CHAPTER II: DEPARTMENT OF BANKING

Industrial Investment Bank of India Limited

2.1.1 Investment in non-convertible Debentures without security

Injudicious investment decision and failure to take timely advantage of One Time Settlement proposals resulted in loss of interest of Rs.2.93 crore.

Industrial Investment Bank of India Limited (Company) subscribed (November 2000) Rs. eight crore to secured non-convertible redeemable Debentures (NCD) of a new customer Eskay (India) Limited (EKIL) on private placement basis. The NCDs were for a period of six years and redeemable in three equal instalments at the end of the fourth, fifth and sixth years from date of allotment (November 2000). The NCDs carried interest at the rate of 13.25 *per cent per annum* payable semi annually in March and September every year.

The performance of EKIL deteriorated from 2000-01 due to unremunerative product mix and it started incurring losses from 2000-01. EKIL defaulted in timely payment of interest from April 2003 onwards. The Company initiated legal proceedings against EKIL (March 2006) for recall of the principal amount of Rs. eight crore and interest due thereon.

Audit observed (November 2005) various shortcomings in the decision to invest in NCDs. The Company relied solely on the Information Memorandum (IM) issued by EKIL and did not conduct any independent assessment of the proposal. This was despite categorical statements in the IM that the potential investors were required to make their own independent valuation and judgment before making an investment and that the UTI Bank, the sole arranger, did not take any responsibility for the financial soundness of the NCDs or for the correctness of the IM. For making investment in the long term loan, the Company relied on the credit rating of the EKIL which was actually for short term instruments. Further, the Company neither signed any subscription agreement with EKIL nor did it ensure execution of an agreement by the trustees in the interest of the NCD holders, as per practice. EKIL did not issue debenture certificates which constituted a violation of the Companies Act, 1956. Personal guarantee of the promoters or mortgage was also not obtained as a security. Though NCDs were to be secured by first charge on assets, no such security was created.

EKIL proposed One Time Settlement (OTS) of dues in April 2004 with 75 *per cent* principal repayment which was subsequently (July 2004) enhanced to 81*.25 per cent* (Rs.6.50 crore). The Company did not accept the proposal and asked (November 2004) EKIL for further enhancement of the OTS amount. EKIL could not redeem any part of the NCDs and the entire principal of Rs. eight crore was outstanding apart from the loss of interest of Rs.1.20 crore[♣] upto September 2006. Meanwhile, the Government of India

[♣] ***Calculated at the rate of 8.5 per cent per annum (prime lending rate as of March 2004)***

(GOI) had decided (July 2006) to close down the Company (Industrial Investment Bank of India Limited) as it was unviable and had huge non performing assets.

The Management stated (April 2006) that the Company had taken a normal business risk and did everything possible to persuade the trustee to create the security. It had also initiated legal action at an appropriate time after giving adequate opportunity to EKIL to improve its OTS offer. The contention of the Management was not tenable as the Company had invested in the NCD without independent appraisal of the investment proposal and could not ensure creation of security in favour of the Debenture trustee. Considering the unsecured nature of NCD and continuous losses incurred by EKIL during the last five years, it would have been prudent to accept the OTS proposal of EKIL.

The Ministry stated (December 2006) that EKIL had submitted its revised offer for repayment of entire principal of Rs. eight crore with waiver of interest dues of Rs.4.76 crore. Further, the performance of EKIL had improved. Thus, there was no risk of losing outstanding principal. The contention of the Ministry was not acceptable though EKIL submitted its revised offer, the Company had not yet decided about the OTS (December 2006). Moreover, the provisional accounts (June 2006) for the year 2005-06 indicated that EKIL incurred a cash loss of Rs.15.50 crore altering the perception of improvement in EKIL's performance.

Similarly, the Company disbursed (March 1999) Rs.20 crore to Shri Digvijay Cement Company Limited (SDCCL), a loss making cement company, as subscription to their NCD on private placement basis for a period of 18 months. This was done to part finance the turnaround scheme of SDCCL, initiated by Grasim Industries Limited (GIL). The rate of interest on NCDs was 14.25 *per cent per annum*. The amount was to be repaid in two equal instalments of Rs.10 crore each in September 2000. The NCDs were secured by *pari passu* first charge over the fixed assets of SDCCL and a letter of comfort was furnished by GIL as the principal shareholder.

SDCCL continued to incur losses due to technological imbalances, high labour cost and general recession in the cement industry and its net worth turned negative (September 1999) leading to failure to repay the NCDs in September 2000. The Board of Industrial and Financial Reconstruction (BIFR) declared SDCCL a sick company in September 2000. The Company could not take any legal action against GIL, as the comfort letter of GIL did not create any indemnity or guarantee in favour of the Company.

In May 2004, SDCCL proposed OTS of dues which envisaged repayment of 81.25 *per cent* of the principal of the NCDs (Rs.16.25 crore) as full and final settlement to be paid within 30 days from the date of sanction of OTS. The Company did not accept the proposal in spite of the recommendation of the Settlement Advisory Committee of the Company in May 2005 and asked for further improvement in the OTS amount.

SDCCL improved (September 2005) the OTS amount to Rs.16.40 crore *i.e.* by Rs.15 lakh which was accepted by the Company in September 2005. SDCCL paid Rs.16.40 crore in

November 2005. The delay of fifteen months (June 2004 to September 2005) in accepting the proposal resulted in loss of interest of Rs.1.73 crore[♦] on the original OTS amount.

The Ministry stated (December 2006) that OTS proposals generally involve negotiations over a period of time and the Company was able to improve OTS offer by Rs.15 lakh through negotiations.

The reply was not acceptable as marginal addition of Rs.15 lakh to the OTS amount came with an interest loss of Rs.1.73 crore over the period of 15 months.

In the aforementioned two cases, the Company decided to go ahead with investments without making adequate independent assessment of the repaying capacity of the borrowers. Besides, the Company did not show any readiness to accept OTS offers on the basis of a realistic assessment of the paying capacity of the borrowers. This resulted in loss of interest of Rs.2.93 crore for the Company besides remaining exposed to the loss of the principal of Rs. eight crore.

[♦] ***Calculated at the rate of 8.5 per cent per annum (prime lending rate as of March 2004)***