additional shares/ cash margin to maintain the security level of 2.5 times of outstanding loan amount. Though the Borrower repeatedly assured to top up the security and repay the dues, it did not keep up the promise.

[9] ***₹12.55 crore = Principal ₹9.00 crore + Interest ₹3.55 crore***

The Company sold (May 2018) 4,20,401 shares at ₹1.04 crore and adjusted the same towards payment of principal/ interest. Though, the Borrower topped up 30 lakh shares[10] between 02 May 2018 and 02 July 2018, the security cover in July 2018 could only reach ₹10.90 crore[11] against the required minimum security cover of ₹37.50 crore on account of the drastic fall in share price and was ultimately 70.93 *per cent* less than required minimum security cover. Considering the continuous default by the Borrower, the Company further sold 7,57,787 shares during 25 September 2018 to 24 December 2020 at ₹0.41 crore. The Company also deposited the post-dated cheques in the bank in May 2018, September 2018 and March 2019, but the same were returned by the drawee banks due to insufficient funds.

The loan account of the Borrower was declared by the Company as Non-Performing Asset (NPA) on 31 December 2018. The Company filed (May 2019) criminal complaint u/s 138 of Negotiable Instruments Act, application before Debt Recovery Tribunal (DRT) in July 2019 and National Company Law Tribunal (NCLT) in November 2020, which were in the process of hearing by the respective Court/ Tribunals (January 2021). The outstanding dues stood at ₹14.79 crore[12] as on 31 January 2021.

In this regared, Audit observed that:

- Loan was given on the security of pledged shares. Considering the fluctuating nature of the share price, timely action for selling the pledged shares in the event of deteriorating share price should have been taken. But the Company did not sell the shares on time as per Share Pledge Agreement despite repeated failure of the Borrower to replenish the additional shares/ cash margin from October 2017 to April 2018. The relaxation in share pledge agreement was approved from time to time by the Managing Director of the Company after October 2017 when share price fell by more than 20 *per cent*. During this period, the share price was ranging from ₹27.55 per share to ₹57.95 per share. Had the Company sold the pledged shares during this period, it could have realised the entire outstanding amount[13].

- As per the Loan Agreement, in the event of cross default committed by the borrower with IFCI Limited (Parent Company) or any of its subsidiary/ associate company in terms of their respective legal agreements in repayment of dues, the said event of default shall be deemed as default committed to the Company also and in such event the Company shall reserve the right to recall the assistance. The borrower defaulted in making payment to IFCI Limited in February 2018. However, the Company was not aware about the status of the

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[10] ***30,00,000 shares = 5,00,000 shares on 02 May 2018, 10,00,000 shares on 14 May 2018, 5,00,000 shares on 08 June 2018 and 10,00,000 shares on 02 July 2018.***

[11] ***No. of pledged shares as on 02 July 2018 = 65,00,000+30,00,000-4,20,401 = 90,79,599~90.8 lakh. Share price on 02 July 2018 was ₹15 and Company takes 80 per cent of the closing market price for evaluating the security cover. Hence, the available security cover was ₹10.90 crore (₹15*80 per cent *90.8 lakh shares) which was 70.93 per cent less than the required minimum security cover of ₹37.5 crore (₹15 crore*2.5).***

[12] ***₹14.79 crore = Principal ₹9.65 crore and interest ₹5.14 crore as on 31 January 2021***

[13] ***Considering the lowest price of ₹27.55 per share, the Company could have realised an amount of ₹17.91 crore (i.e., 65,00,000 shares * ₹27.55), which was sufficient to recover the outstanding dues.***

loan of the borrower in the parent/ subsidiary companies. Therefore, Company could not consider this default for immediate sale of pledged shares.

- Despite that the Borrower topped up the security cover in four installments during 02 May 2018 to 02 July 2018, it was not maintained at the required level of 2.5 times of the outstanding debt. Subsequently, the share price further deteriorated and was ranging from ₹12.55 per share to ₹18.70 per share during 03 July 2018 to 24 September[14] 2018. However, the Company did not sell the pledged shares during this period. Even if the lowest price of ₹12.55 per share is considered, the Company could have recovered at least an amount of ₹11.39 crore (90,79,599 shares[15] x ₹12.55).

- The Borrower regularly defaulted in the payment of interest and principal since May 2017 and August 2017 respectively. However, the Company started depositing the post-dated cheques in the bank only after a lapse of more than 10 months from the default.

