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RBI MASTER DIRECTIONS ON WILFUL DEFAULTERS: A COMPREHENSIVE GUIDE

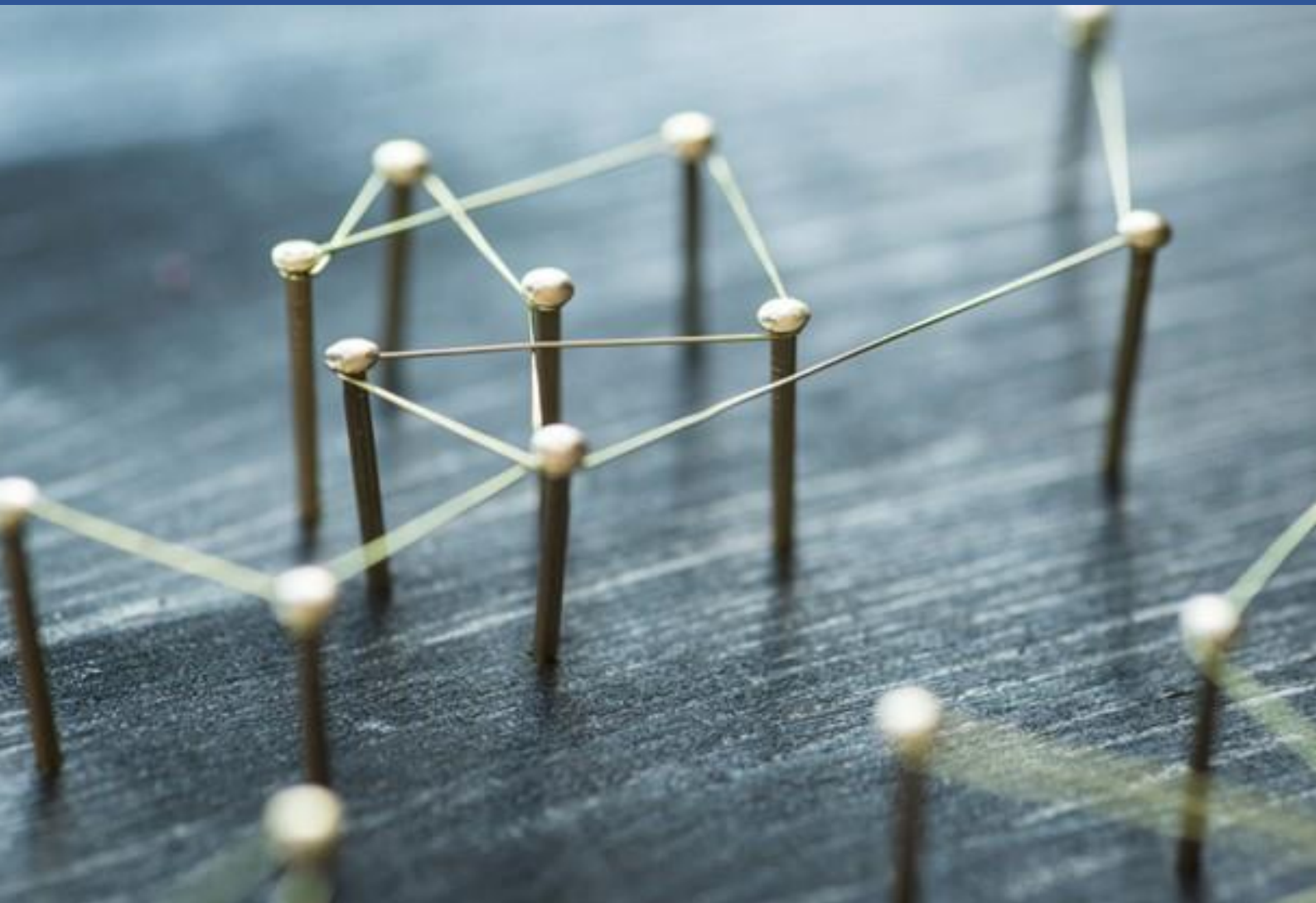


TABLE OF CONTENTS

Preface	2
Background and Purpose	3
Wilful Default - Evolution Of Jurisprudence Over The Years.....	4
Comparative Perspectives In Other Jurisdictions	6
Institutions And Banks Covered Under The Present Master Directions Of Rbi.....	7
Definitions And Requirements For Declaration Of A Borrower As A Wilful Defaulter	8
Changes Between 2015 And 2024 Master Directions	14
Detailed Steps For Institutions And Banks/Regulated Entities.....	15
Preventive Measures Required Under The Master Directions	15
Suggestive Steps For Borrowers To Avoid Declaration In Light Of The Revised Master Directions	16
Timeline For Dealing With Wilful Defaulter Declarations	18
Conclusion.....	18

PREFACE

The Reserve Bank of India (RBI) has on July 30, 2024, issued revised guidelines on the treatment of wilful defaulters with the introduction of the Master Directions on Wilful Defaulters and Large Defaulters (effective from October 28, 2024) (**Master Circular/ Master Directions 2024**). Earlier these directions were consolidated and issued vide RBI circular no.RBI/2015-16/100 DBR.No.CID.BC.22/20.16.003/2015-16 on July 1, 2015, whereby all the earlier instructions issued by the RBO on the above matters up to June 30, 2015 were consolidated (**2015 Master Directions**). The 2015 Master Directions now stand replaced by Master Directions 2024. Along with this, the instructions on Non-Cooperative Borrowers contained in circular DBR.No.CID.BC.54/20.16.064/2014-15 dated December 22, 2014, also stand repealed along with other sixty circulars on the subject.

This guide provides a detailed overview of these guidelines, their background, evolution, key judicial interpretations, and practical steps for institutions, banks, borrowers, and guarantors.

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BACKGROUND AND PURPOSE

The primary objective of these Directions is to ensure a transparent and non-discriminatory procedure for classifying borrowers as wilful defaulters. This directive is critical for maintaining the integrity of the financial system. It outlines measures and consequences for borrowers who intentionally default on their obligations. These guidelines are issued by the RBI in exercise of powers conferred under Section 45-L of the Reserve Bank of India Act, 1934, Section 21, Section 35-A and Section 35-A read with Section 56 of the Banking Regulation Act, 1949 and Section 11 of the Credit Information Companies (Regulation) Act, 2005. As such these guidelines and directions also serves as vital source to the Courts on this issue as RBI Guidelines have been held to have legal force and binding on the entities governed by such guidelines¹.

