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STANDING COMMITTEE ON FINANCE
(2020-21)

SEVENTEENTH LOK SABHA

MINISTRY OF FINANCE (DEPARTMENTS OF ECONOMIC AFFAIRS AND FINANCIAL SERVICES) AND MINISTRY OF CORPORATE AFFAIRS

***[Action taken by the Government on the recommendations contained in Seventy-Second Report* (16th Lok Sabha) on the subject 'Strengthening of the Credit Rating Framework in the Country']**

THIRTY-FIRST REPORT

LOK SABHA SECRETARIAT
NEW DELHI

March, 2021 / Phalguna, 1942 (Saka)

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Presented to Lok Sabha on 16 March, 2021

Laid in Rajya Sabha on 16 March, 2021

LOK SABHA SECRETARIAT
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March, 2021 / Phalguna, 1942 (Saka)

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* *Not appended in the cyclostyled copy*

COMPOSITION OF STANDING COMMITTEE ON FINANCE (2020-2021)

Shri Jayant Sinha - Chairperson

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1. Shri Vinod Kumar Tripathi - Joint Secretary
2. Shri Ramkumar Suryanarayanan - Director
3. Shri Kulmohan Singh Arora - Additional Director
4. Ms. Yugma Malik - Committee Officer

INTRODUCTION

I, the Chairperson of the Standing Committee on Finance, having been authorized by the Committee, present this Thirty-First Report on action taken by Government on the Observations / Recommendations contained in the Seventy-Second Report of the Committee (Sixteenth Lok Sabha) on 'Strengthening of the Credit Rating Framework in the country'.

2. The Seventy-Second Report was presented to Lok Sabha / laid on the table of Rajya Sabha on 13 February, 2019. The updated Action Taken Notes on the Recommendations were received from the Government *vide* their communication dated 28 December, 2020.

3. The Committee considered and adopted this Report at their sitting held on 10 March, 2021.

4. An analysis of the action taken by the Government on the recommendations contained in the Seventy-Second Report of the Committee is given in the Appendix.

5. For facility of reference, the observations / recommendations of the Committee have been printed in bold in the body of the Report.

NEW DELHI
10 March, 2021
19 Phalguna, 1942 (Saka)

SHRI JAYANT SINHA,
Chairperson,
Standing Committee on Finance

CHAPTER – I

REPORT

This Report of the Standing Committee on Finance deals with action taken by the Government on the recommendations/observations contained in their Seventy-second Report (Sixteenth Lok Sabha) on 'Strengthening of the Credit Rating Framework in the country' pertaining to the Ministry of Finance (Department of Economic Affairs and Financial Services) and Ministry of Corporate Affairs which was presented to Lok Sabha / laid in Rajya Sabha on 13 February, 2019.

2. The updated Action Taken Notes have been received from the Ministry of Finance (Department of Economic Affairs) on 28th December, 2020 in respect of all the seven recommendations contained in the Report. The replies have been analyzed and categorized as follows:

(i) Recommendations/Observations that have been accepted by the Government:

Recommendation Nos. 3 and 7

(Total: 02)
(Chapter- II)

(ii) Recommendations/Observations which the Committee do not desire to pursue in view of the Government's replies:

Recommendation Nos. 1, 2, 4 and 6

(Total: 04)
(Chapter- III)

(iii) Recommendations/Observations in respect of which replies of Government have not been accepted by the Committee:

Recommendation No. 5

(Total : 01)
(Chapter -IV)

(iv) Recommendations/Observations in respect of which final replies by the Government are still awaited:

Recommendation No. Nil

(Total: 0)
(Chapter- V)

3. The Committee desire that the replies to the recommendations/observations contained in Chapter-I may be furnished to them expeditiously.

4. The Committee will now deal with the action taken by the Government on their recommendations.

Recommendation (Sl. No. 3)

5. The Committee observe that in the international context, a few years back certain CRAs were stated to have been forced to downgrade their own prior credit ratings on complex mortgage backed securities in the USA, when doyens of the financial markets like Lehman Bros. collapsed and many others were in serious threat of liquidation, which also raised questions on the level of due diligence on the part of the CRAs. More recently, in the Indian context, the credibility of credit rating action has come into sharp question in the crisis involving the Infrastructure Leasing and Financial Services Limited (IL&FS), a major infrastructure development and finance company of systemic importance, which functioned as a holding company involved in investing and lending to its subsidiaries, associates and group entities. As 'rating' of an instrument or entity is being increasingly relied upon by capital markets, bankers and investors and since it constitutes a key input for financial decision-making of far-reaching magnitude, the Committee desire that it should be ensured that the credit rating process becomes absolutely professional, objective and credible. The Committee would therefore expect the key regulator, namely SEBI as well as the RBI to review their Regulations comprehensively, particularly in the face of the serious IL&FS default crisis mentioned above. The regulators should also remain alert and pro-active when it comes to strict enforcement of the Regulations, particularly the punitive provisions, as otherwise, the entire object and process of regulation will be rendered meaningless. The Committee, therefore, desire that the Ministry of Finance (Department of Economic Affairs and Department of Financial Services) should seek a factual report from the concerned regulators regarding the enforcement of the CRA Regulations, particularly the action taken by them against the CRAs who had been giving "stable" ratings to IL&FS prior to the default crisis. The Committee believe that the Regulations should be suitably modified/tightened, benchmarking them on greater objectivity, transparency and credibility in the whole credit rating

framework and process. In the view of the Committee, time has now thus come for a fresh evaluation of the credit rating framework in the country with a view to restoring public confidence and ensuring the accountability of the CRAs to the various stakeholders and the financial system as a whole. The Committee would recommend that the disclosures being made by the CRAs should henceforth include important determinants such as, extent of promoter support, linkages with subsidiaries, liquidity position for meeting near-term payment obligations etc. The Committee desire that the general investors should also be able to get a coherent "big picture" about the entity and its associates/subsidiaries from credit rating.

6. The Ministry of Finance (Department of Economic Affairs) in their action taken reply stated as under:-

> "SEBI Regulations provide for a disclosure-based regulatory regime for Credit Rating Agencies (CRAs), wherein CRAs are required to devise and disclose their rating criteria, methodology/process on their respective websites. Accordingly, each CRA has its own rating models and methodologies which are available on CRAs' website.
>
> The CRA Regulations have been amended from time to time, keeping in mind the dynamic nature of the market, so as to meet the market requirements and to achieve objectivity, transparency and credibility in the credit rating process.
>
> After the default of **financial instruments of IL&FS, SEBI CRA Regulations were reviewed** and SEBI vide circular dated November 13, 2018 further standardised the template of the Press Release used by CRAs while communicating rating actions to disclose additional information viz. disclosure on support from the Parent/ Group/ Government, if factored into a rating, list of all subsidiary/ group companies consolidated to arrive at a rating, along with the extent (e.g. full, proportionate or moderate) and rationale of consolidation, specific section on "Liquidity", highlighting parameters like liquid investments or cash balances, access to unutilised credit lines, liquidity coverage ratio, adequacy of cash flows for servicing maturing debt obligation, etc.
>
> Through the same circular, SEBI has also mandatedthe disclosure ofaverage one-year rating transition rates for long-term instruments for the last 5-financial year period on CRAs' websites and Disclosure of sharp rating actions in investment grade rating category by each CRA on the Stock Exchange and Depository websites. CRAs shall treat sharp deviations in bond spreads of debt instruments vis-à-vis relevant benchmark yield as a material event.

As far as banks are concerned, RBI accredits CRAs for the limited purpose of computation of capital for various bank exposures under the Standardized Approach of Basel II norms. Credit ratings are therefore not the chief drivers of credit decisions by banks. Credit decisions are based on banks' own appraisal and the bank loan ratings by CRAs are used by the banks only to compute the capital. The banks in India compute capital on the basis of norms prescribed by the Basel Committee on Banking Supervision (BCBS), wherein the risk weights assigned are on the basis of ratings provided by the external rating agencies. In this regard, while the risk weights assigned to a given rating grade under the BCBS norms and RBI regulations are same, the reported Corporate Debt Restructuring (CDRs) of Indian CRAs are much higher than the threshold prescribed under the Basel norms. Therefore, the minimum capital-to-risk-weighted assets ratio (CRAR) for banks in India has been kept higher at 9% as compared to the Basel requirement of 8%, precisely in view of the understated probability of default implicit in the ratings given by CRAs in India. RBI can consider prescribing higher risk weights to further mitigate the risk of high default areas on served in respect of ratings given by CRAs and even de-accrediting a CRA if warranted. However, it may not be appropriate to implement such measures based on an isolated incident. RBI shall closely monitor the evolving situation and take necessary action.

Further, as part of the supervisory process, RBI independently assesses the capital requirements of banks and can require banks to hold additional capital as part of Pillar -2 requirements under the Basel framework based on these assessments.

As far as their investments are concerned, banks have been advised to make their own internal credit analysis and rating on investment proposals and not to entirely rely on the ratings of external agencies.

DEA has sought the factual reports from SEBI and RBI regarding the enforcement of the CRA Regulations, particularly any action taken by them against the CRAs who had been giving "stable" ratings to IL&FS prior to the default crisis.

SEBI has informed DEA that actions have been initiated against the 3 CRAs who rated the non-convertible debentures (NCDs) of IL&FS.Further, adjudication proceedings against the CRAs, viz. ICRA Limited, CARE Ratings Limited and India Ratings and Research Private Limited, have been initiated by SEBI under Section 15HB of SEBI Act, 1992, for failure to exercise proper skill, care and due diligence while rating the securities of IL&FS, which is in violation of Regulation 24(7) and Clauses 4 and 8 of Code of Conduct for CRAs read with Regulation 13 of SEBI (Credit Rating Agencies) Regulations, 1999.

RBI has informed DEA that the concerns emanating from the recent IL & FS episode relate largely to the use of ratings of debt instruments issued

by the borrower entities, specifically with regard to the entity referred to.In terms of the RBI Directions, IL&FS Financial Services (IFIN) was disallowed to raise any additional funding from the Commercial Paper (CP) market for six months after a default was reported in August, 2018.

Through its circular dated November 13, 2018, SEBI has mandated disclosure of the said determinants, viz. extent of promoter/ Group/ Government support, linkages with subsidiaries, list of group companies consolidated to arrive at a rating, liquidity position, etc., in the press release regarding rating actions by CRA.

Considering the Committee's recommendation on disclosures, RBI is of the view that as per the extant SEBI instructions, in order to enable investors to understand underlying rating drives better, CRAs are required to specifically disclose the following:

i. When a rating factors in support from a Parent/Group/Government, with an expectation of infusion of funds towards timely debt servicing, the name of such entities, along with rationale for such expectation, may be provided.
ii. When subsidiaries or Group companies are consolidated to arrive at a rating, list of all such companies, along with the extent (e.g. full, proportionate or moderate) and rationale of consolidation may be provided.
iii. The Press Release shall include a specific section on "Liquidity" which shall highlight parameters like liquid investments or cash balances, access to unutilised credit lines, adequacy of cash flows for servicing maturing debt obligation, etc. CRAs shall also disclose any linkage to external support for meeting near term maturing obligations.

To address the concern of the Committee on providing a bird's-eye view about the entity and its associates/subsidiaries/structure, to the investors,SEBI has issued a circular dated November 13, 2018, mandating disclosure linkages with subsidiaries, list of group companies consolidated to arrive at a rating, etc., in the press release regarding rating actions by CRA.

Further, as prudent measure RBI has also advised CRAs to obtain and analyse bank account statements from the rated entities. This will facilitate early recognition of stress in the financials of the rated entity.

Further, a joint inspection of CRAs by SEBI and RBI has been initiated recently, with the role of RBI specifically focused on bank loan ratings assigned by the concerned CRA.Through the course of these inspections, various aspects in the functioning of the CRAs including their rating methodology are examined and observations are drawn for a follow-up with the concerned CRA.

The Ministry submitted the updated action taken reply as follows:

The desired policy changes have been carried out by SEBI in this regard in consultation with RBI and the regulations are amended as and when the market requirements warrants the same. CRAs are jointly inspected by SEBI and RBI. Through the course of these inspections, various aspects in the functioning of the CRAs including their rating methodology are examined for further modification in the policy regime.

