

# FAQ on Wilful Defaulters: India's Economic Suppressors!



**Wednesday Wisdom**  
**27-09-2023**



Recently, Reserve Bank of India (RBI) had released a Draft Master Circular which highlights the Treatment of Wilful Defaulters[1] and Large Defaulters for resolution of stressed accounts by way of Compromised Settlement[2]. It provides instructions to Lenders[3] which include All India Financial Institutions, banks or Non-Banking Financial Companies which grant credit facility to borrowers for undertaking compromise settlements and technical write-offs.

The scope of definition of the Lender has been expanded and has included Non-Banking Financial Company along with Banks and Financial Institutions in comparison to Master Circular on Wilful Defaulters[4]. The draft circular is currently open for discussion and suggestions. It has not been implemented yet, allowing for valuable input and improvements to be incorporated.

This Draft Circular has been issued in order to meet objective of a non-discrimination and transparent procedure, while complying with the principles of natural justice[5] for classifying a borrower as a wilful defaulter by the lenders.

But before diving deep into the circular, let's understand the concept of Wilful Defaulters:

In the ever-booming business arena, banking transactions including Bank Guarantee, Letter of Credit, Loans are few of the easiest modes obtained by/from Lenders for covering a financial obligation or raising capital for the development and expansion of Business.

The Minister of State for Finance, in Rajya Sabha's written statement stated that the Top 50 Wilful Defaulters owe Rs. 87,295 crores to banks and Financial Institutions. Out of which the Top 10 wilful defaulters owe Rs. 40,825 crores to Schedule Commercial Banks[6]. However, non-payment or defaulting on Loans has become tendency and it is unfortunate for economy.

The Reserve Bank of India (RBI) issues Master Circulars and Notifications stating the directions and measures for the regulation of such transactions.

[1] The article reflects the general work of the authors and the views expressed are personal. No reader should act on any statement contained herein without seeking detailed professional advice.

[2] [https://www.rbi.org.in/scripts/bs\\_viewcontent.aspx?id=4318](https://www.rbi.org.in/scripts/bs_viewcontent.aspx?id=4318)

[3] 3(1)m - Definition of Lenders - Draft Master Direction - Treatment of Wilful Defaulters and Large Defaulters dated 21.09.2023.

[4] [https://www.rbi.org.in/Scripts/BS\\_ViewMasCirculardetails.aspx?id=9907](https://www.rbi.org.in/Scripts/BS_ViewMasCirculardetails.aspx?id=9907)

[5] <https://www.ynzgroup.co.in/articles/14-Principles%20of%20Natural%20Justice.pdf>

[6] <https://economictimes.indiatimes.com/industry/banking/finance/banking/top-50-wilful-defaulters-owe-rs-87295-crore-to-banks-finance-ministry/articleshow/102326721.cms?from=mdr>



## 1. What exactly does a wilful default mean[7] ?

A wilful default can occur through a Borrower or a Guarantor. The borrower shall be deemed to have to default in meeting its payment/repayment obligations to the lender and has also undergone any of the following event:

- When the borrower was financially capable to honour the said obligations;
- Borrower has diverted the funds availed under the credit facility from lender;
- Borrower has siphoned off the funds availed under the credit facility from lender;
- Borrower has disposed of movable assets or immovable assets or immovable property which was used as security for obtaining credit facility without the knowledge of lender.
- Borrower has failed in its commitment to the lender to infuse equity despite having the ability to infuse the equity, although the lender has provided loans or certain concessions to the borrower based on this commitment and other covenants and conditions.

**Illustration** - A who has a business of computers and had borrowed a credit facility from the bank for his business. However, he invested the said amount towards personal needs by purchasing a luxurious villa for himself, thereby siphoning the funds. The bank lays down the repayment schedule for the credit facility, but A is unable to repay the same due to said siphoning and this is likely to be held as a wilful default.

The guarantor shall have deemed to have committed a wilful default if the guarantor does not honour the guarantee when invoked by the lender, despite having sufficient means to make the payment of the dues.

This Draft Circular introduces the concept of Borrower as the one who has availed credit facility from the Lender which was earlier defined as a Unit in the Master Circular on Wilful Defaulters. The Lender can initiate proceedings against the guarantor without exhausting remedies against the Principal Debtor and the liability of the guarantor is immediate. Hence, the Draft Circular advises the Lenders to ensure that all the prospective guarantors should be made aware of this position at the time of accepting guarantee.