Concept of Wilful Default

Wilful default occurs when a borrower intentionally defaults on repayment obligations despite having the capacity to pay or when funds are diverted or siphoned off. The revised guidelines expand the definition to include failures by promoters to infuse equity despite commitments and unauthorized disposal of assets.

The concept of wilful defaulter was introduced by the RBI in response to the instructions of the Central Vigilance Commission for collecting information on wilful defaults of INR 25 lakhs and above and disseminating it to reporting banks and financial institutions (FIs).

Effective from April 1, 1999, the scheme for declaration of defaulters as wilful defaulters, is aimed to curb deliberate non-payment of dues by borrowers despite having adequate cash flow and good net worth with funds being siphoned off, misutilization of financed assets, misrepresentation or falsification of records, unauthorized disposal or removal of securities, and fraudulent transactions. Banks and FIs began reporting such cases quarterly, covering non-performing borrowal accounts with outstanding amounts aggregating INR 25 lakhs and above. Respective banks and FI's have a committee headed by the Executive Director and consisting of two General Managers or Deputy General Managers to finalize this list. Recognizing the severe impact of wilful defaults on the financial system, the RBI further mandated examining cases of wilful defaults of INR 1 crore and above for potential suits and criminal action. The need for this concept was underscored by the persistent issue of wilful defaults, as highlighted in the 8th Report of the Parliament's Standing Committee on Finance, leading to the establishment of the Working Group on Wilful Defaulters in May 2001 and subsequent revisions to the scheme. This framework for declaration of defaulter as wilful ensures accountability and mitigates the risks posed by wilful defaulters to the financial system's stability and integrity.

¹ **ICICI Bank Ltd v. Official Liquidator of APS Star Industries Ltd ((2010) 10 SCC 1)** "40. When a delegate is empowered by Parliament to enact a policy and to issue directions which have a statutory force and when the delegatee (RBI) issues such guidelines (policy) having statutory force, such guidelines have got to be read as supplement to the provisions of the BR Act, 1949."

Ganesh Bank of Kurunwad Ltd. & Ors v. Union of India & Ors. (2006) 10 SCC 645, where it was held that RBI has a right to take pre-emptive action taking into account the totality of the circumstances.

"It is not that when there is a run on the bank then only RBI must intervene or that it must intervene only when there are a good number of court proceedings against the bank concerned. RBI has to take into account the totality of the circumstances and has to form its opinion accordingly."

WILFUL DEFAULT - EVOLUTION OF JURISPRUDENCE OVER THE YEARS

In the matter of **M/S Chordia Automobiles vs S. Moosa & Ors**², the Supreme Court had explained the meaning of the term "wilful default", "Wilfulness" to imply an act done intentionally and designedly; a conscious failure to observe care; conscious; knowing; done with stubborn purpose, but not with malice. The word reckless as applied to negligence, is the legal equivalent of wilful or wanton. Thus, a consensus of the meaning of the words wilful default appears to indicate that default in order to be wilful must be intentional, deliberate, calculated and conscious, with full knowledge of legal consequences flowing therefrom."

In the context of default by a borrower in repayment of dues to the bank, the Supreme Court's explanation in the matter of **M/S Chordia Automobiles vs. S. Moosa & Ors**, is highly relevant. This means that for a default to be considered wilful, it must be intentional, deliberate, calculated, and conscious, with the borrower fully aware of the legal consequences of their actions. The Court emphasized that recklessness in negligence is legally equivalent to being wilful or wanton. In the financial system, this concept is critical because wilful defaults are not due to natural business downturns or unforeseen hardships but are deliberate acts where the borrower has the capacity to repay but chooses not to. This understanding ensures that banks can differentiate between genuine financial distress and intentional misconduct, allowing them to take appropriate legal and recovery actions or remedial actions as may be required in the light of facts and circumstance of the case.

Earlier the Delhi High Court³ in the matter of **Punjab National Bank Vs Kingfisher Airlines**, has highlighted the concern about the issue of declaration and consequence of declaration of a wilful defaulter. It has also touched upon the requirements necessary to follow the due process by observing that "The ramifications of a person being labelled as a wilful defaulter are wide and drastic. Such declaration sounds the commercial death knell of the borrower in the sense that credit facilities would no longer be available to such borrower. Not only would such a borrower be deprived of credit facilities from banks and financial institutions but is likely to be also deprived of credit from any other person with whom it may be having financial / commercial dealings. The suppliers of goods and raw materials to such borrowers would stop supplying goods and raw materials on credit and would insist upon delivery against payment. Not only so, such declaration as a wilful defaulter, which is put in public domain, is also injurious to commercial goodwill and reputation of the borrower, likely to make anyone weary of dealing with the borrower. All this is likely to lead to cessation of the business of such a borrower."

The Hon'ble Supreme Court in **Kotak Mahindra Bank Ltd. Vs. Hindustan National Glass and Ind. Ltd**⁴, has highlighted that the purpose of the RBI Master Circular on wilful defaulters, is to caution banks and financial institutions from giving any bank finance to a wilful defaulter. It was held that credit information could not be confined to only wilful defaults made by existing borrowers of the bank but would also cover constituents of banks who had defaulted in their dues under banking transactions with other banks and who intended to avail further finance from the banks. Non-funded facilities such as guarantees were held to be covered by a Master Circular. It was further held that confidentiality of any credit information, either by virtue of any other law or by virtue of any agreement between the banks and its constituent, cannot be a bar for disclosure of credit information under Section 45C(1) of the Reserve Bank of India Act, 1934.

² 2000 (3) SCC 282

³ Punjab National Bank & Ors vs Kingfisher Airlines Limited & Ors on 17 December, 2015

⁴ (2013) 7 SCC 369

It is perhaps because of the serious consequences which follow declaration of a borrower as a wilful defaulter that the Master Circular has now provided for Banks / FIs and Regulated Entities (REs) to notifying the borrower about the proposed intention. It will give the borrower an opportunity to represent against such a proposal and a right of hearing before a review committee.