The Company while sanctioning the loan did not comply with its own lending policy and relaxed the rating condition for the borrower. Further, relaxation in compliance with Share Pledge Agreement was not justified when the Borrower was irregular in payment of principal/ interest and failed to keep up its promise for top up of security. This led to non-recovery of outstanding dues of ₹14.79 crore from the Borrower.

The Management stated (January 2021) that:

- The Company in the event of default did regular follow ups to pressurise the Borrower for top up of additional shares/ alternate security/ for providing cash margins and clear the overdues to regularise the loan account. The Company also started selling with effect from 04 May 2018. Despite regular attempt for sale of shares, the Company could only offload limited quantity of shares due to low trading volumes. Accordingly, considering huge gap in the security cover required and available and also considering pledged shares being the primary security, total recovery only by way of sale of shares at the prevailing price was not possible and the sale of shares was put on hold.

- Matter has been taken up with IFCI Limited to know the status of loan account of the Borrower.

The reply is not tenable in view of the following:

- The huge gap between the security cover required and available had arisen only due to the fact that the Company did not sell the shares on time despite repeated failure of the Borrower to replenish the additional shares/ cash margin from October 2017 to April 2018. Subsequently, the share prices further declined resulting in inadequacy of security cover.

- The contention of the Management that the Company could offload limited quantity of shares due to low trading volumes is also factually incorrect. It was observed that, from

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[14] ***The Company sold further 7,57,787 shares beginning from 25 September 2018. Therefore, the share price up to 24 September 2018 has been considered.***

[15] ***65,00,000 + 30,00,000 - 4,20,401 (sold in May 2018)***

25 October 2017 (i.e., date of decline in the price of pledged shares by 20 *per* cent) to 03 May 2018 (i.e., before the date of first sale of shares by the Company), a total of 14.12 crore shares of the Borrower company were traded in both the stock exchanges (NSE/ BSE). Further, during 03 July 2018 (i.e., after the date of last top up of shares) to 24 September 2018 (i.e., before the date of further sale of shares), 97.66 lakh shares of the Borrower company were traded in both the exchanges. Thus, the trade volume was adequate enough in both the exchanges to sell the pledged shares.

- Borrower defaulted in February 2018 with IFCI Limited. However, nothing was found on record to show that IFCI Venture Capital Funds Limited ever initiated any action to know the status of loan account with its parent company. Moreover, parent Company too, never shared such details with IFCI Venture Capital Funds Limited, which shows that no system/ mechanism was there to give effect to the clause relating to cross default in the loan agreement. The matter was taken up with IFCI Limited only in July 2020 i.e., after a lapse of more than two years.

Thus, non-compliance with the terms of lending policy and loan agreements while sanctioning and disbursing the loans and failure to take timely action in compliance with the Share Pledge Agreements for sale of pledged shares of the borrowers led to non-recovery of outstanding dues of ₹27.34 crore from Ashapura Intimates Fashion Limited (₹12.55 crore) and Arcotech Limited (₹14.79 crore).

The Audit paragraph was issued to the Ministry in March and June 2021; their response was awaited (July 2021).

National Insurance Company Limited

4.3 Non-recovery of service tax from other insurers under reinsurance acceptances

Due to non-maintenance of records and failure to reconcile party-wise reinsurance premium received under reinsurance, NICL was unable to raise invoices for recovery of service tax from other insurers which resulted in non-recovery of ₹23.81 crore.

National Insurance Company Limited (NICL), a public sector general insurance company, is engaged in underwriting of risks by charging premium and settlement of claims in case of loss to insured. NICL also receives premium, under reinsurance, for acceptance of portion of risks of insurance policies underwritten by other general insurance companies.

During Service Tax regime, NICL received reinsurance premium from insurers under reinsurance treaty and agreement and booked the premium in their accounts at the end of each quarter/ year. Subsequent to the booking of the premium, NICL paid service tax on total premium so received to the Service Tax Department as per the provisions of Service Tax Act. Pending receipt of service tax from the insurers, the tax was paid by NICL from its own funds. Thereafter, NICL issued manual invoices to the insurers from whom premium were received and accordingly recovered the service tax so paid by NICL. Government of India introduced Goods and Service Tax (GST) in July 2017. Since then

NICL started generating invoices through the system, in place of manual system, at the time of booking of premium itself.