With regards to action taken against CRAs, SEBI has probed the role of CRAs in the matter of rating of IL&FS and passed an Order dated September 22, 2020 against CARE Ratings limited, ICRA Limited and India Ratings and Research Pvt. Ltd. Imposing a penalty of Rs. 1 crore each (maximum permissible under Section 15HB of the SEBI Act 1992) for failure in exercising due diligence while assigning ratings to IL&FS.

Action has already been taken by SEBI in consultation with RBI as indicated by SEBI in the earlier response.

The desired policy changes have been carried out by SEBI in this regard. w.e.f. January 2020, SEBI has made it mandatory for listed companies to disclose their default on bank loans if the default continues beyond 30 days. This benefits all investors as well as CRAs and acts as an early warning.

7. The Ministry informed the Committee in their reply that the Credit Rating Agency Regulations have been amended from time to time keeping in mind the dynamic nature of the market, so as to meet the market requirements and to achieve objectivity, transparency and credibility in the rating process. Also, the functioning of the CRAs including their rating methodology are examined for further modification in the policy regime. The Committee were further informed that a circular was issued by Securities and Exchange Board of India (SEBI) for disclosure of additional information in the template of the Press Release used by CRAs and the mandatory disclosure of vital information on the stock exchange and depository websites subsequent to the review carried out by SEBI on CRA Regulations after the collapse of IL&FS. In the updated replies, it was informed that the desired policy changes have been carried out by SEBI in consultation with RBI and the regulations are amended as and when the market requirements warrants the same. The Committee note that RBI and SEBI have started joint inspections of CRAs with the role of RBI specifically focussed on bank loan

ratings assigned by CRAs. The Committee feel that no room should be left for complacency in this matter. The Committee thus, would like to reiterate that the regulators remain alert and pro-active to ensure strict enforcement of the regulations. In the same vein, the Committee would like to re-stress on the need for fresh evaluation of the credit rating framework in the country as per the recommendations of the Committee in their original report on this subject with a view to re-inforcing public confidence in the entire process of credit rating.

Recommendation (Sl. No. 5)

8. Similarly, the Committee would also suggest to the Ministry/Regulator to explore the mandatory rotation of rating agencies along the lines of statutory auditors to avoid the pitfalls of long association between the issuer and the CRA and particularly considering the recent instances of failure of CRAs in sensing simmering 'trouble' in their client-entities. This may also help eliminate element of complacency in the credit rating industry and bring fresh perspectives on table. In the same vein, the Ministry may also evaluate the suggestion to have rating compulsorily carried out by more than one agency (dual or multiple), particularly in respect of debt instruments/bank credit involving large amounts say, more than Rs.100 crore. This will help the investors to access different positions/viewpoints for an informed decision. On the same premise, the Committee would also suggest that the existing threshold for registration of CRAs may also be suitably lowered/modified with a view to encouraging more entities, particularly start-ups with the requisite capability and expertise to become part of the industry.

9. The Ministry of Finance (Department of Economic Affairs) in their action taken reply stated as under:-

> "It is felt that the exercise of “auditing” and “rating” cannot be compared since auditors work on past data, whereas CRAs are required to offer forward-looking views on the debt-servicing ability of an issuer. Further, while statutory audit is conducted for a company by an auditor, ratings are assigned to various instruments of a company/ issuer. Accordingly, various instruments issued by a company, having different maturities, may have ratings assigned by multiple CRAs. As a result, the same issuer would be examined by more than one CRA, in respect of rating of different instruments, unlike the examination of the accounts of a company by the same auditor.

Further, as regards the recommendation of the Committee on mandatory rotation of CRAs within the tenure of the instrument, such an exercise may have the following implications:

i. It may result in each CRA taking a short-term view (till the time that CRA is required to rate the instrument) on the creditworthiness of the issuer, instead of a longer-term perspective spanning the entire tenure of an instrument.
ii. While there are stringent conditions for withdrawal of rating from a CRA at present, mandatory rotation of CRAs, may pose the problem of rating shopping as the issuer on rotation may approach a CRA promising a higher rating.
iii. Since CRAs would assign ratings for a fixed period, the rating transition/ default statistics of each CRA, as required to be disclosed by each CRA on its website, shall not be reliable indicators of the performance of the CRA and rating transition of any instrument through its complete tenure would not be captured.

As regards the suggestion of ratings being compulsorily carried out by more than one agency (dual or multiple), particularly in respect of debt instrument/bank credit involving large amounts say, more than Rs. 100 Crore, the following may be noted:

Mandatory requirement of dual rating for debt securities would increase the cost of debt issuance and, therefore, adversely impact the interests of corporate bond issuers and hamper the growth of corporate bond market. In practice, many issuers obtain ratings from two or more CRAs upon the insistence of investors. Further, there is no requirement of mandatory dual/ multiple rating in any major global jurisdiction. It is understood that the European Securities and Markets Authority mandates the use of ratings by two or more CRAs only in case of structured finance instruments, and not for debentures/ loans. Even in cases of banks, the credit ratings are not the chief drivers of credit decisions by banks. Credit decisions are based on banks' own appraisal mechanism and the ratings are used for the limited purpose of capital computation. It is left to the borrowers to avail the external ratings from one or more CRAs. As regards commercial papers (CPs), in terms of the lowered/modified with a view to extant RBI directions, eligible encouraging more entities, issuers, whose total CP issuance particularly start-ups with the during a calendar year is 1000 crore or more, shall obtain credit rating for issuance of CPs from at least two CRAs registered with SEBI and should adopt the lower of the two ratings. Where both ratings are the same, the issuance shall be for the lower of the two amounts for which ratings are obtained.

Further , in terms of the revised framework on resolution of stressed assets,Resolution Plans involving restructuring /change in ownership in respect of ‘large’ accounts (i.e. accounts where the aggregate exposure of lenders is Rs 1 billion and above), shall require independent credit

evaluation (ICE) of the residual debt by CRAs. While accounts with aggregate exposure of Rs 5 billion and above shall require two such ICEs, others shall require one ICE. Only such RPs which receives as credit opinion of RPs or better (indicating moderate degree of safety regarding timely servicing of financial obligations) for the residual debt from one to two CRAs, as the case may be, shall be considered for implementation.

Given the importance of CRAs, it is imperative to ensure that entities granted registration as CRAs are promoted by entities having high credibility, good track record and adequate financial capabilities, and are fit and proper, so as to enable them to invest in building intellectual capital, developing efficient systems and infrastructure and adopting better technology. Maintenance of such high standards is essential for a CRA to function efficiently, professionally and independently, which may not be feasible for a start-up.

Having regard to the significant role played by CRAs in the market, it is felt that the extant eligibility requirements for registration as a CRA, viz. networth requirements, promoter eligibility requirement, “fit and proper person” criteria, etc., are reasonable/ appropriate."

The Ministry submitted the updated action taken reply as follows:

As regards mandatory rotation, as stated earlier, the rating assessment of a CRA has to be forward looking unlike auditing. Further, mandatory rotation would be a disincentive to good and quality CRAs. It will also ensure business for less effective CRAs. Hence, it is better to leave it to the market to discriminate between CRAs based on their performance.

As regards the issue of multiple ratings, the views remain the same.

RBI has further stated that in terms of the Prudential framework on resolution of stressed assets dated June 7, 2019, Resolution Plans involving restructuring / change in ownership in respect of “large” accounts (i.e. accounts where the aggregate exposure of lenders is ₹ 1 billion and above), shall require independent credit evaluation (ICE) of the residual debt by CRAs. While accounts with aggregate exposure of ₹ 5 billion and above shall require two such ICEs, others shall require one ICE. Only such RPs which receive a credit opinion of RP4 or better (indicating moderate degree of safety regarding timely servicing of financial obligations) for the residual debt from one or two CRAs, as the case may be, shall be considered for implementation.

Having regard to the significant role played by CRAs in the market, it is felt that the extant eligibility requirements for registration asa CRA, viz. networth requirements, promoter eligibility requirement, “fit and proper person” criteria, etc., are reasonable/appropriate.

10. The Committee understand the importance of maintaining high standards for a CRA to function efficiently, professionally and independently, but at the same time the Committee wish to reiterate that encouragement be given to more entities, particularly start-ups with the requisite capability and expertise to become part of the industry, as that might aid in fostering healthy competition ensuring a level-playing field and also eliminating complacency in the credit rating industry. The Committee feel that high standards should be maintained by CRAs in terms of their integrity, professional ethics along with strict diligence in abiding by the guidelines issued by the regulators. The Committee further recommend the watchdogs to be more alert and prudent in their enforcement of regulations instead of curbing the growth of credible start-ups in the industry.

Recommendation (Sl. No. 7)

11. As regards the matter of IL&FS crisis, wherein the Government has since intervened and re-constituted the Board (the matter being under National Company Law Tribunal), the Committee would recommend a comprehensive commission of enquiry into the whole gamut of the episode, which will inter-alia probe the role of CRAs that had over-rated the entities sometime before the crisis and the role of the largest institutional stakeholder in IL&FS, namely the LIC of India as well as other institutional stakeholders. The governance failures and indecision/indiscretion on the part of the IL&FS Board should also be thoroughly probed. The Committee desire that urgent measures should be initiated to resurrect IL&FS, as it is the only major institution funding the infrastructure projects in the country.

12. The Ministry of Finance (Department of Economic Affairs) in their action taken reply stated as under:-

> In the opinion of DEA, however, there is no need to set up any Commission of Enquiry in this matter as the role of Directors of IL&FS Board is already being enquired/ investigated by Serious Fraud Investigation Office (SFIO) of Ministry of Corporate Affairs. SEBI & RBI are also looking into the system/procedure of the CRAs. Hence, it is felt that a separate Commission of Enquiry is not warranted at this stage.

Due to continuous failure of the Infrastructure Leasing and Financial Services Ltd. (IL&FS) to service its debt and imminent possibility of contagion effect in the financial market, the Ministry of Corporate Affairs, at the request of Department of Economic Affairs, moved an application under Sections 241 and 242 of the Companies Act, 2013 before the National Company Law Tribunal (NCLT), Mumbai Bench for taking management control. The NCLT, Mumbai Bench vide its order dated 01/10/2018 approved the application filed in this regard, by suspending the erstwhile board of directors of IL&FS and appointed government nominees as directors, who have been tasked with the orderly resolution of the IL&FS and its group companies. The entire process is being carried out under the supervision of the NCLT. Being cognizant of the fact that the mismanagement existed across the Respondent No.1 Group, on an application by the Petitioner, this Hon'ble Tribunal, by an Order dated 09/10/2018, permitted the newly appointed Directors to appoint themselves as Directors on the group/subsidiary/associate/jointly controlled entities or operations of IL&FS.

Further, in order to ensure period of calm during the resolution process, a moratorium was sought against the creditors, which has been granted on interim basis by the National Company Law Appellate Tribunal (NCLAT) until further orders, vide its orders dated 15/10/2018. The matter is sub-judice.

The NCLT, Mumbai Bench vide its orders dated 01/10/2018 had also directed filing of progress reports till resolution, which is a continuous process. As such, till date Ministry of Corporate Affairs has filed first report on 31/10/2018, the second report on 03/12/2018, the third report, its addendum and the fourth report, collectively, on 16/01/2019.

Initially there were 11 Respondents in the original petition moved by Ministry of Corporate Affairs before the NCLT, Mumbai Bench. However, the NCLT, vide its order dated 31/10/2018 directed Ministry of Corporate Affairs to implead all the group companies of IL&FS as Respondents. In compliance of the said order, this Ministry filed an affidavit dated 03/12/2018 arraying the group companies of IL&FS as Respondents, as per information provided by the company.