In the case of **Mr. Milind Patel v. Union Bank of India & Ors**⁵, a Division Bench of the Bombay High Court held that lenders seeking to invoke the RBI Master Circular on Wilful Defaulters must supply all relevant materials to the noticee, including both incriminating and exculpatory evidence. The Court clarified that banks are obligated to provide all pertinent information, not just what is 'referred to' or 'relied upon' in the show-cause notice. This decision aligns with the Supreme Court's ruling in **State Bank of India v. Jah Developers Private Limited and Others**⁶ (2019), where it emphasized that being declared a wilful defaulter has an immediate and direct impact on the fundamental right to carry on business, necessitating a due process that includes the borrower's right to make representations before a Review Committee and for this Committee to issue a reasoned final order. Furthering this stance, the Supreme Court in **T. Takano v. Securities and Exchange Board of India (2021)**⁷ ruled that all relevant materials must be disclosed if they influence the adjudication process, a principle that applies to wilful defaulter proceedings. The Bombay High Court, drawing from these precedents, stated that ensuring transparency requires banks to supply all relevant material to the notice.

Thus, while a wilful default is characterized by intentional, deliberate, calculated, and conscious actions by the borrower, fully aware of the legal consequences. This distinction is critical as it helps differentiate between genuine financial distress and intentional misconduct. The implications of being labelled a wilful defaulter are severe and far-reaching. Recognizing these consequences, the courts have consistently highlighted the need to balance the interests of both the financial institutions and the borrowers. The process of declaring a borrower as a wilful defaulter must adhere strictly to the principles of natural justice, ensuring that borrowers are given a fair opportunity to present their case. This due process is essential to safeguard the rights of borrowers while enabling banks to take appropriate actions against intentional defaults.

Director Liability under Companies Act, 2013: Here it is relevant to note that the Companies Act, 2013 also imposes significant responsibilities on directors to manage companies responsibly and avoid reckless or fraudulent behaviour. Key aspects include:

- **Duty of Care:** Directors must exercise due care, skill, and diligence in managing the company.
- **Duty of Loyalty:** Directors must act in the best interests of the company, avoiding conflicts of interest.
- **Liability for Defaults:** Directors can be held personally liable for defaults, including financial mismanagement, fraudulent trading, and failure to act in good faith.

SEBI Guidelines on Financial Defaults: Similarly, the Securities and Exchange Board of India (SEBI) also imposes obligations on directors and listed companies to make disclosures about financial defaults to banks. Key aspects include:

- **Disclosure Requirements:** SEBI mandates that listed entities must promptly disclose defaults on payment of interest or repayment of principal amount on loans from banks/financial institutions.
- **Director Responsibilities:** SEBI regulations emphasize the responsibility of directors to ensure accurate and timely disclosures.
- **Impact on Credit Rating:** Defaults and disclosures can impact the credit rating of the entity, affecting its ability to raise funds in the future.

⁵Writ Petition No. 3671 OF 2023

⁶ Civil Writ Appeal NO. 4776 OF 2019- Decided on May 06, 2019

⁷ Civil Appeal Nos. 487-488 of 2022

COMPARATIVE PERSPECTIVES IN OTHER JURISDICTIONS

The concept of 'wilful default' appears to be unique to India Banking System, as many major jurisdictions do not have any such concept like the one followed by RBI. For example:

- **United Kingdom:** Directors can be held personally liable if they allow the company to trade while insolvent, intentionally defraud creditors, or misuse company funds.
- **United States:** Debtors who intentionally default can face severe legal consequences, including personal liability for debts and criminal charges in cases of fraud but there is no such concept of wilful default.
- **European Union:** The concept akin to wilful default is addressed through rigorous fraud and mismanagement laws, holding directors and managers accountable for intentional defaults and financial misrepresentations.
- **Singapore:** Directors are held personally liable for fraudulent or reckless trading, which to some extent parallels the idea of wilful action but a wilful default.

The concept of declaring a borrower as a wilful defaulter is unique to India and likely evolved due to the unique challenges faced by the Indian banking system. Without regulatory debarment, borrowers who wilfully defaulted despite having the means to repay were often able to secure financing from other sources and banks. The wilful default framework not only allows banks to share information about such defaulters but also prevents these defaulters from accessing further finance through the banking system, thereby safeguarding the financial ecosystem from repeated defaults.

Key Judgments of Courts in India on the Issue of declaration of borrower as wilful defaulters and matters connected there with

State Bank of India v. Jah Developers Private Limited (2019, Supreme Court) (2019 (6) SCC 787)

Emphasized the importance of the due process and the borrower's right to representation before the Review Committee. The Judgment stressed that non-speaking orders by Identification and Review Committees are unacceptable.

T. Takano v. Securities and Exchange Board of India (2022, Supreme Court) (Civil Appeal Nos. 487-488 of 2022- Decided on 18.02.2022)

Ruled that all relevant materials, not just those referred to in the show-cause notice, must be disclosed if they influence the adjudication process.

"The actual test is not to see whether the material required to be disclosed is relied upon in the show-cause notice, it is to see whether the material is relevant for the purpose of adjudication, since in all probability such material will influence the decision of the authority."

Kavi Arora v. Securities and Exchange Board of India (2022, Supreme Court) (Special Leave Petition (Civil) No. 15149 OF 2021- Decided on 14.09.2022)

Reiterated that only documents relied upon in the show-cause notice need to be supplied, leading to ambiguity in disclosure standards.

Jagdish Prasad Saboo v. IDBI Bank Limited (2023, Gujarat High Court) (R/SPECIAL CIVIL APPLICATION NO. 19261 of 2022- Decided on 27.03.2023)

Ruled that providing relevant findings from a forensic audit report was sufficient without the need for the entire report.