Audit noticed that during the years 2014-15 to 2016-17, NICL paid service tax on total premium received without carrying out insurer-wise reconciliation. Due to non-reconciliation of insurer-wise receipt of total premium, NICL failed to issue invoices to all the insurers from whom premium was received. Thus, NICL failed to recover the service tax paid by it from other insurers.

During the above period, NICL paid a total ₹110.61 crore as service tax to the Service Tax Department of which only ₹86.80 crore was recovered, leaving a shortfall of ₹23.81 crore. The company failed to reconcile the above balances due to non-availability of insurer wise details even after the lapse of over three to five years. Thus, NICL had to absorb an amount of ₹23.81 crore as service tax.

The Management, while confirming the above facts, stated (March 2021) that the deposit of service tax against the premium of acceptances was made based on the summary figure in course of closing of annual accounts for respective years which calls for reconciliation to ascertain the exact party wise recoverable. It further stated that identification/ reconciliation of the above balances was pursued continuously but party-wise reconciliation could not be achieved till date. As service tax calculation, its payments, raising of invoices and further recovery were done manually, it experiences difficulty in the process of reconciliation.

Thus, due to lack of internal control and monitoring, failure to maintain party-wise reconciliations and non-raising of invoices, NICL had to absorb an amount of ₹23.81 crore as service tax, which could have been recovered from other insurers.

The para was issued to the Ministry in March 2021; their response was awaited (July 2021).

Recommendation No. 7

Management should take steps for regular monitoring and ensure timely reconciliations of party-wise reinsurance premium to avoid instances of non-recovery of tax.

The New India Assurance Company Limited

4.4 Failure to obtain stop loss reinsurance cover resulted in loss

The New India Assurance Company Limited failed to obtain stop loss reinsurance coverage, for its exposure in the crop insurance business under Pradhan Mantri Fasal BimaYojana (PMFBY) in the State of Tamil Nadu for 2016-17, as per the operational guidelines of PMFBY, thereby resulting in loss of ₹63.76 crore (₹31.88 crore to the Company and ₹15.94 crore each, for the two co-insurers).

The New India Assurance Company Limited (Company) participated and was selected (August 2016) in the tendering process for identification of implementing agencies for the

'Pradhan Mantri Fasal Bima Yojana' (Scheme), a Crop Insurance Scheme[16] launched by the Ministry of Agriculture, Government of India. The Company was the lead member with 50 *per cent* share of premium while two co-insurers viz., National Insurance Company Limited (NICL) and The Oriental Insurance Company Limited (OICL) shared 25 *per cent* premium each. The Company was selected (August 2016) as the implementing agency in 10 districts[17] of Tamil Nadu for the years 2016-17 to 2018-19. As per the Scheme guidelines, the insurance companies shall take all necessary steps for appropriate reinsurance cover for their portfolio. Insurance Regulatory and Development Authority of India (General Insurance-Reinsurance) Regulations, 2016 also stipulated that the Reinsurance Programme of every Indian Insurer/ Indian Reinsurer/ Foreign reinsurer branch shall be to secure the best possible reinsurance protection/ coverage required to protect the interest of the policy holder/ insurer at a reasonable cost.

Board of Directors of the Company decided (November 2016) that the Company being the lead member would arrange reinsurance protection for all three participating members. The Company took reinsurance for 80 *per cent* of sum insured and decided to bear the risk for the remaining 20 *per cent* on its own (referred to as 'net retention'). This is known as Facultative Quota Share[18] proportional arrangement. Audit noticed that the Company could have secured its own exposure of 20 *per cent* also by taking a 'Stop Loss treaty arrangement' but no cost-benefit analysis in this regard was done by the Company. This was also not in consonance with the Annual Reinsurance Programme of the Company, approved by its Board of Directors. The Company earned a premium of ₹501.96 crore (including the share of co-insurers) for the Scheme against which the total claim outgo was ₹1,496.21 crore[19]. While 80 *per cent* of the difference was covered through reinsurance, 20 *per cent*, which works out to ₹299.24 crore was not covered. Audit noticed that, had the Company taken the stop loss reinsurance cover, it could have partly covered the loss amounting to ₹63.76 crore, after considering the cost of such stop loss insurance cover as ₹16.56 crore[20] (approx.).

Thus, the failure of the Company to take stop loss reinsurance for its exposure under the scheme for 2016-17 resulted in loss of ₹63.76 crore (₹31.88 crore to the Company and ₹15.94 crore each, for two of its co-insurers).