[7] 3(1)(t) - Definition of Wilful Default - Draft Master Direction - Treatment of Wilful Defaulters and Large Defaulters dated 21.09.2023.



## 2. Who is a Wilful Defaulter [8]?

A wilful defaulter means -

- A borrower or guarantor who has committed wilful default and the outstanding amount is Rs. 25 lakh and above, or as may be notified by Reserve Bank of India from time to time, and
- Where the Borrower committing the wilful default is a company, its promoters and the director(s) associated at the time of default, and in case of entity (other than companies), persons who are in charge and responsible for the management of the affairs of the entity.

In the Previous Master Circular on Wilful Defaulters, the definition of Wilful Defaulter comprised of a unit defaulting in its repayment of his obligation whereas in this Draft Circular, the Borrower and the Guarantors have been defined as the entities committing wilful default.

## 3. What does Diversion of Funds[9] mean?

- utilisation of short-term working capital funds for long-term purposes which is not in conformity with the terms of sanction of credit facility.
- deploying funds availed using credit facility for creation or assets or purposes/activities other than those for which the credit was sanctioned.
- transferring the funds availed using credit facility to subsidiaries or group companies or other corporates by any means.
- routing of funds through any lender other than the lender or members of consortium without prior written permission of lender or the members of consortium.
- investment of availed using credit facility in other companies by way of acquiring equities/ debt instruments without approval of lenders.
- shortfall in deployment of funds vis-à-vis the amounts disbursed or drawn and the difference not being accounted for.

[8] 3(1)(u) – Definition of Wilful Defaulter – Draft Master Direction – Treatment of Wilful Defaulters and Large Defaulters dated 21.09.2023.

[9] 3(1)(h) – Definition of Diversion of funds – Draft Master Direction – Treatment of Wilful Defaulters and Large Defaulters dated 21.09.2023.



**Illustration** - LMN Group, has two group companies, namely Company LM and Company N, both the Companies have same Directors. The Company N is a newly incorporated company which has been facing financial issues and is in dire need of funds. Company LM applies for the loan for expansion of business on the instructions of the Directors. Company LM obtains the loan amount, the Directors of the Company N raise fictitious invoices to Company LM. Company LM directs transfer of the said loan amount to Company N as payment against the fictitious invoices, presenting it as legitimate business transaction.

In the Draft Circular, a minor addition has been made to the events of wilful defaults stating that the funds have been availed from credit facility thereby giving precise instructions.

#### **4. Which accounts are reviewed for Identification of Wilful Default[10]?**

The Lenders shall examine the 'wilful default' aspect in all accounts with outstanding amount of Rs. 25 lakh and above as may be notified from time to time and **complete the process of classification/declaring the Borrower as a Wilful Defaulter within 6 months of the account being classified as Non-Performing Asset.**

In the Draft Circular, a major change has been introduced for the Identification of the Wilful Defaulter wherein the process for classification of a Borrower as a Wilful Defaulter has to be completed within a time period of 6 months after it has been declared as NPA. This change can have an impact of creating confusion in bank's procedures and the allocated timelines as a lengthy procedure for such declaration has also been prescribed and the time frame was not prescribed in the previous Master Circular. Banks may face difficulty in adhering to the said timelines, as per certain reports. [11]

[10] 4(2) - Review of Accounts for Identification of Wilful Default - Draft Master Direction - Treatment of Wilful Defaulters and Large Defaulters dated 21.09.2023.

[11] <https://www.livemint.com/news/india/banks-to-tag-wilful-default-in-six-months-under-new-rules-11695322751878.html>



## **5.How does the Transparent Mechanism for identification and Classification of Wilful Defaulters work?**

The Transparent Mechanism for Identification and Classification of Wilful Defaulters consists of an Identification Committee and a Review Committee setup by the Lenders.

An Identification Committee[12] is constituted for identifying Wilful Defaulter by the Lender consists of Whole-time Director other than the Chief Executive Officer (CEO) as Chairperson and two Senior Officials as members, not below 2 ranks of the Chairperson of the Committee.

In the case of Banks, where there is no position of Whole-time Director, the Committee shall comprise of an Officer in the rank just below the CEO as Chairperson and two Senior Officials as members, not below two ranks of the Chairperson of the Committee.

The Committee cannot be chaired by the person who has sanctioned the credit facility and they shall not include any person who was a member of credit sanctioning committee. Lenders can setup multiple Identification Committees with similar Constitution for identification of Wilful Defaulters.

A Review Committee[13] is composed for reviewing the proposal of Identification Committee and comprises of Whole-time Director who is the Chief Executive Officer (CEO) of the Lender as Chairperson and two Independent Directors as members.