Milind Patel v. Union Bank of India & Ors. (2024, Bombay High Court) (Writ Petition No. 3671 OF 2023- Decided on 11.03.2024)

Held that lenders must supply all relevant materials, including exculpatory evidence, to the noticee when declaring a wilful defaulter. *"Lenders/ banks seeking to invoke the Reserve Bank of India, Master Circular on Wilful Defaulters for declaring entities and/or persons as wilful defaulters, must supply all relevant materials to the noticee, which includes not only incriminating material but also exculpatory material."*

INSTITUTIONS AND BANKS COVERED UNDER THE PRESENT MASTER DIRECTIONS OF RBI

The 2024 Master Directions apply to:

- All commercial banks (including Small Finance Banks, Local Area Banks, and Regional Rural Banks)
- All primary (urban) co-operative banks, state co-operative banks, and central co-operative banks
- All India Financial Institutions (Exim Bank, NABARD, NHB, SIDBI, NaBFID)
- All non-banking financial companies (NBFCs) including housing finance companies
- All asset reconstruction companies (ARCs)
- All credit information companies (CICs)

The lenders are required to examine the 'wilful default' aspect in all Non-Performing Assets (NPA) accounts with outstanding amount of INR 25 lakh and above or as may be notified by Reserve Bank of India from time to time. If wilful default is observed in the internal preliminary screening, the lenders shall complete the process of classification/ declaring the borrower as a wilful defaulter within six (6) months of the account being classified as NPA.

DEFINITIONS AND REQUIREMENTS FOR DECLARATION OF A BORROWER AS A WILFUL DEFAULTER

Key Definitions

- **Wilful Defaulter:** A borrower or guarantor with an outstanding amount of INR 25 lakh and above who intentionally defaults or diverts funds.
- **Identification Committee:** A committee formed to identify wilful defaulters, consisting of senior officials from the lender.
- **Review Committee:** A committee formed to review the decisions of the Identification Committee, ensuring due process.

The scope of definition of wilful defaulter has been widened and now a wilful default shall be deemed to have occurred when the borrower defaults in meeting payment/ repayment obligations to the lender and any one or more of the following features are noticed, i.e. (i) the borrower has the capacity to honour the said obligations; (ii) the borrower has diverted the funds availed under the credit facility from lender; (iii) the borrower has siphoned off the funds availed under the credit facility from lender; (iv) the borrower has disposed of immovable or movable assets provided for the purpose of securing the credit facility without the approval of the lender.

This will also include the instances where the borrower or the promoter 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.

Similarly, a wilful default by a guarantor shall be deemed to have occurred if the guarantor does not honour the guarantee when invoked by the lender, despite having sufficient means to make payment of the dues or has disposed of immovable or movable assets provided for the purpose of securing the credit facility, without the approval of the lender or has failed in 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.

Lenders are required to identify and classify a person as a 'wilful defaulter' by following the procedure enumerated in the Master Directions, in the light of the track record of the borrowers and the default must be intentional, deliberate, calculated and should also meet the conditions set out in para 3 (1) (t) of the Master Directions. Thus, the process has been made more objective and should be supported by facts and material on records. The Master Directions specifically prohibit any such declaration based on isolated transactions/ incidents.

Mechanism for Identification and Classification of Wilful Defaulters

- **Evidence Examination and Show-Cause Notice:** The Identification Committee examines evidence of wilful default. If satisfied, the committee issues a show-cause notice to the borrower/guarantor/promoter/director/persons in charge, calling for submissions within 21 days. All relevant materials and information on which the show-cause notice is based must be disclosed to the borrower/guarantor.
- **Proposal and Representation:** After considering the submissions, if the Identification Committee still finds grounds for wilful default, it proposes the classification to the Review Committee, providing written reasons. The

borrower/guarantor is informed about the proposal and reasons for classification and given 15 days to make a written representation to the Review Committee.

- **The Review Committee considers the proposal and representation, providing an opportunity for a personal hearing**

An opportunity is to be provided to borrower/ guarantor/ promoter/ director/ persons who are in charge and responsible for the management of the affairs of the entity for making a written representation to Review Committee within 15 days of such a proposal from the Identification Committee.

If this opportunity is not utilized or the personal hearing is not attended by the parties, the Review Committee will evaluate the facts and materials on record, including any written representations, and decide based on the Identification Committee's proposal. As this classification process is internal, the involved parties do not have the right to legal representation. The Review Committee must issue a reasoned order, which will be communicated to the wilful defaulter. If the Identification Committee determines that the parties do not meet the criteria for wilful default, the case will not be referred to the Review Committee.

Lenders must establish guidelines, based on board-approved policies, specifying the rank of the official responsible for issuing the show-cause notice and written orders on behalf of both committees. These notices and orders must state that they have the approval of the competent authority and identify the committee members.

A non-whole-time director, including **independent and nominee directors**, will only be considered a wilful defaulter if it is conclusively proven that they consented to or were aware of the default without objecting. Their names will be reported as non-whole-time/independent/nominee directors.

The lender must review all Non-Performing Assets (NPAs) with an outstanding amount of ₹25 lakh and above for wilful default. If wilful default is detected during the preliminary screening, the classification process must be completed within six months. Accounts initially not deemed wilful defaults should be periodically re-examined according to the lender's board-approved policy.

Representation through a Lawyer: In this context the Hon'ble Supreme Court in the case of State Bank of India v. Jah Developers ((2019) 6 SCC 787) had held that a borrower does not have the right to be represented by a lawyer during in-house proceedings envisaged in the Master Circular.

Committees and Their Composition

- **Identification Committee: (Three Members)**

Commercial Banks (other than foreign banks and RRBs), and AIFs: Whole-Time Director (except MD & CEO) as chairperson, and two senior officials.

Foreign Banks: Officer not more than one rank below the Country Head/CEO as chairperson and two senior officials.

UCBs and NBFCs: Officer not more than one rank below the MD/CEO as chairperson and two senior officials.

RRBs: Officer not more than one rank below the chairman as chairperson and two senior officials.

- **Review Committee: (Three Members)**

Commercial Banks (other than foreign banks and RRBs), and AIFs: MD & CEO as chairperson, and two independent/non-executive directors.

Foreign Banks: Country Head/CEO as chairperson and two senior officials.

UCBs: MD/CEO as chairperson, and two professional directors.

NBFCs: MD/CEO as chairperson, and two independent/non-executive directors.

RRBs: Chairman as chairperson, and two nominated directors.

The Master Circular clarifies that in respect of credit facilities below a threshold, commercial banks (excluding Foreign Banks, Small Finance Banks, LABs and RRBs) may, as per their board-approved policy constitute a Review Committee with an officer of the rank of Whole-Time Director or equivalent official as the chairperson and two senior officials as members, not more than two ranks below the chairperson of the committee. Commercial banks (excluding Foreign Banks, Small Finance Banks, LABs and RRBs) may form multiple review committees under this clause. However, the Review Committee shall not be comprised of members who are part of the Identification Committee.