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[16] ***The scheme, launched w.e.f. Kharif 2016 season, provided a comprehensive insurance cover against failure of crops due to non-preventable natural calamities. The farmers contributed a share of 2 per cent, 1.5 per cent and 5 per cent of the actuarial premium for Kharif, Rabi and Horticulture crops respectively. The balance of actuarial premium was borne by the Government, equally shared between the State and Central Government.***

[17] ***Pudukottai, Nagapattinam, Tuticorin, Thanjavur, Virudhunagar, Theni, Krishnagiri, Dharmapuri, Villupuram, and Vellore***

[18] ***A Quota Share Treaty is a pro-rata re-insurance contract (proportional arrangement) in which the insurer and re-insurer share premiums and losses according to a fixed percentage. Facultative means case to case basis.***

[19] ***The claims outgo occurred in the years 2017-18, 2018-19, 2019-20 and 2020-21 was ₹1,159.28 crore, ₹323.22 crore, ₹7.86 crore, and ₹5.85 crore respectively.***

[20] ***On the lines of stop loss cover taken in 2017-18.***

The Company's reply (January 2021/ February 2021), endorsed (March 2021) by Ministry of Finance, Department of Financial Services stated that:

- This was the first year of business and hence past claim data/ trend was not available.
- The *Kharif* season 2016 was nearing its end at that time and there was no capacity for reinsurance in the market. Even if stop loss reinsurance was available, the cost would have been higher.
- Subsequent data has shown that there was profit on the *Kharif* portion but for *Rabi*, vagaries of nature took over leading to the loss. Also, the year (2016-17) was particularly bad in terms of severity.
- Scheme guidelines did not specifically mention that stop loss reinsurance was to be taken and it was left to the insurance companies to mitigate their exposure and honour their claims.
- Though loss has occurred, it was within the tolerance limit of the Company. This was because the Company's net worth for 2016-17 was ₹12,000 crore and the general rule of thumb is that per risk exposure should not be more than three *per cent* to five *per cent* of net worth, which was not exceeded in this case.

The reply is to be viewed against the following:

- The Company was in crop insurance business earlier also through coinsurance arrangement[21] and hence was not entirely unfamiliar with the risk. Further, the procedures for coinsurance and reinsurance in crop insurance business were discussed in the meeting held on 27 September 2016 by Agriculture Insurance Company of India Limited (AICL), wherein the terms for stop loss reinsurance were also elaborated. The Company took part in this meeting and hence was aware of the terms regarding stop loss reinsurance. Other insurance companies (United India Insurance Company Limited and AICL) have taken stop loss cover for their crop insurance coverage in 2016-17 (part-year). The Company itself had earlier, placed stop loss reinsurance protections for less than annual period/ in the middle of the year in other portfolios (Fire/ Engineering and Miscellaneous). In this case, no such cost benefit analysis was done on whether or not to take a 'Stop Loss' cover.

- Management's contention regarding capacity constraints and higher costs for stop loss reinsurance are not supported by records and hence, not taking stop loss reinsurance was not a conscious decision of the Company.

- The argument citing the profit earned for *Kharif* may be misplaced since Rabi is a different season. Further, more than 99 *per cent* premium was for *Rabi* crop (₹498.99 crore) as compared to *Kharif* crop (₹2.97 crore), indicating higher exposure and the need for better protection for *Rabi*. Regarding exceptional severity of vagaries of nature in 2016-17, Audit

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[21] ***Prior to 2016-17, the Company was the co-insurer for Weather Based Crop Insurance Scheme with 49 per cent holding and Agriculture Insurance Company of India Limited was the leader with 51 per cent holding.***

noticed that there was loss in all the years and the situation was worse in 2019-20[22] than in 2016-17, which calls for a robust reinsurance strategy for crop insurance.

- The Scheme Guidelines mention 'appropriate' reinsurance and hence the onus was on the insurance company to choose the type of reinsurance, which proved to be inadequate in this case.

- Though management has contended that the loss was within the tolerance limit of the Company as per general rule of thumb of per risk exposure not exceeding three to five *per cent* of net worth, no such tolerance limit/ rule of thumb is mentioned in the Reinsurance Programme for the year 2016-17 or the policy decisions taken while underwriting the business in 2016-17. Also, no supporting document has been provided by management for this contention.