Simultaneously, vide order dated 30/09/2018, in exercise of powers under Section 212(1)(a) & (c) of the Companies Act, 2013, Ministry of Corporate Affairs has ordered investigation into the affairs of IL&FS and its subsidiary companies to be carried out by the Serious Fraud Investigation Office (SFIO). The SFIO has submitted an interim report dated 30/11/2018. On the basis of said interim report, this Ministry vide its aforementioned affidavit dated 03/12/2018, also sought impleadment of further persons as Respondents in the original petition filed under Section 241 and 242 of the Companies Act, 2013. Additionally, application was also filed by Ministry of Corporate Affairs for seeking orders, qua the additional respondents, to restrain them from mortgaging

or creating charge or lien or creating third party interest or in any way alienating, the movable or immovable properties owned by them, including jointly held properties. The NCLT was pleased to grant relief to this Ministry, vide orders dated 03/12/2018, which are still in operation. As such, there are a total of 318 Respondents in petition before the NCLT.

Simultaneously, in view of the negative impact that the IL&FS Group had on the financial markets at large and that there was considerable allegations in respect of the financial statements of the said Companies, the Disciplinary Directorate of the Institute of Chartered Accountants of India (ICAI), in the interest of the profession, suomoto sought to consider the performance of the statutory auditors of the said Companies. Pursuant to an enquiry conducted in respect of the statutory auditors of the said Group Companies, the ICAI found that there were key lapses, shortcomings and manipulations on the financial statements by the statutory auditors of the said Companies. Most significantly, it was noted that the condition of the said Companies as a result of mismanagement reflects upon the statutory auditors of the said Companies. The ICAI has held the statutory auditors of the said Companies prima facie guilty of professional misconduct. As such, in view of the prima facie findings of ICAI and the interim report dated 30/11/2018 submitted by SFIO, Ministry of Corporate Affairs filed a petition before the NCLT, Mumbai Bench on 21/12/2018 under Section 130 of the Companies Act, 2013 seeking reopening of the books of account of IL&FS, IL&FS Financial Services Ltd. (IFIN) and IL&FS Transportation Networks Ltd. (ITNL) for the last 5 (five) years, and for recasting the financial statements of the said companies, which has been allowed by the NCLT, Mumbai Bench vide its judgment dated 01/01/2019.

In addition to the above, the IL&FS Group of companies have been classified into three categories – Green, Red and Amber – on the basis of 12-month cash flow based solvency test, which classification has been communicated to NCLAT vide affidavit dated 25/01/2019. Vide subsequent affidavits dated 11/02/2019 and 23/03/2019 filed before the NCLAT, detailed information regarding number of companies falling under each category has been brought to the knowledge of the Appellate Tribunal.The categorization is as under:

Category	Domestic Entity Count	Domestic IL&FS Group External Fund Based Debt (as of October 8, 2018) (INR Cr)
Green Entities which can reply all financial debt obligations as and when due no default subsists	50	5,596.6
Amber Entities which are not able to meet ALL obligations (financial and operational), but can meet operational and senior secured financial debt	13	16,372.6
Red Entities which CANNOT fully repay even senior secured financial debt obligations as when due	80	61, 375.6
Entities for which classification is still underway	18	5895.9
Entities which are undergoing liquidation proceedings, winding up and/or insolvency resolution proceedings.	8	5.7
Total	**169**	**89,246.4**

Vide orders dated 11/02/2019, the Hon'ble NCLAT has directed for exclusion of '133 Offshore Group Entities' incorporated out of India, from the purview of the Hon'ble NCLAT's order dated 15/10/2018 i.e. order for moratorium. However, the Appellate Tribunal directed that resolution for such 'Offshore Group Entities' may be taken up by the Board of Directors of 'IL&FS' under the supervision of the Hon'ble Justice (Retd.) D.K. Jain, who has been engaged to supervise the operation of the 'Resolution Process' of the 'IL&FS Group Companies', as per the directions of the Hon'ble NCLAT.

Further, vide the aforementioned orders dated 11/02/2019, the Hon'ble NCLAT also directed that all "Green Entities" are permitted to service their debt obligations as per scheduled repayment, which should be within the 'Resolution Framework' and subject to the supervision of the Hon'ble Justice (Retd.) D.K. Jain.

Furthermore, upon an application filed by PTC India Financial Services Ltd., the Hon'ble NCLAT has without going into the rival contention of the parties, vide its order dated 25/02/2019, made it clear that due to non-payment of dues by the 'Infrastructure Leasing & Financial Services Limited' or its entities including the 'Amber Companies', no financial institution will declare the accounts of 'Infrastructure Leasing & Financial Services Limited' or its entities as 'NPA' without prior permission of the NCLAT. However, the Reserve Bank of India has filed an intervenor application before the Hon'ble NCLAT seeking stay on aforesaid part of the order dated 25/02/2019 and the matter is still sub-judice.

It has also come to the knowledge of Ministry of Corporate Affairs that IL&FS had availed loans from ADB and KfW, which are backed by sovereign guarantee from the Government of India (Department of Economic Affairs) and that the Government of India has made payment of USD 2,072,333.99 and EUR 731,954.06 from the Contingency Fund of India, on behalf of IL&FS to ADB and KfW respectively, against repayment due in December 2018. It further came to notice that the aforementioned loans were taken by IL&FS for on-lending to infrastructure projects undertaken by group companies of IL&FS and a considerable portion of the said loans are yet to be repaid. In that regard, Ministry of Corporate Affairs has referred the matter to Serious Fraud Investigation Office (SFIO), to investigate the aforesaid aspect too in the ongoing investigation into the affairs of IL&FS and its subsidiary companies, and include the same in its investigation report.

Recently, upon gathering compliance information from various banks, it was noticed that one of the respondents, Mr. Ramesh C. Bawa (ex-Director on the Board of IL&FS) in Company Petition No. 3638/2018, pending before the Hon'ble NCLT, Mumbai Bench, has operated his individually and jointly held bank accounts and lockers, despite there being restraint directions against alienation of moveable and immoveable properties by the Hon'ble NCLT, Mumbai Bench, vide its order dated 03/12/2018. As such, Ministry of Corporate Affairs has filed a contempt petition before the Hon'ble NCLT, Mumbai arraying Mr. Ramesh C Bawa, his wife Mrs.AshaKiranBawa, Axis Bank Ltd. through its MD & CEO and Standard Chartered Bank Ltd. through its CEO, as contemnors and has sought punishment for the contemnors as per the provisions of Section 425 of the Companies Act, 2013 read with the Contempt of Courts Act, 1971. In addition to the above, Ministry of Corporate Affairs has also sought impleadment of Ms.AshaKiranBawa and Ms.AkankshaBawa, wife and daughter of Mr. Ramesh C Bawa, respectively, as additional respondents in the main Company Petition No. 3638/2018, pending before the Hon'ble NCLT, Mumbai Bench, and also sought extension of order dated 03/12/2018 (as modified by the Hon'ble NCLT, Mumbai Bench's order dated 16/01/2019) to the additional respondents, restraining them from alienating their moveable and immoveable properties. This step has been taken in light of the fact that Ms.AshaKiranBawa and Ms.AkankshaBawa, wife and daughter of Mr. Ramesh C Bawa, respectively, have been found to be the beneficiaries of the contempt/misfeasance committed by Mr. Ramesh C Bawa. The Hon'ble NCLT, Mumbai Bench, vide its orders dated 26/04/2019 was pleased to issue notice to the contemnorrespondents and further pleased to array Ms.AshaKiranBawa and Ms.AkankshaBawa, as Respondent No. 319 and 320 in Company Pet`ition No. 3638/2018, pending before itself. The Hon'ble Tribunal was also please to extend the operation of its order dated 03/12/2018 (as modified by the Hon'ble Tribunal's further order dated 16/01/2019) to the additional Respondent Nos. 319 and 320,

restraining them from alienating their moveable and immoveable properties. The matter is now listed for hearing on 07/06/2019.

The resolution of IL&FS remains sub-judice before the Hon'ble NCLAT.

The Ministry submitted the updated action taken reply as follows:

With regards to action taken against CRAs, SEBI has probed the role of CRAs in the matter of rating of IL&FS and passed an Order dated September 22, 2020 against CARE Ratings limited, ICRA Limited and India Ratings and Research Pvt. Ltd. imposing a penalty of Rs.1 crore each (maximum permissible under Section 15HB of the SEBI Act 1992) for failure in exercising due diligence while assigning ratings to IL&FS.

MCA has informed that the Serious Fraud Investigation Office (SFIO) has submitted its Report dated 28/05/2019 titled "Investigation Report of IL&FS Financial Services Ltd." extensively detailing the role of the Statutory Auditors in the perpetration of fraudulent activities by the management of IFIN. In consequence thereof ,this Ministry filed a petition before the NCLT under Section 140(5)of the Companies Act, 2013 seeking removal of the existing Statutory Auditors of IL&FS Financial Services Ltd.(IFIN) and further seeking a ban on appointment of Deloitte Haskins &Sells LLP and BSR & Associates LLP, along with their engagement partners for IL&FS, for a period of 5 years, in view of extensive findings by the SFIO against the Statutory Auditors related to their role in the perpetration of fraudulent activities by the management of IFIN. The challenge by the Auditors to the maintainability of the Ministry's petition under Section 140(5) was dismissed by the NCLT. However, the concerned Auditors challenged the constitutional validity of Section 140(5) before the Hon'ble Bombay High Court by way of writ jurisdiction. The Hon'ble Bombay High Court vide its judgment dated 21/04/2020 has disposed of the writ petitions filed by the auditors, and has upheld the vires of Section 140(5) of the Companies Act, 2013. However, the Hon'ble High Court quashed the criminal proceedings before the Special Court, Mumbai, initiated by SFIO against the auditors, and further held that auditors who have resigned or have been rotated out as per the provisions of the Companies Act, 2013 cannot be sought to be debarred for a period of 5 years under the second proviso of Section 140(5). The MCA has preferred an appeal before the Hon'ble Supreme Court, against the Hon'ble Bombay High Court's order dated 21/04/2020.

Further, on the basis of SFIO's IFIN Report dated 28/05/2019, MCA sought the impleadment of the company's Statutory Auditors as additional respondents in the Company Petition No. 3638/2018 pending before the NCLT and also sought extension of order dated 03/12/2018 (as modified by the NCLT's order dated 16/01/2019) to the additional respondents, restraining them from alienating their moveable and immoveable properties. Deloitte, BSR, their partners and certain other individuals named by the SFIO in its IFIN Report dated 28/05/2019,were impleaded in CP3638/2018

by the NCLT vide its order dated 18/07/2019. Subsequently, the appeals against the NCLT order dated 18/07/2019 have been dismissed by the NCLAT vide its common order dated 04/03/2020. The matter with regard to extension of order dated 03/12/2018 (as modified by the NCLT's order dated 16/01/2019) to the additional respondents for restraining them from alienating their moveable and immoveable properties, is subjudice.

With regard to the resolution of the IL&FS Group, the NCLAT vide its order dated12/03/2020, has accepted the suggestion of pro-rata distribution (as proposed by the new Board of IL&FS and further suggested by the Ministry)and the procedure specified thereof, for the purpose of completing the resolution process of the group. Furthermore, the NCLAT has also accepted October 15, 2018 as the cut-off date for distribution of the assets, because the said date is the date of initiation of the resolution process of the companies and also observed that the said date should be treated as initiation of the resolution process of the IL&FS and Group Companies. The NCLAT has directed: "The Union of India, the Board of Directors of IL&FS and the 'Committee of Creditors' already constituted or which may be constituted are directed to conclude resolution of all the Entities preferably within 90 days. The development should be brought to the Notice of this Appellate Tribunal every month. The resolution of IL&FS also remains sub-judice before the NCLAT. Discussion on the resolution framework is attached as Annexure I**.**

The judgment dated 01/01/2019 was affirmed by the NCLAT vide its orders dated 31/01/2019 and subsequently by the Hon'ble Supreme Court of India vide its order dated 04/06/2019. An updated summary of the debt profile of the IL&FS group is at **AnnexureII.** Subsequent payments have been made by the Government of India as sovereign guarantor of IL&FS, in view of the fact that the IL&FS remains under moratorium and as such, is unable to make loan repayments.