Specific Measures Against Wilful Defaulters

- **Initiation of Criminal Proceedings by the Lenders:** Lenders, based on the facts and circumstances of each case, can assess whether initiating criminal proceedings against wilful defaulters under applicable laws is warranted. If criminal proceedings are initiated, removing the wilful defaulter's name from the List of Wilful Defaulters (LWD) will not affect the continuation of these proceedings.
- **Publishing of Photographs of Wilful Defaulters:** Lenders must formulate a non-discriminatory, board-approved policy for publishing the photographs of persons classified as wilful defaulters. This policy should clearly define the criteria for publication, ensuring transparency and fairness. This requirement is based on the RBI's circular DBR.CID.BC.No.17/20.16.003/2016-17 dated September 29, 2016.
- **Penal and Other Measures Against Wilful Defaulters:** Lenders are required to implement several penal measures to prevent further credit misuse by wilful defaulters:
 - **No Additional Credit Facility:** No additional credit facility shall be granted to a wilful defaulter or any entity associated with them. This restriction remains effective for one year after the defaulter's name is removed from the LWD.
 - **Bar on New Ventures:** Wilful defaulters or their associated entities are barred from obtaining credit facilities for new ventures for five years after their name is removed from the LWD.
 - **Ineligibility for Restructuring:** Wilful defaulters or their associated entities are ineligible for restructuring credit facilities.

After removal from the LWD, restructuring is allowed, subject to specific conditions outlined in the RBI directions.

Explanation on Association: A company is deemed associated with a wilful defaulter if it is a subsidiary, joint venture, or associate company as defined under the Companies Act, 2013.

For individuals, all entities where they are promoters, directors, or in charge are considered associated.

- **Ceasing Penal Provisions**
 - Penal provisions cease for associated entities once they are no longer linked to the wilful defaulter.
 - **Restructuring Based on Viability:** If new promoters replace existing ones as per the 'Prudential Framework for Resolution of Stressed Assets' dated June 7, 2019, lenders may restructure based on viability, regardless of criminal proceedings against former promoters.
- **Incorporation of Covenant in Credit Agreement:** Lenders must incorporate specific covenants in credit agreements to prevent wilful defaulters from holding managerial positions:

- **Board and Management Restrictions:** Credit agreements must include a covenant prohibiting the induction of persons listed in the LWD into the borrower’s board or management.
- **Removal of Listed Individuals:** If such a person is found in management, the borrower must take effective steps for their removal.
- **Restrictions on Credit Facility Renewal**
 - Lenders must not renew, enhance, or provide new credit facilities or restructure existing facilities for borrowers while any promoter, director, or responsible person is listed in the LWD.
- **Handling Group Companies:** When dealing with a group of companies, lenders should consider the repayment performance of individual companies. If guarantees provided by group companies on behalf of defaulting units are not honoured, those group companies should also be considered for classification as wilful defaulters.
- **Reporting of Wilful Defaulters and Large Defaulters:** All entities regulated by the Reserve Bank, regardless of whether they fall under the definition of ‘lender’ as provided in these Directions, must comply with the following reporting requirements:
 - Monthly Reporting to CICs: Entities must submit information to all Credit Information Companies (CICs) in Annex I format attached to the Master Circular, at monthly intervals, covering:
 - List of suit-filed accounts of large defaulters
 - List of non-suit filed accounts of large defaulters classified as doubtful or loss.
- **Threshold Calculation:** For calculating the INR 1 crore threshold, include unapplied interest. For suit-filed accounts, the threshold pertains to the amount for which suits have been filed.
- **Access and Display by CICs:** CICs must provide access to non-suit filed accounts of large defaulters to all credit institutions and display the list of suit-filed accounts on their websites.
- **Definition and Treatment of Suit-Filed Accounts:** ‘Suit-filed accounts’ include those where recovery proceedings have been initiated and are pending. This includes SARFAESI proceedings and cases under cooperative society laws, as well as accounts under resolution or liquidation proceedings.
- **Role of Third Parties in Wilful Defaults**

The Master Direction also highlight that the role of third parties in the context of wilful defaults is crucial, as these entities often play a significant role in the processes of credit sanction and disbursement. The RBI’s Master Directions on Frauds Risk Management, effective from July 15, 2024, outline the responsibilities and accountability of these third parties. Here are the key aspects:

 - **Accountability of Third Parties:** Responsibility for Negligence or Deficiency: Third parties engaged by lenders, such as auditors, appraisers, and legal advisors, who play a significant role in the credit sanction and disbursement process, must be held accountable if found negligent or deficient in their work. In cases of wilful defaults, if these third parties are found to have facilitated the wilful default by the borrower, their actions are subject to scrutiny and accountability.
 - **Reporting to the Indian Banks’ Association (IBA):** Lenders must forward details of these third parties to the Indian Banks’ Association (IBA) for record-keeping. This reporting requirement is mandatory for all lenders defined under the Master Directions, irrespective of their membership status with the IBA.

Based on the information received, the IBA will prepare caution lists of such third parties and circulate these lists to all regulated entities of the Reserve Bank. This helps ensure that entities are cautious when assigning work to these third parties in the future.
 - **Ensuring Fairness and Due Process:** Before reporting third parties to the IBA, lenders must ensure the involvement of these parties in the wilful default is substantiated. Lenders must provide these third parties with an opportunity to be heard, ensuring fairness and due process. This involves a thorough internal review,

where lenders satisfy themselves of the third parties' involvement, record all proceedings appropriately, and follow standard protocols to ensure justice and accuracy.

