

Contain IL&FS contagion, but probe fraud & take action

By: [The Financial Express](#) | New Delhi | Published: September 26, 2018 4:09 AM



X

While the contagion effect from the IL&FS episode has been relatively small so far, the money markets have been spooked by the fact that mutual funds (MFs) are unable to sell debt paper of some NBFCs except at very high yields.

It is shocking and deeply worrying that the financial problems at IL&FS were not flagged all this while, and that the rating agencies were so late in declaring the loans were junk grade. In the IL&FS case, it is inexplicable how the rating was downgraded several notches in one shot.

SEBI needs to take penal measures to ensure rating agencies don't just get away with pocketing fat fees without doing adequate homework and being held accountable for their ratings.

The more important question, however, relates to the roles of the audit committee, the several directors on the board and the large investors in IL&FS such as LIC, HDFC, SBI and Central Bank of India. How did they fail to red-flag the weak financials since these couldn't have become precarious overnight? Did they not see IL&FS's balance sheet for what it is—full of holes—or did they choose not to highlight these? And RBI has to share a large part of this blame, as does the Financial Stability and Development Council, for allowing IL&FS's loan book to cross `90,000 crore without a thorough inspection of its books as well as those of its maze of subsidiaries—both organisations failed miserably in their oversight of a systemically-important company that, today, is being described by some as India's Lehman.

Even as the government and the regulators work out a solution to prevent a contagion, the failure of the institution to repay its debts merits a full-fledged probe. Ideally, there should be no bailout as that creates a moral hazard, but Rs 90,000 crore is a very large sum and so LIC will probably need to throw IL&FS a lifeline while it tries to sort out the mess and sell off parts of the business over time. All those invested in IL&FS, either by way of equity or debt, will have to take large haircuts as punishment for their negligence. A full-fledged SFIO probe, and detailed forensics are also required to see whether funds were siphoned off; apart from senior company officials, top bureaucrats who chaired various IL&FS's SPVs must be probed and, if need be, prosecuted.

While the contagion effect from the IL&FS episode has been relatively small so far, the money markets have been spooked by the fact that mutual funds (MFs) are unable to sell debt paper of some NBFCs except at very high yields. The problem is also of their own creation because MFs don't seem to have realised there could be a risk lending to NBFCs for short tenures, when typically the NBFCs' lending is long-term in nature; in which case, MFs need to pay the price though an RBI window of credit will ensure no immediate meltdown. Credit Suisse points out that the exposure of MFs to NBFCs is up three-fold since March 2016 and they now hold an estimated 60% of the total issuances of Commercial Paper (CP) by NBFCs. MFs must take more than adequate care while picking their investments—not chasing yields at the expense of quality—and not expect to be bailed out. For their part, NBFCs must focus less on profitability and ensure their assets and liabilities are better matched. Indeed, the regulator should make it mandatory for both NBFCs and housing finance companies to

borrow at least 80% of their requirements via long term instruments; the over-dependence on short-term instruments such as commercial paper is what is causing the problem. In their greed for profits, very few players are taking care to see if their business models are sound. While there may be no cause for panic, this is a good time for the regulators to put in place stricter guidelines for borrowing and lending.

ADVERTISING

inRead invented by Teads

Get live [Stock Prices](#) from BSE and NSE and latest NAV, portfolio of [Mutual Funds](#), calculate your tax by [Income Tax Calculator](#), know market's [Top Gainers](#), [Top Losers](#) & [Best Equity Funds](#). Like us on [Facebook](#) and follow us on [Twitter](#).

PROMOTED STORIES