13. The Committee note the various steps taken so far with regard to IL&FS. The Committee understand that resolution of IL&FS remains sub-judice before the NCLAT and feel that delays in the resolution process not only brings a steep value erosion to the bankers and other creditors but more importantly leaves the understanding of the lacunae in the system evasive. It is necessary to plug these loopholes as the defaults jeopardised hundreds of investors, banks and mutual funds associated with IL&FS and several NBFCs also faced default scare, until the government's timely intervention in the matter while taking note of the various investigations being undertaken and subsequent penalties being imposed for the failure in exercising due diligence, the Committee desire that a thorough systemic

review should be conducted by RBI so that such episodes involving 'systemically important entities' are pre-empted.

CHAPTER - II

RECOMMENDATIONS/OBSERVATIONS THAT HAVE BEEN ACCEPTED BY THE GOVERNMENT

Recommendation (Sl. No. 3)

The Committee observe that in the international context, a few years back certain CRAs were stated to have been forced to downgrade their own prior credit ratings on complex mortgage backed securities in the USA, when doyens of the financial markets like Lehman Bros. collapsed and many others were in serious threat of liquidation, which also raised questions on the level of due diligence on the part of the CRAs. More recently, in the Indian context, the credibility of credit rating action has come into sharp question in the crisis involving the Infrastructure Leasing and Financial Services Limited (IL&FS), a major infrastructure development and finance company of systemic importance, which functioned as a holding company involved in investing and lending to its subsidiaries, associates and group entities. As 'rating' of an instrument or entity is being increasingly relied upon by capital markets, bankers and investors and since it constitutes a key input for financial decision-making of far-reaching magnitude, the Committee desire that it should be ensured that the credit rating process becomes absolutely professional, objective and credible. The Committee would therefore expect the key regulator, namely SEBI as well as the RBI to review their Regulations comprehensively, particularly in the face of the serious IL&FS default crisis mentioned above. The regulators should also remain alert and pro-active when it comes to strict enforcement of the Regulations, particularly the punitive provisions, as otherwise, the entire object and process of regulation will be rendered meaningless. The Committee, therefore, desire that the Ministry of Finance (Department of Economic Affairs and Department of Financial Services) should seek a factual report from the concerned regulators regarding the enforcement of the CRA Regulations, particularly the action taken by them against the CRAs who had been giving "stable" ratings to IL&FS prior to the default crisis. The Committee believe that the Regulations should be suitably modified/tightened, benchmarking them on greater objectivity, transparency and credibility in the whole credit rating

framework and process. In the view of the Committee, time has now thus come for a fresh evaluation of the credit rating framework in the country with a view to restoring public confidence and ensuring the accountability of the CRAs to the various stakeholders and the financial system as a whole. The Committee would recommend that the disclosures being made by the CRAs should henceforth include important determinants such as, extent of promoter support, linkages with subsidiaries, liquidity position for meeting near-term payment obligations etc. The Committee desire that the general investors should also be able to get a coherent "big picture" about the entity and its associates/subsidiaries from credit rating.

6. The Ministry of Finance (Department of Economic Affairs) in their action taken reply stated as under:-

> "SEBI Regulations provide for a disclosure-based regulatory regime for Credit Rating Agencies (CRAs), wherein CRAs are required to devise and disclose their rating criteria, methodology/process on their respective websites. Accordingly, each CRA has its own rating models and methodologies which are available on CRAs' website.
>
> The CRA Regulations have been amended from time to time, keeping in mind the dynamic nature of the market, so as to meet the market requirements and to achieve objectivity, transparency and credibility in the credit rating process.
>
> After the default of **financial instruments of IL&FS, SEBI CRA Regulations were reviewed** and SEBI vide circular dated November 13, 2018 further standardised the template of the Press Release used by CRAs while communicating rating actions to disclose additional information viz. disclosure on support from the Parent/ Group/ Government, if factored into a rating, list of all subsidiary/ group companies consolidated to arrive at a rating, along with the extent (e.g. full, proportionate or moderate) and rationale of consolidation, specific section on "Liquidity", highlighting parameters like liquid investments or cash balances, access to unutilised credit lines, liquidity coverage ratio, adequacy of cash flows for servicing maturing debt obligation, etc.
>
> Through the same circular, SEBI has also mandatedthe disclosure ofaverage one-year rating transition rates for long-term instruments for the last 5-financial year period on CRAs' websites and Disclosure of sharp rating actions in investment grade rating category by each CRA on the Stock Exchange and Depository websites. CRAs shall treat sharp deviations in bond spreads of debt instruments vis-à-vis relevant benchmark yield as a material event.

As far as banks are concerned, RBI accredits CRAs for the limited purpose of computation of capital for various bank exposures under the Standardized Approach of Basel II norms. Credit ratings are therefore not the chief drivers of credit decisions by banks. Credit decisions are based on banks' own appraisal and the bank loan ratings by CRAs are used by the banks only to compute the capital. The banks in India compute capital on the basis of norms prescribed by the Basel Committee on Banking Supervision (BCBS), wherein the risk weights assigned are on the basis of ratings provided by the external rating agencies. In this regard, while the risk weights assigned to a given rating grade under the BCBS norms and RBI regulations are same, the reported Corporate Debt Restructuring (CDRs) of Indian CRAs are much higher than the threshold prescribed under the Basel norms. Therefore, the minimum capital-to-risk-weighted assets ratio (CRAR) for banks in India has been kept higher at 9% as compared to the Basel requirement of 8%, precisely in view of the understated probability of default implicit in the ratings given by CRAs in India. RBI can consider prescribing higher risk weights to further mitigate the risk of high default areas on served in respect of ratings given by CRAs and even de-accrediting a CRA if warranted. However, it may not be appropriate to implement such measures based on an isolated incident. RBI shall closely monitor the evolving situation and take necessary action.

Further, as part of the supervisory process, RBI independently assesses the capital requirements of banks and can require banks to hold additional capital as part of Pillar -2 requirements under the Basel framework based on these assessments.

As far as their investments are concerned, banks have been advised to make their own internal credit analysis and rating on investment proposals and not to entirely rely on the ratings of external agencies.

DEA has sought the factual reports from SEBI and RBI regarding the enforcement of the CRA Regulations, particularly any action taken by them against the CRAs who had been giving "stable" ratings to IL&FS prior to the default crisis.

SEBI has informed DEA that actions have been initiated against the 3 CRAs who rated the non-convertible debentures (NCDs) of IL&FS.Further, adjudication proceedings against the CRAs, viz. ICRA Limited, CARE Ratings Limited and India Ratings and Research Private Limited, have been initiated by SEBI under Section 15HB of SEBI Act, 1992, for failure to exercise proper skill, care and due diligence while rating the securities of IL&FS, which is in violation of Regulation 24(7) and Clauses 4 and 8 of Code of Conduct for CRAs read with Regulation 13 of SEBI (Credit Rating Agencies) Regulations, 1999.

RBI has informed DEA that the concerns emanating from the recent IL & FS episode relate largely to the use of ratings of debt instruments issued

by the borrower entities, specifically with regard to the entity referred to.In terms of the RBI Directions, IL&FS Financial Services (IFIN) was disallowed to raise any additional funding from the Commercial Paper (CP) market for six months after a default was reported in August, 2018.

Through its circular dated November 13, 2018, SEBI has mandated disclosure of the said determinants, viz. extent of promoter/ Group/ Government support, linkages with subsidiaries, list of group companies consolidated to arrive at a rating, liquidity position, etc., in the press release regarding rating actions by CRA.

Considering the Committee's recommendation on disclosures, RBI is of the view that as per the extant SEBI instructions, in order to enable investors to understand underlying rating drives better, CRAs are required to specifically disclose the following:

i. When a rating factors in support from a Parent/Group/Government, with an expectation of infusion of funds towards timely debt servicing, the name of such entities, along with rationale for such expectation, may be provided.

ii. When subsidiaries or Group companies are consolidated to arrive at a rating, list of all such companies, along with the extent (e.g. full, proportionate or moderate) and rationale of consolidation may be provided.

iii. The Press Release shall include a specific section on "Liquidity" which shall highlight parameters like liquid investments or cash balances, access to unutilised credit lines, adequacy of cash flows for servicing maturing debt obligation, etc. CRAs shall also disclose any linkage to external support for meeting near term maturing obligations.

To address the concern of the Committee on providing a bird's-eye view about the entity and its associates/subsidiaries/structure, to the investors,SEBI has issued a circular dated November 13, 2018, mandating disclosure linkages with subsidiaries, list of group companies consolidated to arrive at a rating, etc., in the press release regarding rating actions by CRA.

Further, as prudent measure RBI has also advised CRAs to obtain and analyse bank account statements from the rated entities. This will facilitate early recognition of stress in the financials of the rated entity.

Further, a joint inspection of CRAs by SEBI and RBI has been initiated recently, with the role of RBI specifically focused on bank loan ratings assigned by the concerned CRA.Through the course of these inspections, various aspects in the functioning of the CRAs including

their rating methodology are examined and observations are drawn for a follow-up with the concerned CRA.

The Ministry submitted the updated action taken reply as follows:

The desired policy changes have been carried out by SEBI in this regard in consultation with RBI and the regulations are amended as and when the market requirements warrants the same. CRAs are jointly inspected by SEBI and RBI. Through the course of these inspections, various aspects in the functioning of the CRAs including their rating methodology are examined for further modification in the policy regime.

With regards to action taken against CRAs, SEBI has probed the role of CRAs in the matter of rating of IL&FS and passed an Order dated September 22, 2020 against CARE Ratings limited, ICRA Limited and India Ratings and Research Pvt. Ltd. Imposing a penalty of Rs. 1 crore each (maximum permissible under Section 15HB of the SEBI Act 1992) for failure in exercising due diligence while assigning ratings to IL&FS.

Action has already been taken by SEBI in consultation with RBI as indicated by SEBI in the earlier response.

The desired policy changes have been carried out by SEBI in this regard. w.e.f. January 2020, SEBI has made it mandatory for listed companies to disclose their default on bank loans if the default continues beyond 30 days. This benefits all investors as well as CRAs and acts as an early warning.

Comments of the Committee

(Please see Para No. 7 of Chapter-I)

Recommendation (Sl. No. 7)

As regards the matter of IL&FS crisis, wherein the Government has since intervened and re-constituted the Board (the matter being under National Company Law Tribunal), the Committee would recommend a comprehensive commission of enquiry into the whole gamut of the episode, which will inter-alia probe the role of CRAs that had over-rated the entities sometime before the crisis and the role of the largest institutional stakeholder in IL&FS, namely the LIC of India as well as other institutional stakeholders. The governance failures and indecision/indiscretion on the part of the IL&FS Board should also be thoroughly probed. The Committee

desire that urgent measures should be initiated to resurrect IL&FS, as it is the only major institution funding the infrastructure projects in the country.

The Ministry of Finance (Department of Economic Affairs) in their action taken reply stated as under:-

> In the opinion of DEA, however, there is no need to set up any Commission of Enquiry in this matter as the role of Directors of IL&FS Board is already being enquired/ investigated by Serious Fraud Investigation Office (SFIO) of Ministry of Corporate Affairs. SEBI & RBI are also looking into the system/procedure of the CRAs. Hence, it is felt that a separate Commission of Enquiry is not warranted at this stage.
>
> Due to continuous failure of the Infrastructure Leasing and Financial Services Ltd. (IL&FS) to service its debt and imminent possibility of contagion effect in the financial market, the Ministry of Corporate Affairs, at the request of Department of Economic Affairs, moved an application under Sections 241 and 242 of the Companies Act, 2013 before the National Company Law Tribunal (NCLT), Mumbai Bench for taking management control. The NCLT, Mumbai Bench vide its order dated 01/10/2018 approved the application filed in this regard, by suspending the erstwhile board of directors of IL&FS and appointed government nominees as directors, who have been tasked with the orderly resolution of the IL&FS and its group companies. The entire process is being carried out under the supervision of the NCLT. Being cognizant of the fact that the mismanagement existed across the Respondent No.1 Group, on an application by the Petitioner, this Hon'ble Tribunal, by an Order dated 09/10/2018, permitted the newly appointed Directors to appoint themselves as Directors on the group/subsidiary/associate/jointly controlled entities or operations of IL&FS.
>
> Further, in order to ensure period of calm during the resolution process, a moratorium was sought against the creditors, which has been granted on interim basis by the National Company Law Appellate Tribunal (NCLAT) until further orders, vide its orders dated 15/10/2018. The matter is sub-judice.
>
> The NCLT, Mumbai Bench vide its orders dated 01/10/2018 had also directed filing of progress reports till resolution, which is a continuous process. As such, till date Ministry of Corporate Affairs has filed first report on 31/10/2018, the second report on 03/12/2018, the third report, its addendum and the fourth report, collectively, on 16/01/2019.
>
> Initially there were 11 Respondents in the original petition moved by Ministry of Corporate Affairs before the NCLT, Mumbai Bench. However, the NCLT, vide its order dated 31/10/2018 directed Ministry of Corporate Affairs to implead all the group companies of IL&FS as Respondents. In

compliance of the said order, this Ministry filed an affidavit dated 03/12/2018 arraying the group companies of IL&FS as Respondents, as per information provided by the company.