- **Responsibility for Correct Reporting**
 - **Responsibility of Lenders:** Lenders bear the primary responsibility for reporting accurate information and ensuring the accuracy of all facts and figures related to credit information. This responsibility is critical to maintaining the integrity of financial data and ensuring that all reports submitted to Credit Information Companies (CICs) are reliable and correct.
 - **Verification of Director Details:** When furnishing information to CICs, lenders must ensure the accuracy of the particulars of the directors of borrowing entities. Wherever possible, lenders should cross-check this information with the database maintained by the Registrar of Companies to prevent errors and misreporting.
 - **Reporting of Guarantors:** Entities regulated by the Reserve Bank of India, including lenders, are required to report details of guarantors who have failed to honour their commitments when invoked. Such guarantors should be classified as either large defaulters or wilful defaulters, as applicable.
 - The details of these guarantors must be reported to CICs using the formats specified in Annex I and II of the relevant guidelines.
- **Reporting of Directors**
 - For business enterprises registered as companies under the Companies Act, 2013, lenders must report the full names of the directors in the relevant columns of Annex I and II to the Master Circular
 - Use of Director Identification Number (DIN): To ensure that directors are correctly identified and to prevent individuals with similar names from being wrongfully denied credit facilities, lenders must include the Director Identification Number (DIN) in the data submitted to CICs.
- **Preventive Measures and Role of Auditors:** Lenders must verify whether the names of any directors, guarantors, or persons in charge of management appear on the list of large defaulters or wilful defaulters, using DIN or PAN for reference. In case of doubt due to identical names, lenders should use independent sources for confirmation rather than relying solely on declarations from the borrowing company.
- **Monitoring End-Use of Funds:** Regulated entities of the RBI must closely monitor the end-use of funds and obtain certifications from borrowers regarding the proper utilization of funds. In case of any misrepresentation by the borrowers, lenders should consider appropriate legal actions, including criminal proceedings if necessary.
- **Role of Statutory Auditors:** If falsification of accounts is observed and auditors are found negligent or deficient, lenders should lodge formal complaints against the statutory auditors with the National Financial Reporting Authority (NFRA) or the Institute of Chartered Accountants of India (ICAI). Pending disciplinary action, these complaints should be forwarded to the RBI and the Indian Banks' Association (IBA) for further action.
- **Engaging Auditors for Specific Certification:** Lenders may engage their own auditors for specific certifications regarding the diversion or siphoning of funds by borrowers. This can be supplemented by forensic audits of the borrowers' accounts, particularly for accounts with significant outstanding amounts.

Compromise Settlements and Treatment of Defaulted Loans

Compromise Settlement with Wilful Defaulters

- **Board Approved Policy:** The compromise settlement with a wilful defaulter must be in alignment with the board-approved policy of the lender or Asset Reconstruction Company (ARC). This policy should encompass guidelines on staff accountability examination, reporting of the compromise or settlement to the board, and stipulations for higher upfront payments, if any.

- **Staff Accountability Examination:** The policy should include mechanisms to examine the accountability of staff involved in the compromise settlement process, ensuring that the settlement is conducted transparently and without any conflict of interest.
- **Reporting to the Board:** Any compromise or settlement reached with a wilful defaulter must be reported to the board of the lender or ARC, providing full details of the terms and conditions of the settlement.
- **Higher Upfront Payment:** The policy should encourage higher upfront payments from wilful defaulters as part of the settlement to ensure immediate and substantial recovery of dues.
- **Continuation of Criminal Proceedings:** It is important to note that the compromise settlement shall not prejudice the continuation of any criminal proceedings against the wilful defaulter. Criminal proceedings will continue independently of the settlement process.

Treatment of Defaulted Loans Sold to Other Lenders and ARCs

- **Comprehensive Investigation:** Before transferring a defaulted loan with an outstanding amount of ₹25 lakh and above, the lender must conduct a thorough internal investigation to determine if there is any aspect of wilful default. This investigation need not involve a two-stage committee but must be comprehensive.
- If wilful default is observed during the investigation, the lender must complete the process of classifying the borrower as a wilful defaulter, before selling the asset to other lenders or ARCs, including reporting in the List of Wilful Defaulters (LWD) to Credit Information Companies.
- The details of the reporting done must be conveyed to the "transferee" lenders or ARCs, and they must continue reporting the account to the CICs.
- **Treatment of Sale:** The sale of the loan to other lenders or ARCs shall not be considered as recovery for the purpose of calculating the threshold limit for classification as a wilful defaulter. The loan amount is not fully recovered until the actual recovery occurs.
- The transferee lenders or ARCs must continue to report the account as a wilful defaulter until the remaining balance to be recovered plus the amount written off by the transferor lender falls below ₹25 lakh or as notified by the RBI.

Treatment of Accounts Resolved under IBC or Prudential Framework

- **Removal from LWD:** In cases where an account included in the LWD has undergone liquidation or resolution under the Insolvency and Bankruptcy Code (IBC) or the Prudential Framework for Resolution of Stressed Assets, resulting in a change in management and control, the name of the borrower or guarantor classified as a wilful defaulter shall be removed from the LWD after the resolution plan is implemented.
- **Non-Applicability of Penal Measures:** The penal measures detailed in paragraph 5(3)(a) of the Master Circular shall not apply to such entities or business enterprises after the implementation of the resolution plan under the IBC or the prudential framework.
- **Continued Penal Measures for Erstwhile Promoters/Directors/Guarantors:** The penal measures outlined in paragraph 5(3)(a)(ii) and (iii) of the Master Circular shall continue to apply to the former promoters, directors, guarantors, or individuals in charge who were responsible for the management of the entity or business enterprise. These measures will also apply to the entities they are associated with as promoters or directors or as individuals in charge of management.