In the case of Banks, where there is no position of Whole-time Director, the Committee shall comprise of CEO as the Chairperson and two Senior Officials as members, not below one rank of the Chairperson of the Committee.

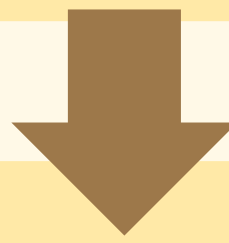
[12] 3(1)(j) – Definition of Identification Committee – Draft Master Direction – Treatment of Wilful Defaulters and Large Defaulters dated 21.09.2023.

[13] 3(1)(r) – Definition of Review Committee – Draft Master Direction – Treatment of Wilful Defaulters and Large Defaulters dated 21.09.2023.

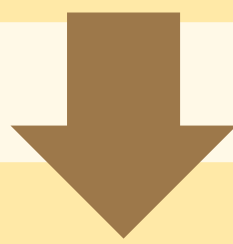


The Process of Identification and Classification of Wilful Defaulters is as follows:

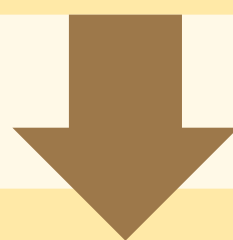
Identification Committee examines the Wilful Default which has occurred.



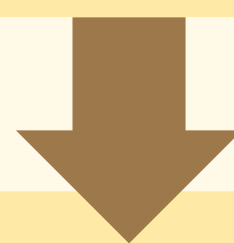
If Committee concludes wilful default has occurred, a Show Cause Notice is issued to concerned Borrower/Guarantor/Promoter who are directed to submit reply to the Show Cause Notice.



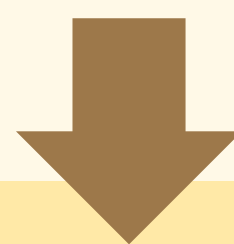
Identification Committee makes a proposal to Review Committee for classification as a wilful defaulter by explaining in writing



If opportunity is not availed by Borrower/Guarantor/Promoter for Hearing, the Review Committee relies on the material facts in the written representation and the Proposal from Identification Committee.



Written Representation against the Proposal has to be submitted within 15 days to Review Committee by the Borrower/Guarantor/Promoter in charge of management of Entity



Review Committee passes a reasoned Order and communicates the same to the Wilful Defaulter

[14] 4(1) - Mechanism for Identification and Classification of Wilful Defaulters - Draft Master Direction - Treatment of Wilful Defaulters and Large Defaulters dated 21.09.2023.



The Process of Identification and Classification of Wilful Defaulters has been refined in this Draft Circular as previously, the Identification and Classification was conducted by Committees wherein the process involved passing of Order by one of the Committee and then the Order such passed was reviewed by another Committee who finalized the Order. However, in case of the Draft Circular, there are two Committees defined, Identification Committee who identifies the wilful default and passes a Proposal to Review Committee which gives an opportunity for hearing to defaulter party for a fair resolution of the Proposal.

### **6.How is the Reporting of Wilful Defaulters done and to whom?**

All Lenders submit the List of Wilful Defaulters on a monthly basis to a Credit Information Company (CIC) who has obtained a certificate of registration from RBI[15]. They shall disseminate information pertaining to suit filed accounts and non-suit filed accounts of Wilful Defaulters on their respective websites.

RBI by Act and Regulations framed thereunder, has granted Certificate of Registration to the following to carry on the business of credit information[16]:

- Experian Credit Information Company of India Private Limited
- Equifax Credit Information Services Private Limited
- CRIF High Mark Credit Information Services Private Limited
- Credit Information Bureau (India) Limited.

The Lenders or the Asset Reconstruction Companies (ARC) shall on account of transfer, inform all the CICs for the removal of name of the Wilful Defaulter from the list not later than 30 days from the date when the outstanding amount falls below the threshold of Rs. 25 lakhs.

The Draft Master Circular has introduced reduction in the timespan for Reporting the list of suit filed accounts and non-suit filed accounts from quarterly basis to a monthly basis. According to another similar change introduced during the removal of name of the Borrower as Wilful Defaulter from the List of Wilful Defaulter, the Lender has to intimate such transfer to the Credit Information Companies within a period of 30 days after the outstanding amount falls below the Threshold of Rs. 25 lakhs. The defined time period shall be beneficial to the Borrowers.