Simultaneously, vide order dated 30/09/2018, in exercise of powers under Section 212(1)(a) & (c) of the Companies Act, 2013, Ministry of Corporate Affairs has ordered investigation into the affairs of IL&FS and its subsidiary companies to be carried out by the Serious Fraud Investigation Office (SFIO). The SFIO has submitted an interim report dated 30/11/2018. On the basis of said interim report, this Ministry vide its aforementioned affidavit dated 03/12/2018, also sought impleadment of further persons as Respondents in the original petition filed under Section 241 and 242 of the Companies Act, 2013. Additionally, application was also filed by Ministry of Corporate Affairs for seeking orders, qua the additional respondents, to restrain them from mortgaging or creating charge or lien or creating third party interest or in any way alienating, the movable or immovable properties owned by them, including jointly held properties. The NCLT was pleased to grant relief to this Ministry, vide orders dated 03/12/2018, which are still in operation. As such, there are a total of 318 Respondents in petition before the NCLT.

Simultaneously, in view of the negative impact that the IL&FS Group had on the financial markets at large and that there was considerable allegations in respect of the financial statements of the said Companies, the Disciplinary Directorate of the Institute of Chartered Accountants of India (ICAI), in the interest of the profession, suomoto sought to consider the performance of the statutory auditors of the said Companies. Pursuant to an enquiry conducted in respect of the statutory auditors of the said Group Companies, the ICAI found that there were key lapses, shortcomings and manipulations on the financial statements by the statutory auditors of the said Companies. Most significantly, it was noted that the condition of the said Companies as a result of mismanagement reflects upon the statutory auditors of the said Companies. The ICAI has held the statutory auditors of the said Companies prima facie guilty of professional misconduct. As such, in view of the prima facie findings of ICAI and the interim report dated 30/11/2018 submitted by SFIO, Ministry of Corporate Affairs filed a petition before the NCLT, Mumbai Bench on 21/12/2018 under Section 130 of the Companies Act, 2013 seeking reopening of the books of account of IL&FS, IL&FS Financial Services Ltd. (IFIN) and IL&FS Transportation Networks Ltd. (ITNL) for the last 5 (five) years, and for recasting the financial statements of the said companies, which has been allowed by the NCLT, Mumbai Bench vide its judgment dated 01/01/2019.

In addition to the above, the IL&FS Group of companies have been classified into three categories – Green, Red and Amber – on the basis of 12-month cash flow based solvency test, which classification has been communicated to NCLAT vide affidavit dated 25/01/2019. Vide

subsequent affidavits dated 11/02/2019 and 23/03/2019 filed before the NCLAT, detailed information regarding number of companies falling under each category has been brought to the knowledge of the Appellate Tribunal.The categorization is as under:

Category	Domestic Entity Count	Domestic IL&FS Group External Fund Based Debt (as of October 8, 2018) (INR Cr)
Green Entities which can reply all financial debt obligations as and when due no default subsists	50	5,596.6
Amber Entities which are not able to meet ALL obligations (financial and operational), but can meet operational and senior secured financial debt	13	16,372.6
Red Entities which CANNOT fully repay even senior secured financial debt obligations as when due	80	61, 375.6
Entities for which classification is still underway	18	5895.9
Entities which are undergoing liquidation proceedings, winding up and/or insolvency resolution proceedings.	8	5.7
Total	**169**	**89,246.4**

Vide orders dated 11/02/2019, the Hon'ble NCLAT has directed for exclusion of '133 Offshore Group Entities' incorporated out of India, from the purview of the Hon'ble NCLAT's order dated 15/10/2018 i.e. order for moratorium. However, the Appellate Tribunal directed that resolution for such 'Offshore Group Entities' may be taken up by the Board of Directors of 'IL&FS' under the supervision of the Hon'ble Justice (Retd.) D.K. Jain, who has been engaged to supervise the operation of the 'Resolution Process' of the 'IL&FS Group Companies', as per the directions of the Hon'ble NCLAT.

Further, vide the aforementioned orders dated 11/02/2019, the Hon'ble NCLAT also directed that all "Green Entities" are permitted to service their debt obligations as per scheduled repayment, which should be within the 'Resolution Framework' and subject to the supervision of the Hon'ble Justice (Retd.) D.K. Jain.

Furthermore, upon an application filed by PTC India Financial Services Ltd., the Hon'ble NCLAT has without going into the rival contention of the

parties, vide its order dated 25/02/2019, made it clear that due to non-payment of dues by the 'Infrastructure Leasing & Financial Services Limited' or its entities including the 'Amber Companies', no financial institution will declare the accounts of 'Infrastructure Leasing & Financial Services Limited' or its entities as 'NPA' without prior permission of the NCLAT. However, the Reserve Bank of India has filed an intervenor application before the Hon'ble NCLAT seeking stay on aforesaid part of the order dated 25/02/2019 and the matter is still sub-judice.

It has also come to the knowledge of Ministry of Corporate Affairs that IL&FS had availed loans from ADB and KfW, which are backed by sovereign guarantee from the Government of India (Department of Economic Affairs) and that the Government of India has made payment of USD 2,072,333.99 and EUR 731,954.06 from the Contingency Fund of India, on behalf of IL&FS to ADB and KfW respectively, against repayment due in December 2018. It further came to notice that the aforementioned loans were taken by IL&FS for on-lending to infrastructure projects undertaken by group companies of IL&FS and a considerable portion of the said loans are yet to be repaid. In that regard, Ministry of Corporate Affairs has referred the matter to Serious Fraud Investigation Office (SFIO), to investigate the aforesaid aspect too in the ongoing investigation into the affairs of IL&FS and its subsidiary companies, and include the same in its investigation report.

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Hon'ble NCLT, Mumbai Bench, vide its orders dated 26/04/2019 was pleased to issue notice to the contemnorrespondents and further pleased to array Ms.AshaKiranBawa and Ms.AkankshaBawa, as Respondent No. 319 and 320 in Company Pet`ition No. 3638/2018, pending before itself. The Hon'ble Tribunal was also please to extend the operation of its order dated 03/12/2018 (as modified by the Hon'ble Tribunal's further order dated 16/01/2019) to the additional Respondent Nos. 319 and 320, restraining them from alienating their moveable and immoveable properties. The matter is now listed for hearing on 07/06/2019.

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With regards to action taken against CRAs, SEBI has probed the role of CRAs in the matter of rating of IL&FS and passed an Order dated September 22, 2020 against CARE Ratings limited, ICRA Limited and India Ratings and Research Pvt. Ltd. imposing a penalty of Rs.1 crore each (maximum permissible under Section 15HB of the SEBI Act 1992) for failure in exercising due diligence while assigning ratings to IL&FS.

MCA has informed that the Serious Fraud Investigation Office (SFIO) has submitted its Report dated 28/05/2019 titled "Investigation Report of IL&FS Financial Services Ltd." extensively detailing the role of the Statutory Auditors in the perpetration of fraudulent activities by the management of IFIN. In consequence thereof ,this Ministry filed a petition before the NCLT under Section 140(5)of the Companies Act, 2013 seeking removal of the existing Statutory Auditors of IL&FS Financial Services Ltd.(IFIN) and further seeking a ban on appointment of Deloitte Haskins &Sells LLP and BSR & Associates LLP, along with their engagement partners for IL&FS, for a period of 5 years, in view of extensive findings by the SFIO against the Statutory Auditors related to their role in the perpetration of fraudulent activities by the management of IFIN. The challenge by the Auditors to the maintainability of the Ministry's petition under Section 140(5) was dismissed by the NCLT. However, the concerned Auditors challenged the constitutional validity of Section 140(5) before the Hon'ble Bombay High Court by way of writ jurisdiction. The Hon'ble Bombay High Court vide its judgment dated 21/04/2020 has disposed of the writ petitions filed by the auditors, and has upheld the vires of Section 140(5) of the Companies Act, 2013. However, the Hon'ble High Court quashed the criminal proceedings before the Special Court, Mumbai, initiated by SFIO against the auditors, and further held that auditors who have resigned or have been rotated out as per the provisions of the Companies Act, 2013 cannot be sought to be debarred for a period of 5 years under the second proviso of Section 140(5). The MCA has preferred an appeal before the Hon'ble Supreme Court, against the Hon'ble Bombay High Court's order dated 21/04/2020.

Further, on the basis of SFIO's IFIN Report dated 28/05/2019, MCA sought the impleadment of the company's Statutory Auditors as additional respondents in the Company Petition No. 3638/2018 pending before the NCLT and also sought extension of order dated 03/12/2018 (as modified by the NCLT's order dated 16/01/2019) to the additional respondents, restraining them from alienating their moveable and immoveable properties. Deloitte, BSR, their partners and certain other individuals named by the SFIO in its IFIN Report dated 28/05/2019,were impleaded in CP3638/2018 by the NCLT vide its order dated 18/07/2019. Subsequently, the appeals against the NCLT order dated 18/07/2019 have been dismissed by the NCLAT vide its common order dated 04/03/2020. The matter with regard to extension of order dated 03/12/2018 (as modified by the NCLT's order dated 16/01/2019) to the additional respondents for restraining them from alienating their moveable and immoveable properties, is subjudice.

With regard to the resolution of the IL&FS Group, the NCLAT vide its order dated12/03/2020, has accepted the suggestion of pro-rata distribution (as proposed by the new Board of IL&FS and further suggested by the Ministry)and the procedure specified thereof, for the purpose of completing the resolution process of the group. Furthermore, the NCLAT has also accepted October 15, 2018 as the cut-off date for distribution of the assets, because the said date is the date of initiation of the resolution process of the companies and also observed that the said date should be treated as initiation of the resolution process of the IL&FS and Group Companies. The NCLAT has directed: "The Union of India, the Board of Directors of IL&FS and the 'Committee of Creditors' already constituted or which may be constituted are directed to conclude resolution of all the Entities preferably within 90 days. The development should be brought to the Notice of this Appellate Tribunal every month. The resolution of IL&FS also remains sub-judice before the NCLAT. Discussion on the resolution framework is attached as Annexure I**.**

The judgment dated 01/01/2019 was affirmed by the NCLAT vide its orders dated 31/01/2019 and subsequently by the Hon'ble Supreme Court of India vide its order dated 04/06/2019. An updated summary of the debt profile of the IL&FS group is at **AnnexureII.** Subsequent payments have been made by the Government of India as sovereign guarantor of IL&FS, in view of the fact that the IL&FS remains under moratorium and as such, is unable to make loan repayments.