CHANGES BETWEEN 2015 AND 2024 MASTER DIRECTIONS

Aspect	2015 Master Directions	2024 Master Directions	Remarks on 2024 Master Directions
Definition of Wilful Default	Focus on intentional defaults and diversion/siphoning of funds	Expanded to include failure to infuse equity despite commitments and unauthorized disposal of assets	Broader scope to cover more scenarios
Committees Involved	Identification Committee and Review Committee, with overlapping membership in some cases	Clear separation of roles and distinct membership requirements for both committees	Ensures impartiality and transparency
Disclosure of Materials	Limited to materials referred to in the show-cause notice	All relevant materials must be disclosed, including exculpatory evidence	Aligns with principles of natural justice/Judgements
Review and Finalisation Timeline	Not explicitly defined	Mandates review and finalisation within six months of an account being classified as NPA	Ensures timely resolution
Scope of Entities	Limited to certain banks and financial institutions	Expanded to include all entities regulated by the RBI, including ARCs and CICs	Broader applicability
Treatment of Sold Loans	Not explicitly covered	Addresses treatment of wilful default loans sold to ARCs and their status under the Insolvency and Bankruptcy Code	Provides clarity on handling sold loans
Role of Internal Audit	Limited emphasis on internal audit	Mandates internal auditors to specifically look into adherence to wilful defaulter classification instructions	Strengthens internal control mechanisms
Criminal Proceedings	Lenders could initiate criminal proceedings based on case specifics	Emphasizes initiation of criminal proceedings based on facts and circumstances	Reinforces accountability and deterrence
Photographs of Defaulters	Optional publishing of photographs	Lenders to formulate a board-approved policy for publishing photographs of wilful defaulters	Standardizes approach across lenders
Preventive Measures	General guidelines on monitoring end-use of funds	Detailed preventive measures, including credit appraisal, monitoring end-use, and role of statutory auditors and third parties	Enhances preventive strategies
Compromise Settlements	Removal from wilful defaulter list upon full payment of compromise amount	Continued listing until full payment of the compromise amount, with specific guidelines on handling compromise settlements	Ensures consistent treatment of settlements

DETAILED STEPS FOR INSTITUTIONS AND BANKS/REGULATED ENTITIES

Identification and Classification Process

- **Preliminary Screening:** Review all NPA accounts with outstanding amounts of INR 25 lakh and above for wilful default aspects.
- **Issuance of Show-Cause Notice:** The Identification Committee issues a show-cause notice, including all relevant materials.
- **Borrower Representation:** Allow 21 days for the borrower/guarantor to submit their representation.
- **Identification Committee Decision:** After considering the representation, the Identification Committee proposes classification as a wilful defaulter.
- **Review Committee Review:** The Review Committee reviews the proposal and representation, providing a personal hearing opportunity.
- **Final Order:** The Review Committee issues a reasoned final order, communicated to the borrower/guarantor.

Reporting Requirements

- Submit information on wilful defaulters and large defaulters to CICs at monthly intervals.
- Report removal of names from the wilful defaulter list promptly upon full payment or other qualifying events.
- Ensure accurate reporting of directors' and guarantors' details, including Director Identification Number (DIN).

PREVENTIVE MEASURES REQUIRED UNDER THE MASTER DIRECTIONS

- **Credit Appraisal:** Verify if any directors/guarantors are listed as wilful defaulters.
- **Monitoring End-Use of Funds:** Implement robust measures to monitor the end-use of funds, including obtaining certifications and conducting inspections.
- **Role of Auditors:** Engage auditors for specific certifications on fund usage and consider forensic audits for larger accounts.

SUGGESTIVE STEPS FOR BORROWERS TO AVOID DECLARATION IN LIGHT OF THE REVISED MASTER DIRECTIONS

- **Maintain Transparency:** Ensure full disclosure and transparency in all financial dealings. This includes providing realistic and achievable financial projections to the lender, avoiding overly optimistic or idealistic scenarios. Regularly update the lender on any significant changes in the business or financial conditions. Transparency builds trust and demonstrates the borrower's commitment to responsible financial management.
- **Adhere to Commitments:** Honor all financial commitments, including equity infusion promises. It is crucial for borrowers to commit only to those conditions and timelines they can realistically meet. Borrowers should be honest about their financial capacity and avoid agreeing to terms beyond their control. This approach helps in maintaining credibility and prevents future disputes with lenders.
- **Monitor Fund Usage:** Ensure that the funds provided by the lender are used strictly for the intended purposes. Regular monitoring and proper documentation of fund usage can prevent unauthorized disposal of assets and misuse of funds. Establish internal controls and regular audits to ensure compliance with the agreed terms of the loan.
- **Provide for Contingencies:** Anticipate potential challenges and make provisions for unforeseen circumstances. Borrowers should include contingency plans in their financial projections and request reserve funding from the lender to address cost overruns or delays. This proactive approach can prevent defaults arising from unexpected issues.
- **Respond Promptly:** Address any lender communications and show-cause notices promptly and comprehensively. Timely and detailed responses demonstrate the borrower's willingness to cooperate and resolve issues. Engage with the lender proactively to discuss any difficulties in meeting financial obligations and seek mutually agreeable solutions.

Steps for Borrowers and Guarantors Facing Notice

- **Gather Information:** Collect all relevant financial documents and evidence supporting compliance. This includes financial statements, transaction records, and any communications with the lender that demonstrate efforts to meet obligations.
- **Prepare Representation:** Draft a detailed representation addressing each point in the show-cause notice. Explain any deviations from the agreed terms and provide evidence of attempts to comply. Highlight any external factors that have impacted the business operations and financial performance.
- **Seek Legal Advice:** Consult legal experts to understand rights and prepare for personal hearings. Legal counsel can help in framing a robust defense and ensure that all procedural requirements are met.
- **Participate in Hearings:** Attend personal hearings with the Review Committee and present a strong case. Be prepared to provide clear and concise explanations, supported by evidence, to demonstrate that the default was not wilful. Highlight any efforts made to rectify the situation and propose viable solutions for restructuring or additional support from the lender.
- **One-Time Settlement and Compromise as per RBI Guidelines and Policies of Banks:** When facing financial distress and potential classification as a wilful defaulter, borrowers can consider a one-time settlement (OTS) or compromise settlement as per the RBI guidelines and the policies of their respective banks. This involves preparing a detailed settlement proposal that outlines the financial difficulties faced, reasons for default, and the proposed amount for settlement.

The proposal should include sources of funds for the settlement and any collateral that can be offered. If considered appropriate the Borrower may also seek advice from a financial advisor or consultant who specializes in debt restructuring to ensure the proposal is realistic and aligns with the bank's policies. The proposal should be comprehensive and include all necessary documents such as financial statements, cash flow projections, and details of assets and liabilities. Once submitted, be prepared to negotiate the terms and conditions, including the settlement amount, payment timeline, and any concessions that can be requested.

The bank will review the settlement proposal through its internal committees, such as the External Committee or Compromise Settlement Committee, as per the bank's policies. This review includes an assessment of the borrower's financial position and the feasibility of the proposed settlement. Upon satisfactory review, the bank's committee will approve the one-time settlement or compromise proposal, which may involve multiple levels of approval depending on the amount and complexity of the settlement.

