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IL&FS case: Govt may crack the whip on rating agencies

MCA may invoke Section 447 of Companies Act to slap penalty and suspend some of the rating agencies

SHRIMI CHOUDHARY
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The Ministry of Corporate Affairs (MCA) is planning to act tough against some of the top credit rating agencies in relation to the IL&FS case, according to sources in the know. These agencies had rated the debt instruments of IL&FS financial services (IFIN) which went bust.

The ministry may invoke Section 447 of the Companies Act for imposing penalty and suspending these firms and their executives, one of the sources said. The development follows the government moving the National Company Law Tribunal (NCLT) on Monday to ban the auditors of IFIN for five years over failure in reporting mismanagement despite being aware of the crisis at IL&FS and its subsidiaries.

The Serious Fraud Investigation Office (SFIO), which is probing the Companies Act violations by rating agencies, has raised some critical issues with the Ministry of Corporate Affairs.

Sources said SFIO had questioned at least four rating agencies including ICRA, CARE Ratings, India Ratings and Brickwork Ratings, seeking explanation on procedural lapses, anomalies in the independent assessment and due diligence done by them. Information is also being collected on whether there's been any top management interference to ensure good ratings. These rating agencies have been monitoring the activities of IL&FS and its subsidiaries between 2014 and 2018.

WIDENING THE PROBE

- **SFIO has questioned** some of the top rating agencies in past few months
- **The agency has sought explanation** from them for maintaining a stable rating for IFIN despite weak financials
- **The rating given to IFIN's debt papers** between 2014 and 2018 has been probed
- **It is suspected that the brass of rating agencies** intervened to ensure good ratings for the IL&FS arm
- **MCA is contemplating invoking Section 447**, Section 36 of Companies Act
- **Ministry may ask Sebi**, the regulator for credit rating agencies, to be the respondent in the matter



“The ministry sought a separate report in the matter covering the aspects involving borrowing from market using instruments like commercial papers, non-convertible debentures and role of the respective rating agencies,” said a person privy to the development.

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Action could be taken soon based on the findings, he added.

The rating agencies did not downgrade the commercial papers of IFIN despite the weak financials. This gave confidence to many companies to invest in the provident funds of IL&FS and its subsidiaries to the tune of over Rs 10,000 crore, the person quoted above pointed out. In fact, the agencies had given IL&FS debentures AAA rating, the highest level of creditworthiness, until its subsidiary IL&FS Transportation Networks defaulted in June.

The section 447 of the Companies Act empowers the MCA to take action against any person or entity found guilty of fraud. The action under this provision pertains to penalty extending to three times of the amount involved and imprisonment of up to 10 years.

In response to a Business Standard query on the matter, CARE Ratings said it had provided all information that was sought by government agencies and regulators on the IL&FS matter. Icr, India Ratings and Brickwork didn't reply.

Even as the Section 447 enables MCA to take action, rating agencies are regulated by the the Securities and Exchange Board of India (Sebi). The Ministry of Corporate Affairs may seek the market

regulator's concurrence to initiate proceedings against the rating agencies, said Pavan Kumar Vijay, Founder, Corporate Professionals.

Meanwhile, Sebi is separately examining the case and had launched adjudication proceedings against three of the rating agencies last December.

Sebi has been of the view that rating agencies should be able to pick up early signs of a crisis and issue a rating watch, followed by rating action. The regulator believes the agencies have failed to act in an appropriate manner in the IL&FS case.