Comments of the Committee

(Please see Para No. 13 of Chapter-I)

CHAPTER - III

RECOMMENDATIONS/OBSERVATIONS WHICH THE COMMITTEE DO NOT DESIRE TO PURSUE IN VIEW OF THE GOVERNMENT'S REPLIES

Recommendation (Sl. No. 1)

The Committee note that Credit rating agencies (CRAs) in India since their inception in 1987, have progressed from rating simple debt products to complex debt structures, covering a wide range of products/services like securities, bank loans, commercial papers, fixed deposits etc. The CRAs in our country are governed by the Securities and Exchange Board of India (SEBI) (Credit Rating Agencies) Regulations, 1999, which provide detailed requirements that a CRA needs to follow/fulfill to be registered with SEBI. These regulations have been amended from time to time, keeping in mind the dynamics of the market. Section 11 of the SEBI Act, 1992 empowers SEBI, as the primary regulator, to regulate the CRAs operating in India and enforce its regulations for their proper functioning. Certain other regulatory agencies, namely, Ministry of Corporate Affairs (MCA), Reserve Bank of India (RBI), Insurance Regulatory and Development Authority (IRDA) and Pension Fund Regulatory and Development Authority (PFRDA) also recognised the requirements for obtaining and disclosing credit rating by various entities under their respective sectoral jurisdiction. The Committee further note that the SEBI Regulations provide for a disclosure-based regulatory regime for CRAs, wherein they are required to disclose on their websites, their rating criteria, methodology, default recognition policy, guidelines on dealing with conflict of interest etc., The Committee understand that SEBI is among the few regulators globally to mandate public disclosure of rating criteria and methodology by CRAs.

Reply of the Government

As per RBI, above observations are factual.

Comments of the Committee

Nil

Recommendation (Sl. No. 2)

The Ministry of Finance (Department of Economic Affairs) have submitted to the Committee that the ratings assigned by CRAs in general, represent their opinion about the credit risk associated with repayment of the credit facilities based on individual proprietary rating framework of CRAs, which takes into account various drivers, namely business risk, industry risk, financial aspects, management capability etc. These frameworks are generally a combination of objective assessments through model outputs as well as subjective assessments through expert opinion of the analysts and rating committee members. The Committee note that there are currently seven CRAs registered with SEBI, out of which three are listed. Under the Basel II Framework, exposure of banks are assigned risk weights based on their credit rating and the capital required to be maintained is linked to the total risk weighted assets of a bank. Accordingly, accreditation of CRAs is granted by RBI, which also undertakes an annual review of accreditation.

Reply of the Government

As per RBI, above observations are factual.

Comments of the Committee

NIL

Recommendation (Sl. No. 4)

The Committee note that under the 'issuer pays model', the entity issuing the financial instrument pays the CRAs upfront to rate the underlying securities. There is a strong view that such a payment arrangement may lead to a 'conflict of interest' and could result in compromising the quality of analysis or the objectivity of the ratings assigned by the agencies. The Committee would therefore suggest that the Ministry/Regulator may consider other options as well, such as "investor pays model" or "regulator pays model" after weighing the relevant pros and cons. Alternately, within the existing framework, the appropriate rating fee structure,

payable by the issuer may be decided by the Regulator - SEBI - in consultation with RBI and the CRAs.

Reply of the Government

In India and globally, issuer pays revenue model is used by CRAs. The pros and cons of Issuer pays model and Investor pays model and Regulator-Allocated model are as under:

Issuer pays Model

Advantages	Limitations
Widespread availability of ratings to all investors at no cost. Enhanced quality of ratings since issuer contractually bound to provide the CRA access to information and regular management interactions. With large and frequent issuers of debt, CRAs typically work on the basis of fee cap (negotiated lump-sum fees as opposed to issue by issue or loan by loan pricing). The same keeps the rating fee low and results in smaller issuers being, in effect, subsidized by larger ones.	Conflict of interest – CRAs may be inclined towards maintaining higher ratings since they receive fees from the issuer.

Investor pays Model

Advantages	Limitations
Eliminates the conflict of interest prevalent in the issuer pays model. Greater responsiveness to investor concerns and furtherance of investor protection agenda. An investor paying for a specific rating could demand customised analysis, attuned to their goals/organizational requirements, from the CRA.	Ratings not publicly available only those who pay for a rating can access it. High cost of rating since only a few investors may seek it. Shifts the source of conflict from issuer to investor – Pressures from investors to avoid rating downgrades would increase since downgrades result in mark-to-market losses on rated securities. Or, CRAs may be pressurised by investors to give lower than warranted ratings to help them negotiate higher coupon rates/get a higher yield. Rating being a pre-requisite for issuance and listing of debt, the rating would not be available till the

	time of placement of issue as the investors for a public issue would not be known prior to the listing of securities. The original investor may not have any incentive to keep the surveillance going if the underlying instrument changes hands anytime during the tenure of the instrument.

Regulator-Allocated Model

Advantages	Limitations
Eliminates rating shopping prevalent in the issuer pays model. No incentive to provide either higher or lower than warranted ratings. Widespread availability of ratings to all investors at no cost.	Rating opinions by CRAs may be perceived as being endorsed by the Regulator. Devising a fair selection model for allocation of issues to CRAs and fixation of fees to be paid to CRAs may be problematic. May breed complacency amongst CRAs who will begin to see it as a steady assured business, and provide little incentive for quality and excellence.

The advantages and challenges posed by various alternative models have also been examined globally and the issuer pays model has been adopted taking into consideration wide spread availability of ratings, cost of ratings for investors, access of information from the issuer to the CRA and regulation addressing the conflict through disclosure of fees, prohibiting rating shopping, prohibiting undertaking other activities, independence of rating committee, disclosure of unaccepted ratings, etc.

With regard to the regulator deciding the appropriate fee structure, within the existing framework, the same may not be feasible for the following reasons:

The fees charges for rating an instrument depends on many other determinants like the complexity of the instrument, structure, type of instrument, sector, size and borrowing requirement of the company, frequency of borrowing,

etc. Therefore, it will be operationally challenging for the regulator to decide fee for every credit.

A standard fee structure may disincentivise CRAs from making investments in building capability, capacity and innovation. Such a mechanism and distortion of competition may reduce the incentive for CRAs to innovate and continually improve their processes and methodologies.

Further, regulator payment model can only be implemented for listed securities. Since the issuer pays model would continue in case of various other instruments of the same entity proposed to be rated, the inherent conflict of interest may not be eliminated as the issuer can adjust the fees paid to the CRA for rating such other instruments, thereby influencing the overall revenue of the CRA.

Further, SEBI does not intervene in fee related/commercial aspects with regard to operations of intermediaries.

RBI's view is that the issuer pays model is not something unique to India. It is noteworthy that the bank loan ratings are generally issued by CRAs upon solicitation i.e. based on the request received from the borrowers. CRAs do not issue unsolicited ratings. Further, there is not specific regulatory prescription of compulsory external rating requirement of borrowers. Borrowers can choose to remain unrated and bank's exposure to unrated borrowers will be assigned risk weight applicable to unrated corporates and capital will be maintained by the banks accordingly. As external credit ratings of borrowers are not mandated in terms of the prevailing regulatory requirements, the concept of the 'Government or Regulator Pays' may not be as such necessary for bank loan ratings. Such a model may also result in moral hazard because ratings may be wrongly construed by investors to be sovereign-backed.

Further, in an 'issuer pays' model, the rating action disclosures are publicly available to all stake holders viz., banks, investors, regulators, intermediaries, etc. at zero cost whereas under the 'investor pays' model, only those who pay get to the know the rating. So if an issuance has to be rated at the behest of multiple investors, there would be a cost ramification and information asymmetry.

In view of the foregoing, due to lack of a feasible alternative payment model, and in accordance with the global practice, the present 'issuer pays model' may continue, while addressing the issue of conflict of interest through greater transparency and disclosures, and better governance practices to ensure independence of CRAs.

The Ministry submitted the updated action taken reply as follows:

As represented in the earlier response, due to lack of a feasible alternative payment model, and in accordance with the global practice, the present 'issuer pays model' may continue, while addressing the issue of conflict of interest presented by the Model through greater transparency and disclosures, and better governance practices to ensure independence of CRAs.

Comments of the Committee

NIL

Recommendation (Sl. No. 6)

The Committee would also recommend changes in the regulatory framework to avoid situations of 'conflict of interest', such as when the CRA or its subsidiaries are also allowed to do advisory/consultancy work besides rating. Further, with a view to provide a level playing field and healthy competition among CRAs, all the SEBI registered CRAs may be considered for eligibility to participate in the bidding process for large debt issues.

Reply of the Government

To mitigate the conflict of interest posed by CRAs undertaking consultancy/ advisory/ other activities, SEBI (CRA) Regulations were amended in 2018, restricting CRAs from undertaking activities other than rating of securities offered by way of public or rights issue, except those undertaken under the respective guidelines of financial sector regulators/ other authorities as specified by SEBI.

RBI is of the view that CRAs including Infomerics Valuation and Ratings Private Limited have been accredited to assign bank loan ratings and there is no size threshold for this. However, for the purpose of Independent Credit Evaluation (ICE) envisaged under RBI's revised framework on resolution of stressed assets, only those CRAs that meet certain conditions which *inter alia* includes accreditation for a minimum period of five years, have been authorised by RBI to undertake the ICE. This is because ICE is a more complex exercise as compared to bank loan ratings. With a view to avoid any conflict of interest, the following conditions have been prescribed in respect of ICE:

i. The CRA will be eligible to accept ICE mandate for Resolutions Plan (RP) of a borrower entity in default if the bank credit facilities of the borrower entity carried an investment grade rating (i.e., BBB- or better) from the concerned CRA at any time during the previous one year period.
ii. The mandate for CRA with regard to ICE shall be restricted to the providing the ICE for the residual debt under the resolution plan submitted by the bank. The CRA or its group entities shall not take part in the formulation or re-formulation of the resolution plan, or any other such advisory roles in this context.

Further, the performance of CRAs will be reviewed by the RBI on an yearly basis as at the end of the financial year with respect to the failure rate of the borrowers subjected to ICE. The observed failure rate of ICEs performed in a financial year is generally not expected to be greater than 10 percent.

It may be noted that SEBI only **regulates** CRAs. It has not prescribed any list with regard to eligibility of registered CRAs to participate in bidding processes. In other words, all SEBI registered CRAs are eligible to participate in the bidding process for large or small debt issues.

<u>The Ministry submitted the updated action taken reply as follows:</u>

Vide SEBI circular dated November 4, 2019 on "Enhanced Governance Norms for Credit Rating Agencies (CRAs)", the following has been mandated:

- MD/CEO of a CRA shall not be a member of rating committees of the CRA.

- Rating committees of a CRA shall report to a Chief Ratings Officer (CRO).
- One third of the board of a CRA shall comprise of independent directors, if the board is chaired by a non-executive director. In case the board of the CRA is chaired by an executive director, half of the board shall comprise of independent directors.
- The board of a CRA shall constitute Ratings Sub-Committee and Nomination and Remuneration Committee.
- The CRO shall directly report to the Ratings Sub-Committee of the Board.

CHAPTER - IV

RECOMMENDATIONS/OBSERVATIONS IN RESPECT OF WHICH REPLIES OF THE GOVERNMENT HAVE NOT BEEN ACCEPTED BY THE COMMITTEE

Recommendation (Sl. No. 5)

Similarly, the Committee would also suggest to the Ministry/Regulator to explore the mandatory rotation of rating agencies along the lines of statutory auditors to avoid the pitfalls of long association between the issuer and the CRA and particularly considering the recent instances of failure of CRAs in sensing simmering 'trouble' in their client-entities. This may also help eliminate element of complacency in the credit rating industry and bring fresh perspectives on table. In the same vein, the Ministry may also evaluate the suggestion to have rating compulsorily carried out by more than one agency (dual or multiple), particularly in respect of debt instruments/bank credit involving large amounts say, more than Rs.100 crore. This will help the investors to access different positions/viewpoints for an informed decision. On the same premise, the Committee would also suggest that the existing threshold for registration of CRAs may also be suitably lowered/modified with a view to encouraging more entities, particularly start-ups with the requisite capability and expertise to become part of the industry.