Thus, the failure of the Company to take stop loss reinsurance cover for its exposure under Pradhan Mantri Fasal Bima Yojana for the year 2016-17 resulted in loss of ₹63.76 crore (₹31.88 crore to the Company and ₹15.94 crore each, for two of its co-insurers).

4.5 Loss due to low fixation of premium rate and high claim ratio

Failure to exercise proper due diligence while underwriting livestock insurance resulted in low fixation of premium rate and loss of ₹10.31 crore under Livestock Insurance Policy.

Telangana State Livestock Development Agency (TSLDA) called for (April 2017) quotations from Public Sector General Insurance Companies for implementation of the centrally sponsored livestock insurance under National Livestock Mission. The scheme envisaged to cover death of milk yielding cows/ buffaloes in Telangana State due to accident, diseases, surgical operations and strike, riot and civil commotion risks. The estimated number of animals to be covered was 83,000. The insured had the option to insure the cattle for one year or three years with the sum insured ranging from ₹10,000 to ₹60,000 depending on the value of the cattle.

The New India Assurance Company Limited (NIA) quoted a premium of 1.77 *per cent* of sum insured for one year and 5.25 *per cent* on the sum insured for three years' insurance coverage and got the insurance contract. A Memorandum of Understanding (MoU) was signed (June 2017) between NIA and TSLDA valid for three years. As against the estimated 83,000 animals, 47,439 animals were covered for a premium of ₹4.99 crore under the scheme for the year 2016-17 from nine districts of Telangana State. However, NIA had to pay total claims of ₹15.30 crore resulting in a loss of ₹10.31 crore with claim ratio of 306 *per cent*.

[22] ***In 2019-20, the incurred claim ratio (ICR i.e., Net claims /Net premium x 100) was 308.81 per cent while it was 298.07 per cent in 2016-17.***

Audit observed that during the previous term (2014-15), the Scheme was underwritten by The Oriental Insurance Company Limited, Regional Office Hyderabad for a premium of 3.24 *per cent* on sum insured for one year and 7.30 *per cent* on sum insured for three years and incurred loss of ₹9.54 crore[23] with an Incurred Claim Ratio (ICR) of 217 *per cent.* While quoting the premium, NIA did not consider the high ICR experienced by The Oriental Insurance Company Limited in the earlier period. The underwriting guidelines of NIA also envisaged adjustment of the premium for claim ratio of 100 *per cent* and above. Thus, failure of NIA to ascertain the ICR of the expiring policy resulted in low fixation of premium and loss of ₹10.31 crore on account of imprudent underwriting of risk.

NIA replied (January 2020) that the rates for covering livestock under National Livestock Mission were approved taking into consideration the All India experience of claims ratio and trend of rates prevailing under the competitive market conditions. It further stated that the tender floated by TSLDA, Hyderabad did not provide the previous claims experience as it was a newly carved State and they were floating the tender for the first time.

Ministry stated (March 2021) that while submitting the quote, NIA requested TSLDA for the previous claims experience and the same was not provided. Hence, NIA had no scope to work out a quote taking into account the past loss experience.

NIA's reply is not tenable because data for trend of rates prevailing under the competitive market conditions was neither found on the record nor provided to Audit. Though Telangana was a new state bifurcated from Andhra Pradesh, National Livestock Mission was a continuing scheme and insured/ beneficiary group was same. Thus, as a prudent underwriter NIA should have explored about claims experience of insurance coverage under the scheme besides considering its own All India experience of claim ratio. Ministry's reply that NIA had no scope to work out the premium taking into account the past loss experience is also not tenable since NIA could have quoted provisional premium rates with appropriate claims loading clause subject to finalisation of premium rates on furnishing of claims data of previous policy.

Thus, failure of NIA to ascertain the ICR of the expiring policy resulted in low fixation of premium and loss of ₹10.31 crore on account of imprudent underwriting of risk.

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[23] ***Claims Incurred – ₹17.64 crore Less Premium received ₹8.10 crore***

The Oriental Insurance Company Limited

4.6 Short-collection of insurance premium

The Oriental Insurance Company Limited (the Company) failed to approach Insurance Regulatory and Development Authority of India (IRDAI) for incorporating a clause in the terms and conditions of the Motor Third Party Liability Insurance policies enabling recovery of the differential amount of premium in the event of revision of rates, which led to revenue loss of ₹7.14 crore during the period 2016-17 to 2019-20. Further, the Company charged old rate of premium in 4,264 cases, instead of revised rate notified by IRDAI, which led to revenue loss of ₹0.49 crore.