[15] 10 - Reporting and Dissemination of Credit Information on Wilful Defaulters - Draft Master Direction - Treatment of Wilful Defaulters and Large Defaulters dated 21.09.2023.

[16] 2.9 - Reporting to RBI /Credit Information Companies - Master Circular on Wilful Defaulters dated 01.07.2014





## 7. What are the consequences that the wilful defaulters face after being reported[17]?

The Master Circular states various measures which can be taken against the Wilful Defaulters such as a criminal action can be taken under the provisions of applicable law, or the Lenders can formulate a non-discriminatory Board-approved policy which states the criteria based on which the photographs of the person classified and declared as wilful defaulter shall be published.

Few of the measures which the Lenders take against the Borrowers are as follows:

1. **No additional credit facilities** should be granted by any Lenders to the Listed Wilful Defaulters or any entity with which a wilful defaulter is associated which can be a subsidiary of the company or Promoters/Directors who are in charge of the company. There is a cooling period of 1 year post the removal of name of Wilful Defaulter from the List of Wilful Defaulters by the Lender. No credit facility shall be granted for floating of new ventures by any lender to a wilful defaulter or any entity with which a wilful defaulter is associated for a period of 5 years from the date the name of the wilful defaulter is removed from the List of Wilful Defaulters.
2. The Wilful Defaulters shall be **ineligible for restructuring of credit facility**. However, if the existing Promoters are replaced by new Promoters and the Borrower Company is totally delinked from such Promoters/Management, the Lenders may take a view on restructuring such accounts based on their viability. But the criminal actions against the former Promoters/Management will continue to persist.
3. The Lenders may initiate **legal action against the Borrowers/Guarantors** for foreclosure or recovery of dues expeditiously.
4. The Lenders can also incorporate a covenant in the Agreement while extending credit facility to a Borrower which shall state that it shall **not induct on its board a person whose name appears in the List of Wilful Defaulters**. If such person is found on Board, effective steps for removal of such person within 90 days should be taken.

[17] 5 - Specific measures against Wilful Defaulters - Draft Master Direction - Treatment of Wilful Defaulters and Large Defaulters dated 21.09.2023.



The consequences that Wilful Defaulters face after being reported in the Master Circular on Wilful Defaulters have been retained, furthermore consequences have been implied such as publication of photographs of the persons classified as Wilful Defaulters. A concept of cooling period has been introduced wherein if the Borrower has been removed from the Wilful Defaulter list, he/she/it cannot avail any credit facility for a period of 1 year despite clearing his outstanding amount. A cooling period of 5 years has been implied for Wilful Defaulters in case of new floating ventures. The imposition of these consequences on the Wilful Defaulter will cause them great difficulties in terms of credit for their business or ventures.

Recently, Reserve Bank of India published a Framework stating that the Wilful Defaulters can opt for Compromise Settlement[18] against the Wilful Default by the Borrower. The following provisions state for the treatment given to the Wilful Defaulters opting for Compromising Settlement.

### **8. What is the Treatment given to Wilful Defaulters who have entered into Compromise Settlement[19]?**

The account, which is included in the List of Wilful Defaulters, where the Lender has entered into a compromise settlement with the Borrower, the name of the Borrower shall only be removed from the List of Wilful Defaulters only when the compromise amount is fully paid.

In case only part payment has been made, name of the Borrower shall not be removed even if the outstanding amount becomes less than the threshold of Rs. 25 lakhs or as may be notified by Reserve Bank of India from time to time.

The Draft Circular has introduced the concept of The treatment to Wilful Defaulters who have entered into Compromise Settlement.

Reserve Bank of India, with this recent amendment has posed a guideline by publishing this Draft Circular for the Identification and Classification of Wilful Defaulters, also attempting to provide a fair chance to the Borrowers to put forth their representation before being classified as Wilful Defaulters. This is initiated to implement a transparent mechanism and accountability for the repayment of the Credit Facility on the Borrower by imposing grave repercussion.

However, since these Guidelines being a Draft Circular, the provisions stated in the same are not in effect until 90 days after posting the same on the RBI Website. Since the Draft Circular is open for suggestions and feedback from the public, the provisions are bound to change and shall be considered final and binding only after the final publication of the Circular on the Treatment of Wilful Defaulters and Large Defaulters, 2023.

[18] <https://www.rbi.org.in/Scripts/NotificationUser.aspx?Id=12513&Mode=0>

[19] 11 -Treatment of Compromise Settlements - Draft Master Direction - Treatment of Wilful Defaulters and Large Defaulters dated 21.09.2023.

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