Reply of the Government

The Ministry of Finance (Department of Economic Affairs) in their action taken reply stated as under:-

> "It is felt that the exercise of “auditing” and “rating” cannot be compared since auditors work on past data, whereas CRAs are required to offer forward-looking views on the debt-servicing ability of an issuer. Further, while statutory audit is conducted for a company by an auditor, ratings are assigned to various instruments of a company/ issuer. Accordingly, various instruments issued by a company, having different maturities, may have ratings assigned by multiple CRAs. As a result, the same issuer would be examined by more than one CRA, in respect of rating of different instruments, unlike the examination of the accounts of a company by the same auditor.
> Further, as regards the recommendation of the Committee on mandatory rotation of CRAs within the tenure of the instrument, such an exercise may have the following implications:

i. It may result in each CRA taking a short-term view (till the time that CRA is required to rate the instrument) on the creditworthiness of the issuer, instead of a longer-term perspective spanning the entire tenure of an instrument.
ii. While there are stringent conditions for withdrawal of rating from a CRA at present, mandatory rotation of CRAs, may pose the problem of rating shopping as the issuer on rotation may approach a CRA promising a higher rating.
iii. Since CRAs would assign ratings for a fixed period, the rating transition/ default statistics of each CRA, as required to be disclosed by each CRA on its website, shall not be reliable indicators of the performance of the CRA and rating transition of any instrument through its complete tenure would not be captured.

As regards the suggestion of ratings being compulsorily carried out by more than one agency (dual or multiple), particularly in respect of debt instrument/bank credit involving large amounts say, more than Rs. 100 Crore, the following may be noted:

Mandatory requirement of dual rating for debt securities would increase the cost of debt issuance and, therefore, adversely impact the interests of corporate bond issuers and hamper the growth of corporate bond market. In practice, many issuers obtain ratings from two or more CRAs upon the insistence of investors. Further, there is no requirement of mandatory dual/ multiple rating in any major global jurisdiction. It is understood that the European Securities and Markets Authority mandates the use of ratings by two or more CRAs only in case of structured finance instruments, and not for debentures/ loans. Even in cases of banks, the credit ratings are not the chief drivers of credit decisions by banks. Credit decisions are based on banks' own appraisal mechanism and the ratings are used for the limited purpose of capital computation. It is left to the borrowers to avail the external ratings from one or more CRAs. As regards commercial papers (CPs), in terms of the lowered/modified with a view to extant RBI directions, eligible encouraging more entities, issuers, whose total CP issuance particularly start-ups with the during a calendar year is 1000 crore or more, shall obtain credit rating for issuance of CPs from at least two CRAs registered with SEBI and should adopt the lower of the two ratings. Where both ratings are the same, the issuance shall be for the lower of the two amounts for which ratings are obtained.

Further , in terms of the revised framework on resolution of stressed assets,Resolution Plans involving restructuring /change in ownership in respect of ‘large’ accounts (i.e. accounts where the aggregate exposure of lenders is Rs 1 billion and above), shall require independent credit evaluation (ICE) of the residual debt by CRAs. While accounts with aggregate exposure of Rs 5 billion and above shall require two such ICEs, others shall require one ICE. Only such RPs which receives as credit opinion of RPs or better (indicating moderate degree of safety

regarding timely servicing of financial obligations) for the residual debt from one to two CRAs, as the case may be, shall be considered for implementation.

Given the importance of CRAs, it is imperative to ensure that entities granted registration as CRAs are promoted by entities having high credibility, good track record and adequate financial capabilities, and are fit and proper, so as to enable them to invest in building intellectual capital, developing efficient systems and infrastructure and adopting better technology. Maintenance of such high standards is essential for a CRA to function efficiently, professionally and independently, which may not be feasible for a start-up.

Having regard to the significant role played by CRAs in the market, it is felt that the extant eligibility requirements for registration as a CRA, viz. networth requirements, promoter eligibility requirement, "fit and proper person" criteria, etc., are reasonable/ appropriate."

The Ministry submitted the updated action taken reply as follows:

As regards mandatory rotation, as stated earlier, the rating assessment of a CRA has to be forward looking unlike auditing. Further, mandatory rotation would be a disincentive to good and quality CRAs. It will also ensure business for less effective CRAs. Hence, it is better to leave it to the market to discriminate between CRAs based on their performance.

As regards the issue of multiple ratings, the views remain the same.

RBI has further stated that in terms of the Prudential framework on resolution of stressed assets dated June 7, 2019, Resolution Plans involving restructuring / change in ownership in respect of "large" accounts (i.e. accounts where the aggregate exposure of lenders is ₹ 1 billion and above), shall require independent credit evaluation (ICE) of the residual debt by CRAs. While accounts with aggregate exposure of ₹ 5 billion and above shall require two such ICEs, others shall require one ICE. Only such RPs which receive a credit opinion of RP4 or better (indicating moderate degree of safety regarding timely servicing of financial obligations) for the residual debt from one or two CRAs, as the case may be, shall be considered for implementation.

Having regard to the significant role played by CRAs in the market, it is felt that the extant eligibility requirements for registration asa CRA, viz. networth requirements, promoter eligibility requirement, "fit and proper person" criteria, etc., are reasonable/appropriate.

Comments of the Committee

(Please see Para No. 10 of Chapter-I)

CHAPTER- V

RECOMMENDATIONS/OBSERVATIONS IN RESPECT OF WHICH FINAL REPLIES OF THE GOVERNMENT ARE STILL AWATED

NIL

New Delhi;
10 March, 2021
19 Phalguna, 1942 (Saka)

SHRI JAYANT SINHA,
Chairperson,
Standing Committee on Finance

Annexure-I

DISCUSSION ON THE RESOLUTION FRAMEWORK

1. It is pertinent to understand the evolution of the resolution framework, which led to the NCLAT order dated 12/03/20202, wherein the revised framework based on pro-rata distribution was approved. The Resolution Framework sets forth that an "asset by asset" solution explored through various methods i.e. an "Asset Level Resolution" and in some cases, the sale of the business vertical comprising of a basket of companies is the most feasible option for the resolution of IL&FS Group. There solution incorporates all the rigour, fairness and procedural transparency which is inherent in resolution processes under the IBC, such as:

(a) (in most cases) a public bidding process[1];
(b) Considering eligibility of prospective bidders under Section29A of the IBC;
(c) obtaining "fair market value" and "liquidation value" reports which are presented to the members of the relevant Creditors Committee formed in respect of each Sale Company (in the manner as contemplated in the Initial Resolution Framework); and
(d) placing the highest bid value received in respect of the relevant Sale Company pursuant to the ongoing Asset Level Resolution before the relevant creditors "Committee for its consideration.

[1]Paragraph 10.2 of the Initial Resolution Framework contemplated that for some companies within the IL&FS Group, the New Board reserves the liberty having regard to, amongst others, issues such as: (i) the nature of existing contractual arrangements in place with counterparties; (ii) nature of the business and jurisdictional issues; (iii) relevant regulatory requirements or prohibitions; (iv) cost-benefit analysis related aspects such as expediency, preservation of value and such other similar aspects, to also consider and where appropriate, either suitably modify the approach outlined above or to undertake such other fair and transparent processes(including 'Swiss Challenge')and stipulate such conditions as it may deem fit, in each case being guided By the principles set out in paragraph 4.2 of the Initial Resolution Framework

(e) and in doing so, it also pertinent to note that the New Board as part of its resolution efforts for the IL&FS Group already performs a variety of functions, which in the context of a corporate debtor undergoing resolution under the IBC, would be within the remit of the committee of creditors.

2. Further features of the Initial Resolution Framework were:

(i) **Crystallisation of claims as of "Cut off Date" (i.e. October 15, 2018) :**No interest, additional interest, default interest, penal charges or other similar charges to accrue after the Cut-Off Date of October 15, 2018.

(ii) **Appointment of valuers for determining the fair value and liquidation value**: Two valuers to be appointed to determine the fair value and liquidation value in respect of "Sale Companies" (*i.e.*, entities being monetized as part of the "Asset Level Resolution").

(iii) **Categorisation of entities (*Category I* and *Category II*) :**Based on the H1 bid value received, a Sale Company would either be, a:

(a) **Category I Company** *i.e.*, where the bidder is willing to assume all liabilities of the Sale Company whether operational or financial

Without compromise of the debt ; or

(b) **Category II Company** *i.e.*, where the financial bid amount offered by the applicant is less than all the liabilities of the Sale Company.

(iv) **Constitution of a Creditors' Committee :** In respect of the relevant Sale Company, Creditors' Committee will be constituted (in lieu of individual creditor consents, which are to be dispensed with) in the following manner:

(a) For a **Category I Company**, the Creditors" Committee shall constitute **all** the **financial creditors** of the IL&FS Group Company

(including IL&FS Group Companies that have provided financial debt to such IL&FS Group Company) which is the "**selling**

shareholder(s)" of that Sale Company;

(b) For a **Category II Company**, the Creditors" Committee shall constitute **all** the **financial creditors of the Sale Company (including**

IL&FS Group Companies that have provided financial debt to such IL&FS Group Company).

(c) Each member of each Creditors" Committee will have voting rights (by value of the financial debt owed to that member) and will be called upon to **only consider the highest bid** in respect of the Sale Company. Specifically, the **Creditors" Committee would not have the ability to determine distribution** of the bid amounts.

(v) **Decision by the New Board:** The decision of the Creditors" Committee to either approve or reject the highest bid for a Sale Company will be placed before the New Board for its consideration.

(vi) **Approval of Justice (Retd.) D.K. Jain:** If the New Board approves a sale proposal, the same will be placed before Justice (Retd.) D.K. Jain (appointed by the NCLAT *vide* order dated February11, 2019) for his approval.

(vii) **Approval of the NCLT**: Upon receipt of approval of Justice (Retd.) D.K. Jain,the proposal will be placed with the NCLT for its approval.

Upon receipt of approval of the NCLT and payment of consideration by the successful bidder, the shares/ assets of the relevant Sale Company will be transferred free and clear of all encumbrances, liens, third party rights to the successful bidder.

(viii) **Distribution of proceeds to creditors**: The Initial Resolution Framework contemplated that the financial bid value received for a Sale Company would be distributed in accordance with Section 53 of the Insolvency and Bankruptcy Code, 2016 (**IBC**) against claims existing as of the *Cut-Off Date (i.e., October15, 2018)*.

3. However, after taking into consideration the complexities and challenges pertaining to the IL&FS Group and due to overwhelming public interest involved in the resolution, **a Revised Framework based on pro-rata distribution on the rationale of "Fair and Equitable" distribution to all Creditors** was proposed by the new Board of IL&FS and further suggested by the Ministry to the NCLAT vide affidavit filed in January 2020. It was submitted before the NCLAT that the Revised Framework **seeks to balance and address the interest of different classes of creditors across all levels of the IL&FS Group and not just the secured creditors of the operating SPVs**. The rationale for "Fair and Equitable" distribution to all creditors stated before the NCLAT is:

(i) As of October 8, 2018, the aggregate principal amounts of the external fund-based debt exposure of the IL&FS Group was approximately INR 94,000 crores (in addition to a non fund-based exposure of approximately INR 5,100 crores). These borrowings were availed by the IL&FS Group by accessing possibly every source of funding available to corporates in India, including but not limited to banks (including nationalised banks, private banks, foreign banks and scheduled co-operative banks) and financial institutions, retail investors (by tapping into the listed bond markets in India and abroad), as well as the Public Fund Creditors such as Pension Funds, Provident Funds, Employee Welfare Funds, Gratuity Funds, Superannuation Funds, Army Group Insurance Funds;

(ii) A significant portion of the Aggregate External Fund Based Debt has been availed by members of the IL&FS Group (and particularly by 4key HoldCos)

from entities such as Pension Funds, Employees Welfare Funds, Army Group Insurance Fund), Provident Funds, Provident Funds, Gratuity Funds, Super Annuation Funds (Public Fund Creditors). These Public Fund Creditors which includes the Army Group Insurance Funds comprise of savings and funds contributed inter alia by employees, army personnel etc. to provide for retirement benefits and related entitlements to employees of such entities, widows of army personnel etc.

(iii) The amounts have been invested by the Public Fund Creditors in debt instruments issued by various IL&FS Group Entities particularly at the level of the HoldCos, which in turn have granted debt to various other entities of the IL&FS Group. Accordingly, for the Public Fund Institutions to be repaid at least part of their dues by the HoldCos (and other such members of the IL&FS Group which have availed debt from these Public Fund Creditors), it is critical that the IL&FS Group Lenders who have lent amounts (mostly on an unsecured basis) to the IL&FS Group Entities are also able to receive some payments from the sale proceeds from the Asset Level Resolution currently underway.

