

WILFUL DEFAULTERS

DEFINITION

A "wilful default" is deemed to have occurred if any of the following events is noted:-

- a) Default in repayment obligations by the unit to the lender even when it has the capacity to honour the said obligations.
- b) Default in repayment obligations by the unit to the lender and has not utilized the finance from the lender for the specific purposes for which finance was availed of but has diverted the funds for other purposes.
- c) Default in repayment obligations by the unit to the lender and has siphoned off the funds so that the funds have not been utilized for the specific purpose for which finance was availed of, nor are the funds available with the unit in the form of other assets.
- d) Default in repayment obligations by the unit to the lender and has also disposed off or removed the movable fixed assets or immovable property given by it for the purpose of securing a term loan without the knowledge of the bank/lender.

Diversion and siphoning of funds

- Diversion of funds referred to para 01(b) above, would include:-
 - a) utilization of short-term working capital funds for long-term purposes not in conformity with the terms of sanction;
 - b) deploying borrowed funds for purposes / activities or creation of assets other than those for which the loan was sanctioned;
 - c) transferring funds to the subsidiaries / Group companies or other corporate by whatever modalities;
 - d) routing of funds through any bank other than the lender bank or members of consortium without prior permission of the lender;
 - e) investment in other companies by way of acquiring equities / debt instruments without approval of lenders;
 - f) shortfall in deployment of funds vis-à-vis the amounts disbursed / drawn and the difference not being accounted for.

- Siphoning of funds referred to at para 01(c) above is construed to occur if any funds borrowed from banks / FIs are utilized for purposes un-related to the operations of the borrower, to the detriment of the financial health of the entity or of the lender.
- The identification of the wilful default should be made keeping in view the track record of the borrowers and should not be decided on the basis of isolated transactions/incidents. The default to be categorized as wilful must be intentional, deliberate and calculated.

Penal Measures

- The penal measures are applicable to any wilful defaulter with an outstanding balance of Rs. 25 lakh or more. This limit of Rs. 25 lakh may also be applied for the purpose of taking cognizance of the instances of 'siphoning' / 'diversion' of funds.
- List of wilful defaulters (non-suit filed accounts) and list of wilful defaulters (suit filed accounts) are forwarded to SEBI by RBI and Credit Information Bureau (India) Ltd. (CIBIL) respectively so as to prevent the access to the capital markets by the wilful defaulters.
- Banks and FIs are required to initiate penal measures against the identified wilful defaulters as under:-
- No additional facilities should be granted by any bank / FI to the listed wilful defaulters.
- The entrepreneurs / promoters of companies where banks / FIs have identified siphoning / diversion of funds, misrepresentation, falsification of accounts and fraudulent transactions should be debarred from institutional finance from the scheduled commercial banks, Development Financial Institutions, Government owned NBFCs, investment institutions etc. for floating new ventures for a period of 5 years from the date the name of the wilful defaulter is published in the list of wilful defaulters by the RBI.
- Initiation of legal process including criminal proceedings, wherever necessary, against the borrowers / guarantors and foreclosure of recovery of dues expeditiously.
- Banks and FIs should adopt a proactive approach for a change of management of the wilfully defaulting borrower unit, etc.

Banks and FIs should put in place a transparent mechanism for the entire process so that the penal provisions are not misused and the scope of such discretionary powers is kept to the barest minimum. It should also be ensured that a solitary or isolated instance is not made the basis for imposing the penal action.

Guarantees furnished by group companies

In cases where a letter of comfort and / or the guarantees furnished by the companies within the Group on behalf of the wilfully defaulting units are not honoured when invoked by the banks / FIs, such Group companies should also be reckoned as wilful defaulters.

Role of Auditors

In case it is noticed that there exists falsification of accounts on the part of the borrowers and the auditors were negligent or deficient in conducting the audit, they should lodge a formal complaint against the auditors of the borrowers with the Institute of Chartered Accountants of India (ICAI) to enable the ICAI to examine and fix accountability of the auditors.

For monitoring the end use of funds, in case the lender desires a specific certification from the borrower's auditors regarding diversion /siphoning of funds by the borrower, the lender should award a separate mandate to the auditors for the purpose. Appropriate covenants may be incorporated in the loan agreements to enable award of such certification by auditors.

Reporting to RBI / Credit Information Companies

Banks/FIs are required to submit to Credit Information Bureau (India) Ltd. (CIBIL) the list of suit-filed accounts of wilful defaulters of Rs.25 lakh and above as at end-March, June, September and December every year and a quarterly list of wilful defaulters where suits have not been filed to RBI.

Banks and FIs need not report cases where outstanding amount falls below Rs.25 lakh and cases where banks have agreed for a compromise settlement and the borrower has fully paid the compromised amount.

Banks and FIs take suitable steps to report the names of current directors as also the directors who were associated with the company at the time the account was classified as defaulter to put other banks and FIs on guard. The names of independent and nominee directors are also be included with suitable distinguishing remarks as applicable.

Grievances Redressal Mechanism

Decisions to classify the borrower as wilful defaulter should be entrusted to a Committee of higher functionaries headed by the Executive Director and consisting of two GMs/DGMs as decided by the Board of the concerned bank/FI with a view to have more objectivity in identifying cases of wilful default.

The borrower should be suitably advised about the proposal to classify him as a wilful defaulter along with reasons therefore. He should be provided reasonable time (say 15 days) for making representation against such decision to a Grievance Redressal Committee headed by the CMD and consisting of two other senior officials.

He should also be given a hearing in case he represents that he has been wrongly classified as wilful defaulter and a final declaration as 'wilful defaulter' should be made after a view is taken by the Committee on the representation and the borrower should be suitably advised.

Source: RBI M. Circular

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