By virtue of the powers vested under section 14(2)(i) of Insurance Regulatory and Development Authority of India (IRDAI) Act 1999, IRDAI has been notifying the Motor Third Party premium applicable to Motor Third Party Liability Insurance every year starting from 2011. For the years 2016-17 to 2018-19, the rates were notified on 28 March[24] of the preceding financial year for each class of vehicles and these rates were applicable from 1 April of each financial year. For the year 2019-20, the rates were notified[25] on 04 June 2019 to be effective from 16 June 2019. Upon receipt of notification from IRDAI, The Oriental Insurance Company Limited (Company) issues a circular to all the Regional Offices for charging the revised amount of premium.

In this regard, Audit observed (November 2019) that in case of 53,871 requests for new/ renewal of existing motor policies, received prior to 1 April 2016, 17 April 2017 and 1 April 2018 with policy effective date from 1 April of each respective financial year, the Company processed the requests and issued motor third party policies at the rates prevailing on the date of proposal. Similarly, in the year 2019-20, in case of 47,190 proposals received prior to 16 June 2019 (i.e., the date from which the revised third party premium rates were effective) and having policy effective date on or after 16 June 2019, the Company charged the motor third party premium at the rate prevailing on the date of proposal as detailed in ***Annexure-III***. As no discount could be allowed by insurers in respect of motor third party rates decided by IRDAI, the differential amount of premium should have been received from the policyholders.

The Company could not recover the differential amount of premium of ₹7.14 crore in the absence of any clause in the terms and conditions of Motor Third Party Liability Insurance policies. Further, the Company charged pre-revised rate in 4,264 proposals received after the date from which revised rates as notified by IRDAI became effective[26] as detailed in ***Annexure-IV*** which led to short collection of premium amounting to ₹0.49 crore.

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[24] ***Rates notified on 28 March 2017 were again revised on 17 April 2017 and made applicable retrospectively from 1 April 2017***

[25] ***IRDAI vide its order dated 28 March 2019 extended the validity of rates for the year 2018-19 beyond 31 March 2019, until further notice. The rates for the year 2019-20 were later notified on 4 June 2019.***

[26] ***1 April 2016 for 2016-17, 17 April 2017 for 2017-18, 1 April 2018 for 2018-19 and 16 June 2019 for 2019-20***

The Management stated (January 2021) that:

- The said policies with risk commencement dates on or after the date of implementation specified in the IRDAI notification were issued before the revised rates were implemented in the IT system. After every instance of such notifications, the OICL system was duly updated and tested either before or on the effective date of revision. Given the time required for system upgrades and subsequent testing, due care was exercised to ensure prompt and timely change in the system to ensure regulatory compliance.
- The Company through its operating offices regularly reaches out to the insured for collection of the differential premium. However, the same is constrained by the fact that insured persons are seldom willing to pay more than what they have already paid.
- As per IRDAI circular[27] "the terms and conditions of cover and the wordings of policies, endorsements, warranties and clauses set out in the erstwhile tariffs shall continue to apply until fresh market wordings are examined and accepted by the Authority after considering the views of various stakeholders." Consequently, any attempt by the Company to modify any of the terms and conditions of the said policy would be grossly ultra vires of regulatory instructions.

The reply is not acceptable in view of the following:

- The fact that premium was not charged as per the revised rate in case of 4,264 proposals received after the effective date of rate revision, itself indicates that the systems were not upgraded on time to ensure regulatory compliance.
- Owing to non-incorporation of an enabling clause in the policy, there was no legal enforceability for recovery of the differential premium from insured.
- The referred IRDAI circular clearly provided the scope for incorporation of fresh market wordings/ change in terms and conditions. However, reply of the Company indicates that it had never approached IRDAI to apprise about the constraint in recovering the differential premium from the insured, leading to revenue loss to the Company.

Thus, deficient terms and conditions of Motor Third Party Liability Insurance policies and inaction on the part of Management to get the deficiencies addressed, coupled with failure to charge revised rates of premium led to revenue loss of ₹7.63 crore to the Company during the period 2016-17 to 2019-20, which would continue to occur until remedial action was taken.

The Audit paragraph was issued to the Ministry in February 2021; their response was awaited (July 2021).

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[27] ***IRDAI circular reference no 048/IRDAI/De-Tariff /Dec-07 dated 18 December 2007***