Once approved, a formal settlement agreement will be entered into between the borrower and the bank, outlining the terms and conditions of the settlement, payment schedule, and other relevant details. The borrower must adhere to the agreed payment schedule and comply with all terms to avoid further complications or penalties.

The bank will monitor the settlement process to ensure compliance, and upon successful completion, the borrower's name will be removed from the list of defaulters. After the full payment of the settlement amount, the borrower should request the bank to update the records with Credit Information Companies (CICs) and remove their name from the list of wilful defaulters, if applicable.

If the settlement proposal is not accepted or there are legal complexities, legal advice should be sought to understand the options for further negotiation or legal recourse.

- **Divesting of Stake as per RBI Guidelines and Policies of Banks:** Similarly, keeping in view their own financial strength and possibility of overcoming the default situation in a short span, borrowers can also consider divesting of stake in their business. The process begins with a thorough assessment of the business's financial position to understand the extent of distress and the capacity to make payment or settle the outstanding dues.

Divesting a stake in the business to other interested parties involves identifying potential investors, preparing a detailed business valuation, and financial projections. Engaging with banks and lenders to seek their approval for the divestment is necessary, based on the financials and credibility of the investor and the bank's internal policies. Negotiating terms with the new investors ensures the transfer of stake salvages value for the borrower, promoters, and investors. Finalizing and executing the divestment agreement requires meeting all legal and regulatory compliances.

When divesting a stake in a business several types of agreements are typically involved to ensure the transaction is legally sound and protects the interests of all parties. These agreements include a **Letter of Intent (LOI) or Term Sheet** to outline preliminary terms, a **Non-Disclosure Agreement (NDA)** to protect confidential information, and a **Share Purchase Agreement (SPA) or Business Transfer Agreement (BTA)** to formalize the sale and transfer of shares or assets. These agreements may attract stamp duty and registration as per the applicable law of the State where the assets/entity is located. Additionally, a Shareholders' Agreement governs the relationship between existing shareholders and the new investor post-transaction, while an **Escrow Agreement** manages the holding and disbursement of funds or documents. A Promoter Undertaking secures commitments regarding **non-compete clauses, and Employment Agreements** retain key employees or promoters. If applicable, an **Assignment of Contracts** transfers existing contracts, and Regulatory Filings and Approvals ensure compliance with legal requirements. Finally, Tax Considerations and Agreements address the tax implications of the transaction. Borrower need to consult experts professional in such complicated transactions.

In this context, the promoters should also seek release of their personal guarantees and securities. Usually, the Banks while considering these requests, would insist on provision of securities of equivalent value and guarantee with net worth satisfactory to the Banks, therefore, while negotiating the terms with the investors, all these aspects need to be considered and negotiated with the potential investor.

The Borrower need to recognize that declaration as a 'wilful defaulter' has serious implications, such a declaration not only affects access to finance but also carries significant civil and criminal implications. Therefore, it is essential that the Borrowers act responsibly by providing realistic projections and maintaining transparency in their dealings to avoid falling into the category of wilful defaulters.

TIMELINE FOR DEALING WITH WILFUL DEFAULTER DECLARATIONS

Stage	Timeline
Preliminary Screening	Immediate upon NPA classification
Show-Cause Notice	Within 1 month
Borrower Representation Submission	Within 21 days
Identification Committee Decision	Within 2 months
Review Committee Review	Within 3 months
Final Order Issuance	Within 6 months

CONCLUSION

The revised RBI Master Directions on Wilful Defaulters provide a comprehensive framework to address wilful defaults effectively, ensuring a transparent and fair process. These guidelines, rooted in the principles of natural justice, are designed to maintain the integrity of the financial system. They were introduced in response to significant concerns over wilful defaults, as highlighted by the Central Vigilance Commission and various parliamentary committees, and have evolved through extensive consultations and recommendations.

The framework mandates detailed processes for classifying borrowers as wilful defaulters, including the collection and dissemination of information on defaults of INR 25 lakhs and above, quarterly reporting by banks and financial institutions, and potential legal and criminal actions for defaults of INR. 1 crore and above. The concept of wilful default is critical, as it addresses intentional, deliberate, and calculated defaults that undermine the financial system's stability.

Understanding the concept of wilful default, legal precedents, and related obligations under various laws, such as the Companies Act, 2013 and SEBI regulations, is essential for all stakeholders in the financial ecosystem. Both lenders and borrowers must navigate these regulations carefully, ensuring compliance and protecting their interests.

We hope you have found this information useful. For any queries/clarifications please write to us at insights@elp-in.com or write to our authors:

Mukesh Chand, Senior Counsel – Email – MukeshChand@elp-in.com

Disclaimer: The information provided in this update is intended for informational purposes only and does not constitute legal opinion or advice.



**ECONOMIC
LAWS
PRACTICE**
ADVOCATES & SOLICITORS

MUMBAI

9th Floor, Mafatlal Centre
Vidhan Bhavan Marg
Nariman Point, Mumbai 400 021
T: +91 22 6636 7000

DELHI NCR

NEW DELHI

DR Gopal Das Bhawan, 16th Floor,
28, Barakhamba Road,
New Delhi – 110 001.
T: +91 11 41528400

NOIDA

9th Floor, Berger Tower, Sector 16 B,
Noida, Uttar Pradesh - 201301.
T: +91 120 6984 300

AHMEDABAD

C-507/508, 5th Floor, Titanium Square
Thaltej Cross Roads, SG Highway,
Ahmedabad - 380054
T: +91 79460 04854

PUNE

202, 2nd Floor, Vascon Eco Tower
Baner Pashan Road
Pune 411 045
T: +91 20 4912 7400

BENGALURU

6th Floor, Rockline Centre
54, Richmond Road
Bengaluru 560 025
T: +91 80 4168 5530/1

CHENNAI

No 18, BBC Homes, Flat-7 Block A
South Boag Road
Chennai 600 017
T: +91 44 4210 4863

GIFT CITY

GIFT CITY Unit No. 605,
Signature, 6th Floor Block 13B,
Zone – I GIFT SEZ, Gandhinagar 382355



elplaw.in



insights@elp-in.com



[/elplaw.in](https://www.facebook.com/elplaw.in)



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