(iv) The intervention of the Ministry of Corporate Affairs that was necessitated on account of the public interest aspects relating to the IL&FS Group and to avoid the catastrophic effect of the IL&FS defaults on the Indian financial markets (as elaborated in the DEA Report). There placement of the erstwhile Board of Directors of IL&FS by the New Board *vide* the 01/10/2018 Order of the NCLT was on account of the burgeoning debt levels at the IL&FS Group and mismanagement of the erstwhile Board of Directors of IL&FS;

(v) The resolution of the IL&FS Group which comprises of 302 entities (of which 169 are Domestic Group Entities, and 133 entities are incorporated in jurisdictions outside India) is being undertaken under Sections 241/242 of the Companies Act, 2013 (which provides the Tribunal with **very wide powers** to pass orders that are "fair and equitable"). It is a **test case for "group insolvency" in India** and represents a watershed moment in the relatively recent and evolving insolvency and bankruptcy laws of India. It is pertinent to note that currently, **no framework exists under Indian law**, which pertains to or could (in its entirety) apply in a **"group insolvency"** scenario;

(vi) While the borrowings were availed at the relevant holding company level within the IL&FS Group by leveraging high credit ratings and a wider investor base, it is pertinent to note that the borrowings at this level (including those availed from investors who subscribed to high rated debt instruments) were primarily utilized to provide unsecured financial debt (barring some cases, where the financial facilities are secured) to the operating level entity, to fund *inter alia* cost overruns and working capital funding, which enabled the operating level entities to complete the project, thereby generating cash and resulted in creation in assets for the IL&FS Group (including those which are currently being monetised) as well as enabling the relevant operating level entity to service its secured financial debt. It is also pertinent to note that the bonds issued and loans availed by IL&FS were assigned "AAA" rating until almost August 2018, when the date of first default by IL&FS. was August 25, 2018. IL&FS, on a standalone basis, has availed of financial debt aggregating to approximately INR 18,000 crores, which was primarily borrowed by leveraging superior credit ratings. **Without this funding by the holding and other IL&FS Group entities, the assets would not have been created at the operating level entity and accordingly, no debt servicing would have happened to the operating level entity lenders as well**. Accordingly, it is "just and equitable" that the interest of the lenders at the holding company levels are also considered in the resolution framework for the IL&FS Group;

(vii) As far as individual creditors (and individual Creditors" Committees) are concerned, they would in all likelihood only be concerned with maximizing their recovery **at an individual entity level** without regard to the adverse impact this would have on the creditors across different levels of the IL&FS Group, from whom debt has been availed of which a significant portion has been invested in these operating assets to make the viable entities;

4. The **resolution** of the IL&FS Group is being undertaken **under Sections 241- 242 of the Companies Act, 2013** and **not under** the provisions of **IBC.** An individual **Creditors" Committee at anSPV level** (constituted as contemplated in accordance with the Initial Resolution Framework) **will not be inclined to consider the interests of any creditor or stakeholder other than their respective exposure to that SPV. The New** Board has been appointed by the NCLT (in furtherance of the intervention by the Union of India) to ensure a **holistic resolution** of the IL&FS Group (under the supervision of Justice (Retd.) D.K. Jain) and an optimal and fair resolution can be achieved for the IL&FS Group only if the interests of the creditors across the IL&FS Group are considered.

5. The Revised Distribution Framework modifies the existing framework for **distribution of financial bid amounts /termination amounts / Settlement amounts/ foreclosure amounts**. The **financial bid amounts /termination amounts /settlement amounts /foreclosure amounts** received by the relevant IL&FS Group entity are to be distributed in the following manner:

(i) *first*, towards **all resolution process costs incurred in the resolution process of the relevant IL&FS Group entity**, whether incurred by that IL&FS Group entity or on behalf of that IL&FS Group entity (including but not limited to fees payable to the financial and transaction advisors, legal counsels, resolution consultant, claims management consultant, independent valuers, costs for issuing advertisements, conducting audits (including special or forensic audits) and conducting meetings of the Creditors" Committees etc.) in full;

(ii) *second*, towards distribution of the net sale proceeds paid by the H1 bidder/ termination amount /settlement amounts /foreclosure amounts **upto the average "liquidation value"** to the creditors of the relevant IL&FS Group company **in accordance with Section 53** of the IBC

(which will include all components of Section 53 of the IBC such as unpaid workmen's dues and unpaid employees dues etc. , as applicable); and

(iii) *third*, the remaining sale proceeds /termination amount /settlement amounts /foreclosure amounts to be distributed pro-rata to each class of creditors of the relevant IL&FS Group company, **adjusted for any recovery made by the relevant creditor on account of distribution under Section 53 (of the IBC), as contemplated above**.

6. **Each such payment** shall be made to a creditor in respect of the admitted claim of the relevant creditor existing as of the Cut-Off Date (i.e. October15, 2018), as admitted by the Claims Management Consultant and **shall be adjusted for any amounts which have been set-off or Appropriated by the relevant creditor in breach of the interim order passed by the NCLAT on October15, 2018**.

7. As stated above, the NCLAT vide its order dated 12/03/2020, has accepted the suggestion of revised framewor based on pro-rata distribution and the procedure specified thereof, for the purpose of completing the resolution process of the IL&FS Group.

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Annexure II

SUMMARY OF DEBT PROFILE OF THE IL&FS GROUP

As set out in the January 2020 Affidavit before the NCLAT, the debt profile of the IL&FS Group is as follows:

Sr. No.	Particulars	Approximate Amount (in INR)[2]
1.	Aggregate **external** fund based debt of the IL&FS Group availed from *interalia:*	**INR 94,215 crores** ("**Aggregate External Fund Based Debt**")
	○Pension Funds, Provident Funds, Employee Welfare Funds, Gratuity Funds, Superannuation Funds, Army Group Insurance Funds, amongst others (collectively the "**Public Fund Creditors**")	**INR 10,173 crores** (almost **10.79%** of the Aggregate External Fund Based Debt)
	○(Indian) Scheduled Commercial Banks	**INR 44,075 crores** (almost **47%** of the Aggregate External Fund Based Debt)
2.	Aggregate External Fund Based Debt of the **4 keyholding companies** **("HoldCos")** (*i.e.*,IL&FS *viz*. Infrastructure Leasing & Financial Services Limited (**IL&FS**); IL&FS Financial Services Limited (**IFIN**); IL&FS Transportation Networks Limited (**ITNL**); and IL&FS Energy Development Company Limited (**IEDCL**)).	**INR48,000crores** (almost **51%**of the Aggregate External Fund Based Debt **of the entire IL&FS Group**)

[2]All external fund based debt numbers specified here in above are as of October 8, 2018;and all debt numbers in relation to loans/financial debt provided by IL&FS Group entity to another IL&FS Group entity is as of September 30, 2018.

Sr. No.	Particulars	Approximate Amount (in INR)[2]
3.	Principal amounts of the (outstanding) **loans/ financial debt** provided to IL&FS Group entities **by other IL&FS Group entities**	**INR 32,836 crores**[3] (approximately **35%** of the Aggregate External Fund Based Debt)
4.	Loans/ financial debt provided by the **4 key HoldCos** (*i.e.* ,IL&FS, IFIN, ITNL and IEDCL, which account for almost 51% of the Aggregate External Fund Based Debt) to other IL&FS Group entities	**INR 26,154 crores** (approximately **80%** of the entire amount lent to the IL&FS Group by other IL&FS Group entities)
5.	Loans /financial debt provided by IL&FS to other IL&FS Group entities	**INR 11,972 crores** (approximately **66%** of the Aggregate External Fund Based Debt **of** IL&FS)
	Amounts lent(as financial debt) by ITNL to IL&FS Group entities	**INR 6,994 crores** (approximately **58%** of the Aggregate External Fund Based Debt **of** **ITNL**)
	Amounts lent (as financial debt) by IFIN to IL&FS Group entities	**INR 5,200 crores** (approximately **32%** of the Aggregate External Fund Based Debt **of IFIN**)
	Amounts lent (as financial debt) by IEDCL to IL&FS Group entities	**INR 1,988 crores** (approximately **89%** of the Aggregate External Fund Based Debt **of IEDCL**)

[3]Amounts as of September 30 ,2018. The gross financial debt lent by the Group Lenders may also include loans that were further on- lent by such Group Lenders to other IL&FS Group entities. Accordingly, the net financial debt provided by the Group Lenders, adjusted for double counting is INR 23, 743crores (as of September 2018).

APPENDIX

(Vide Para 4 of the Introduction)

ANALYSIS OF THE ACTION TAKEN BY THE GOVERNMENT ON THE RECOMMENDATIONS CONTAINED IN THE SEVENTY-SECOND REPORT OF THE STANDING COMMITTEE ON FINANCE (SIXTEENTH LOK SABHA) ON 'STRENGTHENING OF THE CREDIT RATING FRAMEWORK IN THE COUNTRY'

		Total	% of total
(i)	Total number of Recommendations	07	
(ii)	Recommendations/Observations which have been accepted by the Government (vide Recommendations at Sl. Nos. 3 & 7)	02	28.57%
(iii)	Recommendations/Observations which the Committee do not desire to pursue in view of the Government's replies (vide Recommendations at Sl. Nos. 1, 2, 4 and 6)	04	57.14%
(iv)	Recommendations/Observations in respect of which replies of the Government have not been accepted by the Committee (vide Recommendation at Sl. No. 5)	01	14.28%
(v)	Recommendations/Observations in respect of which final reply of the Government are still awaited	NIL	--

Minutes of the Ninth sitting of the Standing Committee on Finance (2020-21)

The Committee sat on Wednesday, the 10th March, 2021 from 1530hrs. to 1745 hrs. in Main Committee Room, Parliament House Annexe, New Delhi.

PRESENT

Shri Jayant Sinha – Chairperson

LOK SABHA

2. Shri S.S. Ahluwalia
3. Shri Subhash Chandra Baheria
4. Dr. Subhash Ramrao Bhamre
5. Smt. Sunita Duggal
6. Smt. Darshana Vikram Jardosh
7. Shri Manoj Kishorbhai Kotak
8. Shri P.V Midhun Reddy
9. Shri Manish Tewari
10. Shri Rajesh Verma

RAJYA SABHA

11. Shri A. Navaneethakrishnan
12. Shri Praful Patel
13. Dr. Amar Patnaik
14. Shri Mahesh Poddar
15. Shri Bikash Ranjan
16. Shri G.V.L Narasimha Rao

SECRETARIAT

1.	Shri Vinod Kumar Tripathi	-	Joint Secretary
2.	Shri Ramkumar Suryanarayanan	-	Director
3.	Shri Kulmohan Singh Arora	-	Additional Director
4.	Shri Kh. Ginlal Chung	-	Under Secretary

PART I

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(The witnesses then withdrew)

PART II

3. The Committee, thereafter, took up the following draft Reports for consideration and adoption :

(i) Twenty-Fifth Report on Demands for Grants (2021-22) of the Ministry of Finance (Departments of Economic Affairs, Expenditure, Financial Services and Investment & Public Asset Management).

(ii) Twenty-Sixth Report on Demands for Grants (2021-22) of the Ministry of Finance (Department of Revenue).

(iii) Twenty-Seventh Report on Demands for Grants (2021-22) of the Ministry of Corporate Affairs.

(iv) Twenty-Eighth Report on Demands for Grants (2021-22) of the Ministry of Planning.

(v) Twenty-Ninth Report on Demands for Grants (2021-22) of the Ministry of Statistics and Programme Implementation.

(vi) Thirtieth Report on Action taken by the Government on the recommendations contained in Seventy-First Report (16th Lok Sabha) on the subject 'Central Assistance for Disaster Management and Relief'.

(vii) Thirty-First Report on Action taken by the Government on the recommendations contained in Seventy-Second Report (16th Lok Sabha) on the subject 'Strengthening of the Credit Rating Framework in the Country'.

After some deliberations, the Committee adopted the above draft Reports and authorised the Chairperson to finalise them and present the Report to Parliament.

The Committee then adjourned.

A verbatim record of the proceedings has been kept.